



**MADURAI KAMARAJ UNIVERSITY**

**(University with Potential for Excellence)**

**DISTANCE EDUCATION**

Recognised by DEC

[www.mkudde.org](http://www.mkudde.org)

**M.Com. & M.Com**

**COMMERCE**

**(Co-op. Management)**

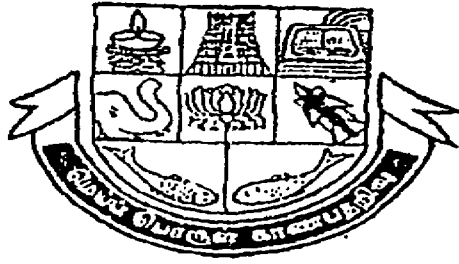
**First Year**

**Volume - 2**

**Lessons : 3 - 10**

**FINANCIAL ACCOUNTING**

**S 214 / 1052**



**S214/1052**

**DIRECTORATE OF  
DISTANCE EDUCATION**

**M.Com & M.Com (Co-op.Management)**

**FIRST YEAR**

**FINANCIAL ACCOUNTING**

**VOLUME-2**

**LESSONS: 3-10**

**Madurai Kamaraj University**

**Madurai – 625 021**

**C  
O  
M  
M  
E  
R  
C  
E**

# **SYLLABUS**

## **1.1 Financial Accounting**

**Unit I : Principles of Book keeping – Rules for debit and Credit – Journalizing – Subsidiary books Ledger – Trial Balance – Rectification of Errors.**

**Unit II : Final Accounts and Balance Sheet of Sole Trader – Trading Account, Profit and Losses Account – Balance Sheet – Opening Entries – Closing Entries Adjusting entries.**

**Unit III: Bills of Exchange – Trade Bills – Accommodations Bills – Mutual Accommodation Bills – Journal entries and ledger.**

**Unit IV: Consignment and Joint Venture, Account Current, Average Due date.**

**Unit V : Depreciation – Methods – necessity – various methods of providing depreciation Account Treatment.**

**Unit VI: Accounting for Non-Trading Concern-Final Accounts-Receipts and Payments account – Income and Expenditure account – Balance Sheet.**

**Unit VII: Single entry and preparation of accounts from incomplete records – Memorandum Method – Conversion method.**

**Unit VIII: Branch Accounts – Independent Branch – Dependent Branch including stock and debtor system.**

**Unit IX: Departmental Accounts – Preparation of departmental trading accounts, allocating of expenditure in the Profit and Loss Account**

**Unit X : Accounting for Insurance claims for stock destroyed, Assets destroyed – Loss of Profit Policy – average clause Policy**

**Books for References:**

1. JAIN AND NARANG - Advanced Accountancy
2. SHYKLA AND GREWAL - Advanced Accounts
3. R.L.GUPTA - Advanced Accountancy
4. WILLIAM PICKLES - Accountancy
5. SPICER AND PEGLER - Book-keeping and Accounts
6. M.A.ARULANDAM & RAMAN - Advanced Accounting.

---

**Note: Distribution of marks between theory and problem in the ratio of 40:60 respectively.**

**Contents**  
**(M.Com & M.Com Co-op Management)**  
**First Year**

**FINANCIAL ACCOUNTING**

<b>Lesson No.</b>	<b>Topic Name</b>	<b>Page No.</b>
3	Bills of Exchange	1-34
4	Consignment, Jointventure, Account- Current & Average Due Date	35-86
5	Depreciation	87-115
6	Accounts of Non-Trading Concerns	116-136
7	Single Entry	137-180
8	Branch Accounts	181-225
9	Departmental Accounts	226-239
10	Accounting for Insurance Claims	240-248

## LESSON -3

### BILLS OF EXCHANGE

“A Bill of exchange is an instrument in writing containing an unconditional order signed by the maker, directing a certain person to pay a certain sum of money only to, or to the order of a certain person or to the better of the instrument” (Section 5 of Negotiable Instruments Act, 1881).

It means that if an order is made in writing by one person on another directing him to pay a certain sum of money unconditionally to a certain person or according to his instructions or to the bearer, and if that order is accepted by the person on whom the order was made, the document is a bill of exchange.

An Indian exporter, Ashok Leyland's Ltd., receives an order from Australia for 3 bus engines valued at Rs.6, 80,000. Having made the bus engines, Ashok Leyland's sends them on the S.S. Jala Usha, to the Australian Bus Company. Having kept their part of the bargain, they would now like to be paid for their bus engines. On the other hand, the Australian firm has not yet received them and is unwilling to pay until they arrive. This problem will be satisfactorily solved by a bill of exchange, which is a commercial form of payment.

Similarly, in Home Trade, a purchaser of goods may not be able to pay immediately, while the seller may not be in a position to wait, Bills of Exchange will admirably solve this difficulty.

Suppose 'X' in Bombay sold goods worth Rs.1, 000 to 'Y' in Madurai and the latter requires 3 months time to pay for it. 'X' might like to have something in writing from 'Y'. Hence, 'X' will send the draft for acceptance to "Y", 'Y' will put his signature on the face of it.

#### Meaning of Bills of Exchange:

Bills of Exchange means a document ordering the payment of money; drawn by one person or bank on another.

## NOTES

### Who is drawer?

Drawer is a person who writes a check or draft instructing the drawee to pay someone else.

### Explanation

1. A Xavier is the drawer.
2. B. Yusuf is the drawee
3. Payee is the person to whom the payment should be made i.e. A. Xavier
4. The same bill is "Bills Receivable" to B. Yusuf because he is liable to pay money for the bill.
5. The same bill is however "Bills Payable" to B. Yusuf he is liable to pay money for the bill.
6. After acceptance, B. Yusuf sends to A. Xavier who retains the bill.
7. Acceptances of others in our possession are B/R
8. Our own acceptances are out B/P

### Advantages of a bill of exchange

1. Since it is a written and signed acknowledgement of debt it serves as a conclusive/proof of indebtedness.
2. It fixes the date of payment
3. It ensures prompt payment by a debtor.
4. The debtor enjoys the full period of credit, because he will not be called upon to pay the amount of bill before the due date.
5. Even before the due date, creditor of a bill can realize the money by discounting it with a banker.
6. It can be transferred like the coin of the country since it is a negotiable instrument.
7. It enables the trader to trade on credit basis. This increases the volume of trade.

### There are four possibilities open to 'X'

- |             |  |
|-------------|--|
| Holding     | 1. 'X' may retain the bill till due date   |
| Or          |  |
| Sending     | 2. 'X' may send the bill to his banker for collection  |
| Discounting | 3. If 'X' is need of money, he may the bill with his bankers   |
| Endorsing   | 4. If 'X' has any debt; he can discharge the same by indorsing it to his creditor and thus pay off his liability |

\$Indorsing of Endorsing. Endorsement means putting signature on the back of the instrument for the purpose of transferring the title of the instrument.

### Calculation of Due Date

Inland bills are usually drawn for a stated period after date. But foreign bills are variously drawn as "on demand" "at sight", "after date" or "after sight"

"On demand" and "at sight" both mean that the bills so drawn are payable upon presentation to the acceptor. For bills so drawn "after date", the period begins to run from the date of the bill, but for those drawn "after sight" the term of the bill runs from the date of "sight".

For bills payable (other than those drawn on "demand" or "at sight") 3 days called "days of grace" are added to the nominal term of the bill, which becomes due and payable on the last day of gracing.

Suppose, a bill is drawn on 1-6-2003 payable after 2 months. Can you fix the due date? Perhaps you may say, the due date is F1-8-2003. But the due date is 4-8-

### What is due date?

Due date is the date on which an obligation must be repaid.

**NOTES**

2003. All bills which are payable otherwise than on demand at sight or presentation are at maturity” on the third day after the date on which they are expressed to be datable. These 3 days are known as grace days”. These three days are considered to be customary, but the law has now made them compulsory in India.

In case, the due date falls on a public holiday (.eg., Republic day (26-1-2003), the bill shall become due on the preceding day (25-1-2003).

In case an emergency holiday has been declared, the bills which fall due on that day, shall become payable the succeeding working day. For example if 14-8-2003 has been declared as emergency holiday, then the bills which matured on 14-8-2003 shall become due on 16-8-2003 as 15-08-2003 is a public holiday.

The following table gives an idea of calculation the due date:

Date of Bill	Period of Bill	Due Date	Working
1.1.2003	3 Months	4.4.2003	1.1.2003 3.2003 1.4.2003 G.D. 3 4.4.2003
29.1.2003	1 Month	3.3.2003	29.1.2003 1 (3days after Feb.28 29.2.2003 because there is no 28 29 <sup>th</sup> February 2003 G.D. 3 3.3.2003
31.7.2003	2 Months	3.10.2003	31.7.2003(3days after Sept. 2 because there is no 31.9.2003 31 <sup>st</sup> Sept.2003) 30 D.D. 3 3.10.2003
1.2.2003	90 days	5.5.2003	1.2.2003 28.2.2003 = 27 days March = 31 days April = 30 days May = 2 days 90 2.5.2003 G.D. 3 5.5.2003

If the month in which the period would terminate has no corresponding day (of maturity) the period shall be held to terminate on the last day of such month.

**G.D. – Grace Days**

**Self Check Test**

**1. Fix the due date**

<b>Date of bill</b>	<b>Period of the bill</b>	<b>Due date</b>
(a) 1.6.2002	3 months	.....
(b) 1.6.2002	90 days	.....
(c) 8.1.2003	2 months	.....
(d) 9.1.2003	1 month	.....
(e) 30.1.2003	3 months	.....
(f) 31.7.2003	3 months	.....
(g) 14.1.2003	30 days	.....
(h) 13.7.2003	30 days	.....
(i) 30.8.2003	3 months	.....
(j) 12.5.2003	3 months	.....

II. (a) A bill dated 1.1.2003 for Rs.300 payable after 3 months is discounted @ 6% per annum with the bankers on 1.1.2003. The discount is Rs.....

(b) A bill dated 1.1.2003 for Rs.300 payable after 3 months is discounted @ 6% per annum with the bankers on 4.2.2003. The discount is Rs.....

**Ans**

(a) 4.9.2002

## NOTES

- (b) 2.9.2002
- (c) 11.3.2003
- (d) 3.3.2003
- (e) 3.5.2003
- (f) 3.11.2003
- (g) 16.2.2003
- (h) 14.8.2003 (same as (i))
- (i) 3.12.2003
- (j) 14.8.2003 (15<sup>th</sup> Independence Day, hence it becomes due on 14<sup>th</sup>)

II. (a)  $300 \times \frac{6}{100} \times \frac{3}{12} = \text{Rs.}4.50\text{p}$

$$100 \quad 12$$

$$6 \times 3 = \text{Rs.}3$$

(b)  $300 \times \frac{\quad}{100} \times \frac{\quad}{12}$

$$100 \quad 12$$

### **Terms used in Bill Transactions**

1. One who draws a bill is called "drawer"
2. One who accepts the bills is known as "drawee"
3. So far drawer is concerned; the bill is a 'B/R'
4. To an acceptor, the same bill is a "B/P"
5. The person to whom the payment should be made is called "Payee"
6. The person who indorses the bill is called "Endorser"
7. The person to whom the bill is indorsed is known as "Endorsee"
8. Failure to accept the bill is "Dishonor"
9. Failure to pay the bill on the due date is "Dishonor"

10. The method of authenticating the fact of dishonor of a bill by a Notary Public is called "Noting".
11. A formal Certificate issued by the Notary Public attesting the dishonor of foreign bill is called "Protest"
12. The fee payable to the notary public for evidencing the fact of dishonor of a bill is called "Noting charges"
13. Date on which a bill becomes payable is called "Due date" or "Date of maturity"
14. Due date is calculated adding 3 extra days known as "Grace Days"
15. To pay the bill before the date is "Retiring"
16. When a bill is retired, a small "Rebate" is allowed for the unexpired period of the bill.
17. It is "Renewal" when the acceptor approaches the drawer before the due date and requests him to cancel the original bill and draw on him fresh bill for the amount due plus interest.
18. The piece of paper attached to a bill for further endorsements when it is filled with endorsement is called "Along"
19. When a bill is paid on the due date, it is said to be "honored".

**Entries for Bill Transactions**

In the books of DRAWER	In the books of ACCEPTOR
1. When a B/R is received: Debit B/R A/c as it is an asset Credit the personal A/c of the party Who gives the bill.	1. When a bill is accepted: Debit personal A/c of the drawer, Because he receives the bill. Credit B/P A/c. since the bill goes out
2. When a B/R is duly honored Debit Cash A/c, since it comes in Credit B/R A/c, since it goes out	2. When a B/P is duly honored Debit B/P A/c, since it comes in Credit Cash A/c, since it goes out
3. When a B/R is discounted Debit Cash A/c, since it comes in Credit B/R, since it goes out	3. No entry is required
4. When a B/R is indorsed to a person: Debit the Receiver's A/c since the Amount is due from him Credit B/R A/c, since it goes out	4. No entry is required
5. When a B/R is dishonored Debit the Acceptor's A/c. since the	5. When a B/P is dishonored Debit B/P A/c in order to cancel the

**NOTES**

<p>Amount is due from him Credit B/R A/c. since it goes out</p>	<p>Original bill Credit the Drawer's A/c Since we are liable to pay the amount Due to him.</p>
<p>6. When a discounted B/R is dishonored Debit the Acceptor's A/c. since the Amount is due from him. Credit Bank A/c. since we are liable To pay amount to the Banker</p>	<p>6. Same as (5) above</p>
<p>7. When an endorsed B/R is dishonored Debit the Acceptor's A/c, since the Amount is due from him Credit Endorsee A/c, since we are Liable to pay the amount to endorsee</p>	<p>7. Same as (5) above</p>
<p>8. When a B/R is noted by the drawer Debit the Acceptor's A/c. since the Amount is due from him (including Noting charges) Credit B/R A/c. since it goes out</p>	<p>8. When a bill is noted by the drawer Debit the B/P A/c with the value of Bill to cancel the original bill Noting charges A/c, since it is a loss To us Credit the Drawer's A/c., Because we are liable to pay him.</p>
<p>9. When a B/R is noted by the Banker Debit the Acceptor's A/c, since the Amount (inclusive of noting charges) Is due from him Credit Bank A/c with Noting charges</p>	<p>9. Same as (8) above</p>
<p>10. When a B/R is noted by the endorsee Debit the Acceptor's A/c, since the Amount is due from him (including Noting charges) Credit</p>	<p>10. Same as (8) above</p>

<p>Endorsee's A/c With noting charges.</p>	
<p>11. When a B/R is renewed (a) Debit the Acceptor's A/c since it Denotes the amount due from him. Credit the B/R A/c, for cancellation Of the old bill: (b) Debit the Acceptor's A/c, for the Interest receivable from him. Credit the Interest A/c since it is an Income. (c) Debit B/R A/c with the amount of The new bill. Credit the Acceptor's A/c, since he Gives the bill</p>	<p>11. When a B/P is renewed (a) Debit B/P A/c for cancellation of the old bill Credit the Drawer's A/c in order to show the amount which is payable to him. (b) Debit the Interest A/c, since we Are liable to pay the interest to him. Credit the Drawer's A/c since we are Liable to pay the interest to him (c) Debit the Drawer's A/c, since he Is the receiver of bill Credit B/P A/c for the value of the New bill. It goes out.</p>
<p>12. When a B/R is retired Debit cash A/c, since cash comes in And Rebate A/c since it is a loss to us Credit B/R a/c. since it goes out.</p>	<p>12. When a BP is retired Debit B/P A/c, with the full credit Cash A/c, because it goes out. Credit Rebate A/c, since it is an Income so far as we are concerned.</p>
<p>13. When a B/P is sent to Bank for Collection Debit Bills for Collection A/c Credit the B/R A/c (a) When it is actually collected Debit Bank A/c Credit Bills for Collection A/c or (b) When it is dishonored Debit the Acceptor's A/c Credit Bills for Collection A/c.</p>	<p>13. No entry  Same as (2) above  Same as (5) above</p>

**Illustration 1**

**Honoring the Bill**

On 1<sup>st</sup> January 2003 'X' drew a two months bill on 'Y' for Rs.500 and the latter accepted the same. On the due date 'Y' met the bill, show the journal entries.

In the books of 'X'	In the books of 'X'
---------------------	---------------------

**NOTES**

1.1.2003 Bills receivable A/c Dr. 500 To 'Y's A/c 500 [being the entry for the receipt of the bill]	Rs.      Rs. 500              500	1.1.2003 Bills receivable A/c Dr. 500 To 'Y's A/c 500 [being the entry for the receipt of the bill]	Rs.      Rs. 500              500
4.3.2003 Cash A/c Dr. 500 To Bills receivable A/c 500 [being the realization of the bill]	Rs.      Rs. 500              500	4.2.2003 Cash A/c Dr. 500 To Bills Receivable A/c 500 [being the realization of the bill]	Rs.      Rs. 500              500

**Illustration 2: (Discounting and Honoring of the Bill)**

On 1<sup>st</sup> March, 2003 'B' accepted 3 months bill for Rs.10, 000 drawn by 'A'. 'A' discounted the bill with State Bank of India at 8%p.a. On the due date, the bill was duly honored by 'B'.

<b>In the books of 'A'</b> 1.3.2003 Bills receivable A/c Dr. 1,000 To 'B's A/c 1,000 [being the entry for the receipt of the bill]	Rs.      Rs. 1,000              1,000	<b>In the books of 'B'</b> 1.3.2003 'A's A/c Dr. 1,000 To Bills Payable A/c 1,000 [being the acceptance given to 'A']	Rs.      Rs. 1,000              1,000
1.3.2003 Cash A/c Dr. 980 Discount Dr. 20 To Bills Receivable A/c 1,000 [being the realization of the bill]	Rs.      Rs. 980      20 1,000		
		4.6.2003 Bill Payable A/c Dr. 1,000 To Cash A/c 1,000 [being the entry for the honor of the bill],	Rs.      Rs. 1,000              1,000

**Illustration 3 (Endorsement, Discounting and Honoring)**

<b>In the Books of Black</b> Brown's A/c Dr. 900 To Sales A/c 900 [being the goods sold to Brown on credit]	Rs.      Rs. 900              900	<b>In the Books of Brown</b> Purchases A/c Dr. 900 To Black A/c 900 [being the goods brought from Black on credit]	Rs.      Rs. 900              900
--	--------------------------------------	---	--------------------------------------

	credit]
Bills Receivable A/c Dr. 900 To Brown's A/c 900 [being the entry for the receipt of the bill]	Black's A/c Dr. 900 To B/P A/c 900 [being the acceptance given to Black]
In the books of Blue	
Bills Receivable A/c Dr. 900 To Black's A/c 900 [being the receipt of the bill indorsed in our favor]	
Cash A/c Dr. 890 Discount A/c 10 To Bills Receivable A/c 900 [being the bill discounted]	Bill payable A/c Dr. 900 To Cash A/c 900 [being the entry for the honor of the bill]

**Illustration: 4**

**(Retiring a Bill under Rebate)**

In the Books of 'A'				In the Books of 'B'			
1.6.2003		Rs.	Rs.			Rs.	Rs.
Bills Receivable A/c Dr.	300			'A' A/c Dr.	300		
To 'B's A/c			300	To Bills Payable A/c			300
[being the entry for the receipt of the bill]				[being the acceptance given to A)			
Cash A/c Dr.	295			Bill payable A/c Dr.	300		
Rebate A/c		5		To Cash A/c			295
To Bills Receivable A/c			300	To Rebate A/c			5
[being the entry for the realization of the bill before the due date]				[being the entry for the retirement of the bill]			

**Illustration 5:**

**(Dishonoring the 'Bill')**

In the Books of 'A'				In the Books of 'B'			
		Rs.	Rs.			Rs.	Rs.
'B's A/c Dr.	4,000			A's A/c Dr.	4,000		
To Sales A/c			4,000	To Bills Payable A/c			4,000
[being the goods sold to B on credit)				[being the acceptance given to A]			
Bills Receivable A/c Dr.	4,000			A's A/c Dr.	4,000		
To B's A/c			4,000	To Bills Payable A/c			4,000
[being the bill received from B)				[being the acceptance given to A]			

B's A/c To Bills 4,000 [being the dishonor of B's acceptance]	Dr. 4,000 Receivable A/c	Bills Payable A/c Dr. 4,000 To A's A/c 4,000 [being the entry for the dishonor of the bill]
--	-----------------------------	--

**Illustration 6:**

**(Discounting and Dishonoring)**

'P' sold goods to 'R' on 1<sup>st</sup> January, 2003 for Rs.2, 575 for which a bill was drawn payable after 3 months and it was accepted by 'R'. On 15<sup>th</sup> 'P' discounted the bill with his bankers who charged a discount of Rs.225 The bill was dishonored by the acceptor on the due date.

In the Books of 'P'				In the Books of 'R'			
1.1.2003		Rs.	Rs.	1.1.2003		Rs.	Rs.
R's A/c	Dr.	2,575		Purchases A/c	Dr.	2,575	
To Sales A/c			2,575	To P's A/c			2,575
[being the goods sold to R on credit]				[being the goods bought from P on credit]			
1.1.2003				1.1.2003			
Bills Receivable A/c	Dr.	2,575		P's A/c	Dr.	2,575	
To R's			A/c	To Bills Payable			A/c
2,575				2,575			
[being the entry for the receipt of the bill]				[being the acceptance given to p]			
15.1.2003							
Cash A/c	Dr.	2,350					
Discount A/c	Dr.	225					
To Bills Receivable A/c			2,575				
[being the entry for discounting the bill]							
1.4.2003				4.4.2003			
R's A/c	Dr.	2,575		Bills Payable A/c	Dr.	2,575	
To Bank A/c			2,575	To P's A/c			2,575
[being the entry for the dishonor of R's acceptance]				[being the entry for the dishonor of the bill]			



**Illustration 8: (Dishonoring and drawer taking up)**

Ashok draws a B/E on Babu for Rs.1, 000. On receiving acceptance from Babu, he endorses in favour of Chandran who indorses it to David discounted it with his bank and received Rs.980. On the due date Babu failed to honour his acceptance and Ashok had to take up the bill from the Bank.

In the Books of Ashok		In the Books of Babu	
Bills Receivable A/c	Dr. 1,000	Ashok A/c	Dr. 1,000
To Babu's A/c	1,000	To Bills Payable A/c	1,000
[being the bill receivable]		[being the bill accepted]	
Chandran's A/c	Dr. 1,000		
To Bills Receivable A/c	1,000		
[being the bill indorsed in favour of Chandran]			
Babu's A/c	Dr. 1,000	Bill Payable A/c	Dr. 1,000
To Bank A/c	1,000	To Ashok's A/c	1,000
[being the bill dishonored and had to take it up]		[being the entry for the dishonour of the bill]	
In the Books of Chandran		In the Books of David	
Bills Receivable A/c	Dr. 1,000	Bill Receivable A/c	Dr. 1,000
To Ashok's A/c	1,000	To Chandran's A/c	1,000
[being the bill endorsed in our favor]		[being the bill indorsed in out favor]	
David's A/c	Dr. 1,000	Cash A/c	Dr. 980
To Bills Receivable A/c	1,000	Discount A/c	20
[being the bill indorsed in favor of David]		To Bills Receivable A/c	1,000
		[being the bill discounted]	

**Illustration 9: (Renewal of a Bill with Interest)**

Mr. A received B's acceptance for Rs.850. Before the due date B offers Rs.300 to A and agrees to accept another bill for Rs.590 including interest. A agreed to accept this offer.

In the Books of 'A'		In the Books of 'B'	
Bills Receivable A/c	Dr. 850	A's A/c	Dr. 850
To B/s A/c	850	To Bills Payable A/c	850
[being the bill receivable]		(being the bill accepted)	
B's A/c	Dr. 850	Bills Payable A/c	Dr. 850
To Bills Receivable A/c	850	To A's A/c	850
[being the bill cancelled]		[being the bill cancelled]	
Cash A/c	Dr. 300	A's A/c	Dr. 300

To B's A/c [being the amount received]	300	To Cash A/c [being the amount Paid]	300
B's A/c To Interest A/c [being the interest receivable]	Dr. 40 40	Interest A/c To A's A/c [being the Interest payable]	Dr. 40 40
Bills Receivable A/c To B's A/c [being the new bill received]	Dr. 590 590	A's A/c To Bills Payable A/c [being the new bill accepted]	Dr. 590 590

**Illustration 10: (Dishonoring with Noting Charge)**

'N' owes 'M' Rs.100 who draws a two months bill for Rs.100 on 'N' on 1.7.2003. 'N' accepts it and returns it to 'M' on the due date. 'N' fails to honor his acceptance and 'M' gets the bill noted by paying Rs.5 as noting charges.

In the Book of 'M'		In the Books of 'N'	
	Rs.		Rs.
1.7.2003 Bills Receivable A/c To N's A/c [being the bills received]	Dr. 100 100	1.7.2003 M's A/c To Bills Payable A/c 100 [being the bill accepted]	Dr. 100 100
4.9.2003 N's A/c To Bills Receivable A/c To Cash A/c [being the bill dishonoured and noting charges paid by us]	Dr. 105 100	4.9.2003 Bills Payable A/c Noting Charges A/c To M's A/c 105 [being the bill dishonoured and the noting charges that had to be paid]	Dr. 100 5 A/c

**Illustration 11: (Endorsements, discounting, dishonoring, With nothing changes, taking up and renewal with interest)**

For goods supplied 'P' draws a bill at 3 months on 'Q' for Rs.15, 000 on 1<sup>st</sup> May 2003. 'Q' accepts it and returns it to 'P'. On the next day, 'P' endorses the bill in favor of the creditor 'R' and on 26<sup>th</sup> May. R endorses it to 'S'. On 1<sup>st</sup> June, 2003 'S' discounts the bill with his bank at 6% p.a. On the due date, the bill is dishonored and the bank pays noting Rs.60 'Q' accepts a new bill a months for the amount then due to 'P' with interest @ 10 per annum.

**NOTES**

In the Books of 'P'		In the Books of 'Q'	
	Rs	Rs	
1.5.2003 Q's A/c Dr. 15,000 To Sales A/c 15,000 [being the bill received]			1.5.2003 Purchases A/c Dr. 15,000 To P's A/c 15,000 [being the goods bought from P on credit]
1.5.2003 Bills Receivable A/c Dr. 15,000 To Q's A/c 15,000 [being the 3 months bill received from Q]			1.5.2003 P's A/c Dr. 15,000 To Bills Payable A/c 15,000 [being the 3 months bill accepted]
2.5.2003 R's A/c Dr. 15,000 To Bill Receivable A/c 15,000 [being the bill indorsed in favour of R]			
4.8.2003 Q's A/c Dr. 15,000 To Bank A/c 15,000 [being the amount paid to the bank and the amount receivable from Q due to dishonour]			4.8.2003 Bills payable A/c Dr. 15,000 Noting Charges A/c Dr. 60 To P's A/c 15,060 [being the 3 months bill dishonoured by us and the noting charges having had to pay]
4.8.2003 Q's A/c Dr. 251 To Interest A/c 251 [being the interest @ 10% on Rs.1,060 receivable from Q]			4.8.2003 Interest A/c Dr. 251 To P's A/c 251 [being the interest 10% on Rs.15,060 payable to P]
4.8.2003 Bills Receivable A/c Dr. 15,311 To Q's A/c 15,311 [being the new 2 months bill received from Q inclusive of interest]			4.8.2003 P's A/c Dr. 15,311 To Bills Payable A/c 15,311 [being the new 2 months bill accepted by us with interest]
2.5.2003 Bills Receivable A/c Dr. 15,000 To P's A/c 15,000 [being the 3 months bill indorsed by P in our favour]			26.5.2003 Bills Receivable A/c Dr. 15,000 To R's A/c 15,000 [being the 3 months bill indorsed by R in our favour]
26.5.2003 S's A/c Dr. 15,000 To Bills Receivable A/c 15,000 [being the 3 months bill indorsed to S]			1.6.2003 Cash A/c Dr. 14,850 Discount A/c Dr. 150 To Bills Receivable A/c 15,000 [being the 3 months bill discounted discharged @ % p.a for 2 months]

$$\text{Interest} = 15,060 \times 10 \times \frac{2}{100} = \text{Rs.} 251$$

**Illustration 12:**

**(Bill and P/N)**

'A' sells goods for Rs.2,500 less 20 T.D. to 'B' on 1<sup>st</sup> April 2003/ 'B' executes a pro note for Rs.500 in favor of 'A' and endorsed C's acceptance to 'A' for the balance due. Both the pro note and the bill are retired before the due date for which rebates of Rs.5 and Rs.15 were given.

In the Books of 'A'				In the Books of 'B'			
B's A/c	Dr.	Rs. 2,000	Rs.	Purchases A/c	Dr.	Rs. 2,000	Rs.
To Sales A/c			2,000	To A's A/c			2,000
[being the goods sold on credit to B]				[being the pro note for Rs.500 executed in favor of A]			
Bills Receivable A/c	Dr.	2,000		A's A/c	Dr.	500	
To B's A/c			2,000	To Bills Payable A/c			500
[being the entry for the receipt of pro note and C's bill indorsed in our favor]				[being the pro note for Rs.500 executed in favor of A]			
Cash A/c	Dr.	1,980		Bills Payable A/c	Dr.	500	
Rebate	Dr.	20		To Cash A/c			495
To Bill Receivable A/c			2,000	To Rebate A/c			5
[being the pro note and bill retired before the due date]				[being the pro note retired before the due date]			

**Illustration 13:**

**(Circuits of Action)**

'A' received a bill Rs.3, 000 duly accepted by 'B'. An endorsed the same in favor of 'C', 'C' endorsed the same in favor of 'B' for the amount due. Show the entries in the books 'A','B' and 'C'

In the Books of 'A'				In the Books of 'B'			
Receivable A/c	Dr.	Rs. 3,000	Rs.	A's A/c	Dr.	Rs. 3,000	Rs.
To B A/c			3,000	To Bills Payable A/c			3,000
[being the bill received from B]				[being the bill accepted by us]			
C's A/c	Dr.	3,000		Bills Payable A/c	Dr.	3,000	
To bills Receivable			3,000	To C's A/c			3,000
[being the bill indorsed in favor of C]				[being our own acceptance received from C]			
In the Books of 'C'							
Bills Receivable A/c	Dr.	3,000					
To A's A/c			3,000				
[being the bill indorsed by us in our favor]							
B's A/c	Dr.	3,000					
To Bills Receivable A/c			3,000				
[being the bill indorsed in favor of B]							

**Illustration 14:****(Ledger accounts required)**

Mr. A. Sold goods to B for Rs.8,000 on credit on 1.1.2003. A drew a bill of exchange on B for Rs.5,000 at one dated January 10. B endorsed to A, C's acceptance for 3,000 at three months from January 1.

The Rs.5,000 bills was discounted and discount being Rs.50. The Rs.3,000 bills was paid into the bank for collection and was returned dishonored with noting charges amounting to Rs.25. B paid the noting charges and accepted a new bill at two months including Rs.100 towards interest. Assuming that the bills were met on the due dates shows the journal entries and the necessary accounts in the books of 'B'.

**In the books of 'B'****Ans:****Journal**

Date	Particulars	L.F.	Dr.		Cr.	
			Rs.	P.	Rs.	P.
2003 Jan.1	Purchases A/c To A's A/c [being the goods purchased on credit]	Dr.	8,000.00			8,000.00
2003 Jan.1	A's A/c To Bills Payable A/c [being the goods purchased accepted]	Dr.	5,000.00			5,000.00
2003 Jan.1	A's A/c To Bills Receivable [being the C's three months bill endorsed in favor of A]	Dr.	3,000.00			3,000.00
2003 Feb.4	Bills Payable A/c To Cash A/c [being the bill honored by us]	Dr.	5,000.00			5,000.00
2003 Apr.4	C's A/c To Cash A/c [being the entry to record the amount due from C and payable to A due to dishonor including noting Charges]	Dr.	3,025.00			3,025.00
2003	A's A/c Dr.			25.00		

Apr.4	To Cash A/c [being the noting charges paid]			25.00
2003 Apr.4	Interest A/c To A's A/c [being the interest payable to A]	Dr.		100.00 100.00
2003 Apr.4	A's A/c To Bills Payable A/c [being the new bill accepted]	Dr.		3,100.00 3,100.00
2003 June 7	Bills Payable A/c To Cash A/c [being the new two months bill honored by us]	Dr.		3,100.00 3,100.00

**Ledger**

**A's A/c**

Date	Particulars	Rs.P.	Date	Particulars	Rs.P.
2003 Jan.1	To Bills Payable A/c	8,000.00	2003 Jan.1	By Purchases	8,000.00
Jan.10	To Bills Receivable A/c		Apr.4	A/c	3,025.00
	To Cash A/c	3,000.00	Apr.4	By C's A/c	100.00
Apr.4	To Bills Payable A/c	25.00		By Interest A/c	
Apr.4		3,100.00			
		11,125.00			11,125.00

**BILLS PAYABLE**

Date	Particulars	Rs.P.	Date	Particulars	Rs.P.
2003 Feb. 4	To Cash A/c	5,000.00	2003 Jan.1	By A's A/c	5,000.00
June 4	To Cash A/c	3,110.00	Apr.4	By A's A/c	3,100.00
		8,100.00			8,100.00

N: B.Students is advised to pass the Journal and Ledger Entries in the books of 'A' for their own practice.

**Illustration 15:****(Journal Entries alone)**

Journalize the following transactions in the books of R. Krishna.

(a) R. Krishna's acceptance to B. Balan for Rs.2,000 discharged by a Cash Payment of Rs.1,000 and an acceptance of new bill for the balance plus Rs.10 for interest.

(b) G. Gopal's acceptance for Rs.4,000 which endorsed over by R. Krishna to M. Mohan was dishonored M. Mohan paid Rs.20 noting charges.

(c) D. Davaraj retires a bill for Rs.2,000 drawn on him by R. Krishna for Rs.10 discount.

(d) R. Krishna's acceptance to P. Palani for Rs.5,000 discharged by M. Moody's acceptance for a similar amount to R. Krishna's acceptance to S. Some for Rs.4,000 was discharged by a cash payment of Rs.2,020 which included Rs.20 for interest; a new bill was accepted for the balance.

**IN THE BOOKS OF KRISHNA**

Date	Particulars	L.F.	Dr.	Cr.
			Rs.P.	Rs.P.
(a) Feb.4	Bills Payable A/c To B. Balan's A/c [being the bill cancelled]	Dr.	2,000.00	2,000.00
	B. Balan's A/c To Cash A/c [being the amount paid]	Dr.	1,000.00	1,000.00
	Interest A/c To B. Balan's A/c [being the interest payable to B. Balan]	Dr.	10.00	10.00
	B. Balan's A/c To Bills Payable A/c	Dr.	1,010.00	1,010.00
(b)	G. Gopal's A/c To M. Mohan's A/c [being the entry to record the amount due from G. Gopal payable to Mohan due to dishonor]	Dr.	4,020.00	4,020.00

(c)	Cash A/c	Dr.	1,900.00	
	Discount A/c	Dr.	10.00	
	To Bills Receivable A/c			2,000.00
	[being the bill retired]			
(d)	Bills Payable A/c	Dr.	5,000.00	
	To Bills Receivable A/c			5,000.00
	[being our acceptance discharged]			
(e)	Bills Payable A/c	Dr.	4,000.00	
	To S. Somu's A/c			4,000.00
	[being the bill cancelled]			
	Interest A/c	Dr.	20.00	
	To S. Somu's A/c			20.00
	[Being the interest payable to S. Some]			
	S.Somu's A/c	Dr.	2,020.00	
	To Cash A/c			2,020.00
	[being the cash paid]			
	S. Somu's A/c	Dr.	2,000.00	
	To Bills Payable A/c			2,000.00
	[being a new bill accepted]			

## EXERCISES

1. Ravi bought goods from Avi for Rs.250 on 16<sup>th</sup> Feb.2003. Avi draws a bill for amount on Ravi which the latter accepts and returns it to Avi. The bill is for two months. On the due date Ravi honors bill.

Pass Journal entries in the books of Ravi and Avi.

2. On 1<sup>st</sup> September, 2003 'X' received from 'A' three Bills of Exchange for Rs.700, Rs.600 and Rs.500 for 3 months, 2 months and 1 month respectively.

On 1<sup>st</sup> October 2003 the first bill was indorsed in favour of a creditor, 'K'. On the same date the second bill; was discounted through Bank @ 5% p.a and the last bill was retained until the due date. On the due date all the bills were dishonored with nothing charges amounting Rs.15 and Rs.10 respectively. Show the entries that would appear in 'X's books.

3. Amrit owed Rs.1, 000 for which Balakrishnan drew a three months bill on 1-6-2003. Being unable to meet the bill on the due date, Amrit requested Balakrishnan to draw another bill for Rs.725 for two months inclusive of Rs.25 and paid Rs.300 the balance in cash.

Balakrishnan accepted this proposal and drew Amrit new bill. The bill was duly met by Amrit on due date.

Pass journal entries in the books of the parties.

4. 'Q' accepts a three months bill drawn on him by 'P' for Rs.1, 000 dates April 1, 2003. On May 1, 'P' discounts it at 6% p.a. On the date of maturity. 'O' not being able to meet the bill, offers 'P' Rs.450, and asks him to draw another bill for the three months for the balance plus interest at 6% p.a 'P' agrees to this arrangement. but before the second bill becomes due. 'Q' becomes bankrupt.

Give Journal entries in P's books.

5. On 31<sup>st</sup> December 2002. Black write off bad debt a balance of Rs.1,000 on an account due to him by White. On 30<sup>th</sup> June, 2003 white paid cash Rs.600 to Black

in full settlement of the account. On the 1<sup>st</sup> July, Black sold further **goods** to White invoiced at Rs.1560 which White paid for by a cheque Rs.300 and a **Bill** for Rs.1260 at two months. Black, discounted the Bill at his bank was called **upon** to take it up and pay the nothing charge of Rs.14. The following day White **met his** obligation with a bill at one month for the amount and paid cash for nothing **charges and interest** at 9%. When this bill became due white met it by paying cash **Rs.600** and accepting a fresh bill at three months for Rs.695. On 11<sup>th</sup> December **2003** White, having become insolvent, paid a compensation of 50 paise in the Rupee.

Journalise the above transactions in Black's books. Also show the **Bill Receivable** Account.

(Hints: Bad debts written off Rs.347.50)

6. A three months bill for Rs.2, 000 was returned **duly accepted** by Ram on 10.3.02 to the drawer, Mohan, who endorsed the bill in **favour** of Senthil. **Senthil** discounts the bill with his bank for Rs.1, 920 Ram did **not meet** the bill on **the due** date.

Press the Journal entries in the books of Ram, Mohan and Senthil.

## ACCOMMODATION BILLS

The Student has been previously told of the prevailing practices that bills are normally drawn and accepted in connection with genuine trade transaction. Before a bill comes into existence, there is already a genuine trade transaction between the parties which acts as a consideration, for the bill. However, even without a genuine trade transaction, to meet a temporary financial need, bills can be used for raising funds. For instance 'X' is in need of money and approached his friend 'Y' who, instead of lending the money directly proposes to draw an Accommodation. Bills, in his favor if the credit of 'Y' is good, this device enables 'X' to get an advance from banker at the commercial rate of discount. Thus, there is no business transaction to support the Accommodation Bill. Such a bill is also called "Kite or Fictitious Bill".

The bill is discounted with the banker and the proceeds are used either by 'X' or both in some agreed proportions. The discount charges are borne by the party or parties receiving the proceeds of bill. Before the due date of the bill, the drawer sends the amount to the acceptor who pays it to the bank.

### Definition:

Accommodation Bills are those which are drawn to enable one or both the parties temporarily raise funds by getting the bills discounted at a bank.

Entries are passed in the books of the drawn and acceptor exactly in the way already pointed out for ordinary bills. An additional entry will have to be passed for sending the remittance to the other party with the requisite amount of discount.

In the books of "X"

Y's A/c                      Dr.

To Cash A/c

To Discount A/c

In the books of 'Y'

Cash A/c Dr.

Discount A/c Dr.

To X's A/c

(Being the...the proceeds sent of 'Y' (being the...of the proceeds received)

**What is Accommodation Bills?**

Accommodation Bills are those which are drawn to enable one or both the parties temporarily raise funds by getting the bills discounted at a bank.

1. A B/E may be either an Inland Bill or a Foreign Bill. An Inland Bill is one which is drawn by a person in a country on some resident of that country itself. A Foreign Bill is one which is drawn by a person residing of another country.

2. A B/E may be either a Trade Bill or an Accommodation Bill. A Trade bill is bills of exchange drawn by a trader on his debtor for the value of goods sold to him. An accommodation bill is a bill of exchange drawn, accepted or endorsed to help a party in need of money. No value is given or taken. These also known as 'kite' or 'fictitious' or 'wind bill'.

House Bills are in effect accommodation bills drawn by the head office of a trading firm upon one of its agencies or branches (or vice versa) and are discounted to supply the drawer with funds or trading operations.

3. When a B/E is accompanied by Bill of Ladi. Machine Insurance Policy, Invoice etc., it is known as a Documentary Bill. When a B/E is not accompanied by such documents, it is known a Clean Bill.

The documents of title to goods may be handed over to the buyer as soon as the buyer accepts the B/E. This is known as a D/A Bill (Documents against Accept of the B/E). Sometimes the documents of title to goods will be handed over to the buyer only against payment of B/E. This is known as a D/P Bill (Documents against Payment of the B/E.)

4. When a B/E is expressed to be payable to the person mentioned therein, it is an Order Bill if it is expressed to be payable to the bearer, it is a Bearer Bill.

5. When a B/E is made payable on demand, it is a Demand Bill. If a B/E is made payable at the expiry of a certain period after date is called a Time Bill or Usance Bill.

Hundi: A hundi is an Indian Bill of exchange. It is drawn in an Indian language in accordance with native customs. There are several varieties of hundies such as Shaw Jog Hundi, Nam Jog Hundi etc.

## PROMISSORY NOTE

A Promissory Note may be executed by one person or by more than one person. When more than one person executes a P/N it is called a Joint Promissory Note. Then the entire maker is jointly and severally liable for the amount payable stated therein.

Bills of Exchange	Promissory Note
<ol style="list-style-type: none"> <li>1. A bill is an order to pay</li> <li>2. A bill requires acceptance</li> <li>3. There are 3 parties The Drawer The Drawee and The Payee</li> <li>4. After acceptance, the acceptor is the Only principal debtor, the drawer Being only secondarily liable.</li> <li>5. Protest is sometimes necessary (i.e. Foreign bill)</li> <li>6. Two acceptors of a bill are liable Jointly.</li> </ol>	<ol style="list-style-type: none"> <li>1. A note is a promise to pay</li> <li>2. No Acceptance is required</li> <li>3. There are only 2 parties The Maker and The Payee</li> <li>4. The Maker is the principal debtor</li> <li>5. No such thing exists</li> <li>6. Two or more makers may be liable Jointly and severally.</li> </ol>

### Illustration: 1

(Bill for mutual accommodation, each party meeting his share)

A draws a bill on B for Rs.500 for their mutual accommodation. After getting the acceptance of B, A discounts the same with his bankers and receives Rs.480. The proceeds are shared equally between A & B. On the due date, A remits his proportion to B who meets the bill. Pass the necessary entries in the books of A & B.

Particulars	L.F.	Dr.	Cr.
		Rs. P.	Rs. P.
Bills Receivable A/c T B's A/c (being the bills received)	Dr.	500.00	500.00
Bank A/c Discount A/c (being the bills discounted)	Dr. Dr.	480.00 20.00	500.00
B's A/c To Cash A/c To Discount A/c (being one-half of the proceeds remitted to B)	Dr.	250.00	240.00 10.00
B's A/c To Cash A/c (being the amount remitted to A)	Dr.	250.00	250.00

**IN THE BOOKS OF 'B'**

**Journal**

Date	Particulars	L.F.	Dr.	Cr.
			Rs. P.	Rs. P.
2003 Jan 15	Bills Receivable A/c To B's A/c (being the two months bill received)	Dr.	3,000.00	3,000.00
Jan 15	B/s A/c To Bills Payable A/c (being the two months bill accepted)	Dr.	3,000.00	3,000.00
Jan 18	Cash A/c Discount A/c To Bills Receivable A/c (being the bill discounted)	Dr. Dr.	2,975.00 25.00	3,000.00
Mar 18	Bills Payable A/c To Cash A/c (being the amount remitted to A)	Dr.	3,000.00	3,000.00
Mar 18	B's A/c To Bank A/c (being the bill dishonored B)	Dr.	3,000.00	3,000.00

Discount = Rs.3,000 X 5 X 2 = 25

## IN THE BOOKS OF 'B'

## Journal

Date	Particulars	L.F.	Dr.		Cr.	
			Rs.	P.	Rs.	P.
2003 Jan 15	A's A/c To Bills Payable A/c (being the two months bill accepted)	Dr.		3,000.00		3,000.00
Jan 15	Bills Receivable A/c To A's A/c (being the two months bill received)	Dr.		3,000.00		3,000.00
Jan 18	Cash A/c Discount A/c To Bills Receivable A/c (being the bills dishonored)	Dr. Dr.		2,975.00 25.00		3,000.00
Mar 18	Bills Payable A/c To A's A/c (being the bills dishonored by us)	Dr.		3,000.00		3,000.00

**Illustration: 3**

(Bills of unequal amount drawn by two parties on each other for mutual accommodation. One of them has become insolvent)

R, for the mutual accommodation, on himself and M draws upon the latter a bill for 3 months date for Rs.800 dated 1<sup>st</sup> January. The bill is discounted by R at 5% and half the proceeds are remitted to M.

M, at the same time, draws a bill at 3 months on R for Rs.400. After securing R's acceptance, the bill is discounted at 6% by M, who remits half the proceeds to R. M becomes Bankrupt on 31<sup>st</sup> March and 1/4<sup>th</sup> in a rupee is received on 15<sup>th</sup> May, as first and final dividend from his estate.

## IN THE BOOKS OF 'R'

### Journal

Date	Particulars	L.F.	Dr.		Cr.	
			Rs.	P.	Rs.	P.
Jan 1	Bills Receivable A/c Dr. To M's A/c (being the 3 months bills receivable)		800.00			800.00
Jan 1	Cash A/c Dr. Discount Dr. (being the discounted)		790.00	10.00		
Jan 1	M's A/c Dr. To Cash A/c To Discount A/c (being on-half of the proceeds remitted to M)		400.00		395.00	5.00
Jan 1	M's A/c Dr. To Bills Payable A/c (being the 3 months bills accepted)		400.00		400.00	
Jan 1	Cash A/c Dr. Discount A/c Dr. To M's A/c (being the one half of the proceeds received from M)		197.00	3.00		200.00
Apr. 4	M's A/c Dr. To Bank A/c (being the 3 months bills dishonored by M)		800.00		800.00	
Apr 4	Bills Payable A/c Dr. To Cash A/c (being the bill honored by us)		400.00		400.00	
May 15	Cash A/c Dr. To M's A/c (being the receipt of a dividend of 1/4 <sup>th</sup> (25p) in a Rupees in full satisfaction of our claim against M for Rs.6,000)		150.00		150.00	
May 15	Bad Debts A/c Dr. To M's A/c (being the balance irrecoverable from M written off as bad debt)		450.00		450.00	

**LEDGER****M'S A/C**

Dr.			Cr.		
Jan 1	To Cash A/c	Rs 395.00	Jan 1	By Bills Receivable A/c	Rs. 800.00
Jan 1	To Discount A/c	5.00	Jan 1	By Cash	197.00
Jan 1	To Bills Payable A/c	400.00	Jan 1	By Discount A/c	3.00
Jan 1	To Bank A/c (1)	800.00	May 15	By Cash A/c (4)	150.00
Apr. 4			May 15	By Bad Debts A/c (5)	450.00
	(2)	<u>1,600.00</u>		(3)	<u>1,600.00</u>

**BILLS RECEIVABLE A/C**

Dr.			Cr.		
Jan 1	To M's A/c	Rs 800.00	Jan 1	By Cash A/c	Rs. 790.00
		<u>800.00</u>		By Discount A/c	10.00
					<u>800.00</u>

**BILLS PAYABLE A/C**

Dr.			Cr.		
Apr. 4	To Cash A/c	Rs 400.00	Jan 1	By M's A/c	Rs. 400.00
		<u>400.00</u>			<u>400.00</u>

**IN THE BOOKS OF 'M'****JOURNAL**

Date	Particulars	L.F.	Dr.	Cr.
			Rs. P.	Rs. P.
Jan 1	R's A/c To Bills Payable A/c (being the 3 months bills accepted)		800.00	800.00
	Cash A/c Discount To R's A/c (being the one half-of the proceeds received from R)		395.00 5.00	400.00

Jan 1	Bills Receivable A/c To R's A/c (being 3 months bill received)	Dr.		400.00	400.00
Jan 1	Cash A/c Discount A/c To Bills Receivable A/c (being the bill discounted)	Dr. Dr.		394.00 6.00	300.00
Jan 1	R's A/c To Cash A/c To Discount A/c (being the half-of the proceed remitted to R)	Dr.		200.00	197.00 3.00
Apr. 4	Bill Payable A/c To R's A/c (being the bill dishonored by us)	Dr.		800.00	800.00
May 15	R's A/c To Cash A/c (being the payment of dividend 25Ps. In the Rupee in full satisfaction of R's claim for Rs.600)	Dr.		150.00	150.00

**LEDGER**

**R'S A/C**

Dr.

Cr.

Jan 1	To Bills Payable A/c	Rs.	800.00	Jan 1	By Cash A/c	Rs.	395.00
Jan 1	To Cash A/c		197.00	Jan 1	By Discount A/c		5.00
Jan 1	To Discount A/c		3.00	Jan 1	By Bills Receivable A/c		400.00
May 15	To Cash A/c		150.00		By Bills Payable A/c		800.00
May 15	To Balance c/d		450.00	Apr.4			
			<u>1,600.00</u>		By Balance b/d		<u>1,600.00</u>
							<u>450.00</u>

**NOTES****BILLS RECEIVABLE A/C**

Dr.

Cr.

Jan 1	To R's A/c	Rs. 400.00	Jan 1	By Cash A/c	Rs. 395.00
				By Discount A/c	5.00
		<u>400.00</u>			<u>400.00</u>

**BILLS PAYABLE A/C**

Dr.

Cr.

Apr. 4	To R's A/c	Rs. 800.00	Jan 1	By R's A/c	Rs. 800.00
		<u>800.00</u>			<u>800.00</u>

**EXERCISES**

1. Senthil and Arasu drew on each other 30 days bill on 8.7.03 for Rs.2,600 each. Each discount the other's Bill at 6% per annum. Both bills are paid on due date.

Journalise the transactions in the books of Senthil and Arasu.

2. On 1<sup>st</sup> January 2003 Prakash draws on Mulla a bill for 3 months for Rs.6,000 which Mulla duly accepts. Prakash discounts the bill for Rs.5,940. On the same date Mulla draws on Prakash a bill for Rs.6,000 which is accepted by Prakash Mulla gets one bill discounted with his bankers at 6% p.a on the due date Prakash meets his bill, but Mulla falls to honour his acceptance, the bank having to pay Rs.20 as noting charges.

Give Journal entries in the books of Prakash.

3. Prince, for mutual accommodation of himself and Queen draws upon the latter a bill of exchange at 3 months date for Rs.8,000 dated 1.1.2003. The bill is discounted by Prince at 5 percent and half the proceeds are remitted to Queen. Queen

at the same time draws a bill of exchange at 3 months on Prince of Rs.4, 000. After securing Prince's acceptance the bill is discounted at 6 percent by queen who remits half the proceeds to Prince. Queen becomes bankrupt on 31<sup>st</sup> March. 2003 and the first and final dividend of 25 paise in the Rupee was received from her estate on 12<sup>th</sup> May 2003.

Write up the ledger accounts in the books of both the parties.  $\sphericalangle$

4. X draws on Y, for mutual accommodation of both, a bill of Rs.2, 000 at three months. X discounts the bill for Rs.1, 980 and remits half the proceeds to Y. On maturity, X is unable to send the amount due and therefore Y draws on X a bill for Rs.2,500 which is duly accepted by X, Y discounts the bill for Rs.2,400 and remits Rs.200 to X before the bill is due for payments. X becomes insolvent. Later 30% dividend is received from his estates.

Give X's Account in Y's books and Y's Account in X's books.

5. Akbar for his own accommodation draws upon Babar a bill for Rs.500 on 1.2.2003 payable after three months. This bill is accepted by Babar on the same date and Akbar discounted it at 6% p.a.

On the due date, Babar meets the bill but Akbar fails to provide Babar with the necessary funds. Instead, he pay Babar Rs.200/- in cash and given a bill for two months for Rs.300 plus interest @ 4% p.a. This bill is duly met on maturity.

Give journal entries the books of Akbar and Babar.

6. Journalize the following transactions in the books of Pandurangan and Rajendran.

(a) Pandurangan's acceptance to Rajendran for Rs.1, 000 renewed for 4 months at 9% p.a interest.

(b) Rajendran's acceptance to Pandurangan for Rs.2, 000 was renewed by a cheque of Rs.800 and a new bill for the balance at 3 months at 9% p.a. interest.

## NOTES

(c) Rajendran's acceptance for Rs.1, 600 was returned by a cheque of Rs.800 and new bill for the balance for 2 months. Interest at 9% per annum being paid in cash forth with.

3. Murali sold goods to Mohan for Rs.10, 000. For his Mohan accepted Murali's bill of exchange. Murali discounted this bill at bank for Rs.9, 900. For this bill Mohan does not pay money on the due date. For this the bank's expenses were Rs.50.

After some time, for the total amount payable to Murali. Mohan accepted a new bill and also paid to Murali in Cash Rs.100 for interest. Before the due date of his bill Moah became insolvent. From Mohan's estate Murali could recover only 50%.

Show the necessary Journal entries in the books of Murali and Mohan.

## LESSON- 4

### CONSIGNMENT, JOINT VENTURE, ACCOUNT-CURRENT AND AVERAGE DUE DATE

#### Consignment – What?

A Consignment is the dispatch of a quantity of goods from one place to another, usually to some country or place abroad for the purpose of sale by an agent on commission.

#### Consignment – Why?

Sometimes, a manufacturer who does not find ready market for his goods in his own place becomes desirous of seeking a good market elsewhere. Even when there is a good market in his own place, he is often anxious to make his goods popular elsewhere.

#### Consignment – Ho?

For this purpose, the manufacturer employs a leading dealer at the place where he wants to push his goods to act as his agent and sell goods on his behalf and risk and as agent on commission.

- Goods so sent to a person are known as Consignment.
- The person who sells goods is known as Consignor.
- The person to whom the goods are sent is known as Consignee.
- The remuneration of the consignee for selling the goods, usually a percentage on sales value, is known as Commission.

#### Consignment – Legal Implications:

The Consignee to whom the goods are sent does not buy them, but merely undertakes to sell them on behalf on the Consignor. This is such goods sent to the consignee remains the property of the consignor. The consignee is not responsible

#### Meaning of Consignment:

A Consignment is the dispatch of a quantity of goods from one place to another, usually to some country or place abroad for the purpose of sale by an agent on commission

**NOTES**

for any loss or damage to the goods, if such loss or damage is caused for no fault of the consignee.

Such a shipment of the goods by the consignor cannot be treated as ordinary sale and thus such transactions require special treatment in the books of account.

**Difference between Sale and Consignment.**

Sale	Consignment
<b>1. OWNERSHIP</b>	
When goods are sold, the right of ownership over the goods immediately passes to the buyer.	When goods are sent on consignment, the rights of the ownership to the goods remains with the consignor.
<b>2. RISK</b>	
Risk is transferred to buyer	Risk is not transferred to consignee.
<b>3. RELATION</b>	
It becomes a relationship of a buyer and Seller or a debtor and creditor.	It becomes a relationship of Principle and An Agent between the Consignor and the Consignee.
<b>4. CALL BACK</b>	
Once the goods are sold they are sold for ever for which they are non-returnable according to the Sale of Goods Act	The goods are refundable if they cannot be marketed.
<b>5. PROFIT</b>	
Profit on re-sale of goods is enjoyed by The buyer himself.	Profit on consignment belongs to the Consignor. The consignee is entitled to Get only the commission.

**Difference between Consignment and Goods on Sale or Return:**

In the case of consignment the person to whom the goods are sent is an agent of the sender; but in the latter case, the person to whom the goods are sent is merely an optional purchaser.

The consignee will be treated as debtor only when entire goods or part of them have been sold by him. But if goods remain unsold, the consignee will send them back to the consignor and the consignor will pay the consignee all the expense he has incurred in keeping the goods in safety and in attempting to push the good in his market.

**Agent's Remuneration:**

When the goods are sold by the consignee, he is paid a commission for his services on the gross sold by him. In addition to this commission, he is to be reimbursed for all expenses incurred by him in connection with the consignment sales. Usually, these expenses are in the nature of dock charge, custom duties, carriage, godown rent, advertisement, insurance of the goods while in his possession etc.

**Del Credere commission**

Usually the consignor advises the consignee to set the goods consigned to him for cash only, because if such goods are sold on credit by the consignee and if any amount becomes irrecoverable from debtors, the loss will fall upon the consignor. As the consignee acts as agent only in effecting the sales he does not become responsible for any bad debts. But sometimes an arrangement is made between the consignor and the consignee whereby the latter guarantees payment and undertakes responsibility for bad debts (see illustration 2). For this Consignee receives an additional commission known as 'Del Credere Commission' on the total sales.

**Performed Invoice:**

When goods are dispatched, consignor makes out a "Proforma Invoice" giving indication of price of the goods at which the Consignee ought to sell the goods. Pro-forma invoice is a statement which is similar to that of an invoice, but it is called proforma because, it does not make the consignor responsible to pay the amount stated therein.

The Consignor generally mentions higher price his cost so that the Consignee does not know the profit of the Consignor.

The following are the main reasons for adopting higher prices in the Pro-forma invoice by the Consignor:

1. In these days of cut-throat competition, the trader maintains secrecy in order to avoid rivalry that is why, the cost of production is not leaked out even to the agent.
2. The consignor is guaranteed a margin of profit because the consignee records it as the minimum price below which he is not permitted to sell the goods.
3. There is the risk of damage to the goods-in-transit when the goods are sent to foreign countries. To cover this risk, a Marine Insurance Policy is taken out. This Policy is taken on the basis of Pro-forma Invoice Price, which will cover the cost, expenses and also a margin of profit in the case of destruction of goods in transit.

At the end of the year, the difference is adjusted either by writing off or creating a reserve in respect of the excess price relating to the goods still remaining unsold.(See Illustration 2)

**Advance against consignment:**

Until the goods are sold by the consignee, he is not indebted to the consignor and is not expected to pay for them. This results in a part of the Consignor's capital

being locked up for a period. To overcome this difficulty, the consignee often remits sum of money in advance to the consignor. This may be done in the form of an acceptance of a Bill of Exchange drawn by the consignor on the consignee or a simply bank draft. An advance is readily sent against consignment by the consignee goods become popular in the consignee's place.

**Account Sales:**

Periodically the consignee will send statements of sales made, expenses incurred, commission earned and the consequent amount due to the consignor. Such a statement is made in a form known as 'Account Sales'. An Account Sales may be defined as 'a statement prepared and sent by the consignee to the consignor of periodical intervals, say three months or six months, detailing herein the gross amount payable and the net amount due from consignee after deducting the advances. If any paid already'.

**1. ENTRIES IN THE BOOK OF THE CONSIGNOR**

**1. on Despatch of Goods**

	Rs.	Rs.
Consignment A/c D.	?	
To Good sent on Consignment A/c (Being the cost of the goods consigned)		?

Here Sales Account is not credited because sending goods on consignment does not mean actual sale. These goods are returnable by the consignee if he cannot effect sale, Hence, a new account, "Goods sent on Consignment" is opened.

**2. on Paying Expenses (By the Consignor)**

Consignment A/c	Dr.
To Cash (or Bank) A/c (being the amount spent on carriage, freight insurance, etc., at the time of dispatching the goods)	

## NOTES

### 3. on Receipt of an Advance from the Consignee:

Cash or (Bank or Bills Receivable) A/c	Dr.
To Consignee's Personal A/c	
(being the advance of Rs.....received against consignment from the consignee)	

### 4. If the Advance is in the form of a Bills Receivable and the same is discounted by the Consignor:

Cash or (Bank) A/c	Dr.....
Discount A/c	Dr.....
To B/R A/c	
(being the B/R discounted)	

No further entry is made in the books of consignor till an Account Sales is received from the consignee.

### 5. On Receipt of Account Sales

Consignee's Personal A/c	Dr.....
To Consignment A/c	
(being gross proceed of the Account Sales)	

(ii)

Consignment A/c	Dr.....
To Consignees Personal A/c	
(being the expenses incurred by the consignee plus the commission payable to the consignee as per Account Sales)	

### 6. On Receipt of Remittance From Consignee

Cash (or Bank or Bill Receivable) A/c	Dr.....
To Consignee's Personal A/c	
(being the balance received)	

7. If the goods sent have all been sold, and the Consignment Account was debited with the cost price of goods the Consignment Account will now reflect profit or loss. In case it results in a profit, the entry will be

Consignment A/c	Dr.....
To Profit and Loss A/c	
(being the profit on Consignment A/c transferred to Profit and Loss A/c.)	

In case the consignment deal results in a loss, the entry will be reversed i.e.,

Profit and Loss A/c	Dr.....
To Consignment A/c	
(being the loss on Consignment A/c transferred to Profit and Loss A/c)	

But if the goods consigned at a price in excess of cost and the Consignment Account was debited and Goods sent on Consignment A/c credited at that excess price, then an adjustment entry will have to be made before ascertaining the profit or loss on consignment. The adjustment entry will be made before ascertaining the profit or loss on consignment. The adjustment entry will be

Goods sent on Consignment A/c	Dr.....
To Consignment A/c	
(being the amount of the excess price charged now written back)	

Lastly, the "Goods sent on Consignment A/c" will be transferred to the Trading A/c.

Note: This entry is the reverse of the entry passed at the time when the goods are sent on consignment to the consignee but with the excess price charged.

## NOTES

### Unsold Stock of Consignment Goods & its Valuation

If a part of goods sent to the consignee has remained unsold, the unsold stock with the consignee must be valued and brought into books before profit or loss can be ascertained. This unsold stock is valued at cost price or at market price whichever is lower.

The cost price here should not mean merely the cost at which the goods were invoiced but should include such proportionate expenses as normally increase the value of goods consigned. Such expenses are freight, customs duties, clock duties, insurance-in-transit, loading and unloading charges etc. It does not matter whether these expenses are paid by the consignor himself or by the consignee. But the expenses incurred by the consignee in effecting sales, such as future advertisement, travelers commission, storage, insurance against fire and theft, godown rent etc., are not included in determining the cost price of the unsold stock.

#### Example – 1

Suppose the consignor sends to the consignee 1000 units at Rs.250 per unit and pays customs duty Rs.10, 000 marine insurance Rs.5, 000. Consignee pays, at the time of taking delivery unloading charges of Rs.5, 000. Only, 800 units have been sold. The Consignee also pays godown rent Rs.5, 500 and advertisement Rs.2, 500.

1/2th of the Total Goods (i.e.200 units) remain unsold. They will be valued as:

1/5 <sup>th</sup> Units i.e., 200 units at Rs.250	= 50,000
1/5 <sup>th</sup> of Rs.10, 000 customs duty paid by the consignor	= 2,000
1/5 <sup>th</sup> of Rs.5, 000 Marine Insurance	= 1,000
1/5 <sup>th</sup> of Rs.5, 000 unloading charges paid by the consignee	= <u>1,000</u>
Total	= <u>54,000</u>

If the market price of the unsold stock is more than Rs.54,000. It will be valued of Rs.54, 000 If however, the market price is less than Rs.54,000 it will be valued at the market price. (See Illustration 5) Any loss of or depreciation of stock should be duly taken into account.

The unsold stock valued in the above manner will be brought to books by passing an entry.

Stock (on Consignment) A/c	Dr.....
To Consignment A/c	
(being the closing stock brought into Account)	

Note: If the proforma invoice was made out at price higher than the cost, it will also be valued at invoice price and not at cost. But it is wrong to show unsold stock in the Balance Sheet at a figure higher than the cost. Hence, for the difference, (i.e.) difference between value of stock at invoice price and value of stock at cost, reserve must be created. The entry is:

Consignment A/c	Dr.....
To Stock Reserve A/c	
(being the excess value now written off)	

The Stock on Consignment less Stock Reserve will appear as an asset in the Balance Sheet of the consignor.

### Loss of Goods:

Goods sent on consignment may be lost or damaged or destroyed either in transit or after they reach the agent. Such a loss may be either (1) Abnormal Loss or (2) Normal Loss.

#### 1. Abnormal Loss:

Loss of goods due to flood, fire, earth quakes, riot, war, insects, or by theft etc., is of abnormal nature. It is beyond the control of the business-man.

## NOTES

### Example: 2

100 Units of a commodity were consigned at cost for Rs.200 per unit. The consignor pays Rs.2,000 as custom duty and Rs.1,000 for marine insurance. 10 units have been damaged and destroyed by fire.

The value of the loss will be calculated as follows:

	Rs.	Rs.
10 Units at Rs.200 each		2,000
Add 10/100 <sup>th</sup> of customs duty	2,000	200
Add 10/100 <sup>th</sup> of marine insurance	<u>1,000</u>	<u>100</u>
Irrecoverable Loss		<u>2,300</u>

To ensure that the Consignment account shows true consignment profit, such a loss would be recorded by means of the following entry.

		Rs.	Rs.
Profit & Loss A/c	Dr.	2,300	
To Consignment A/c			2,300
(being the loss brought into account)			

Suppose in the above illustration, the Insurance company has agreed to meet the claim to the extent of Rs.2,000 Amount recoverable is Rs.2,000 Amount irrecoverable is Rs.300. The above entry would be changed into

		Rs.	Rs.
Profit & Loss A/c	Dr.	300	
Insurance Co's A/c	Dr.	2,300	
To Consignment A/c			2,300
(being claim admitted by Insurance Co., and the balance treated as irrecoverable)			

**Normal Loss:**

Loss of goods due to normally expected but unavoidable causes of evaporation, leakage, breakage, dusting or weighment etc., called normal loss. It is inherent and unavoidable. Such normal loss should be allowed while calculating the cost of the unsold stock.

**Example: 3**

Mr. 'Xavier' consigned to Mr. Yusuf 1,000 kg. Of flour costing Rs.3,000. The freight is Rs.60. Due to loss in weighing and handling only 900kg are received by the consignee. At the end of the year 200 kg remained unsold.

The value of the Closing Stock of 200kg will be calculated as follows;

$$\begin{aligned} & \frac{3,000 + 60}{900} \times 200 \\ = & \quad \quad \quad 900 \\ = & \quad \quad \quad \text{Rs.680.} \end{aligned}$$

Formula for calculating this:

Total cost of Goods sent + Non-recurring Expenses

$$\frac{\text{Rs. 3,000} + \text{Rs.60}}{\text{Total units sent less Normal Wastes in units (1000-100)}} \times \text{Stock in units (200)}$$

**2. ENTRIES IN THE BOOKS OF THE CONSIGNEE**

As it has already been pointed out the consignee receives the goods of the consignor as an agent and sells them on behalf of the principle. These goods do not belong to him as he is not to make any entry till he incurs expenditure on them and sells them at his place (illustration 7). But he must keep a detailed note of the receipt of these goods: otherwise they are mixed with his own goods.

Who is consignee?

The person to who merchandise is delivered over.

**NOTES**

**1) On Receipt of Goods:**

No Entry: Only a detailed note is maintained
--

**Who is Consignor?**

The person who delivers over or commits merchandise

**2) Expenses of the Consignee :**

Consignor's Personal A/c	Dr.....
To Cash (or Bank) A/c	
(being the customs duty charges, unloading charges at the time of receiving the goods and later on advertisement, godown rent, etc., paid)	

**3) When (and if ) an advance is given:**

Consignor's Personal A/c	Dr.....
To Cash (or Bank or Bills Payable) A/c	

**4) When goods are sold:**

i) for cash

Cash (or Bank) A/c	Dr....
To Consignor's Personal A/c.....	

ii) On credit

Debtors A/c	Dr.....
To Consignor's Personal A/c.....	

Purchases A/c	Dr.....
To Consignor's Personal A/c.....	

iii) if purchased by the Consignee

**5) For Commission earned:**

Consignor's Personal A/c	Dr.....
To Commission A/c	
(being the entry for commission)	

**6. On Setting the Account of the Consignor:**

Consignor's Personal A/c	Dr.....
To Cash (or Bank or B/P A/c)	
(being the balance sent)	

7) If the consignee is paid Del-Credere commission and if any amount due from debtors (to whom Consignment goods have been sold on credit) becomes irrecoverable, the debt will be consignee's loss. The entry then will be:

Commission A/c	Dr.
To Bad Debts A/c	
(being the loss adjusted)	

8) The balance or commission earned will then be transferred to the Profit and Loss Account Thus

Commission A/c	Dr.....
To Profit and Loss A.c	
(being the amount transferred to P & L A/c)	

**Illustration: 1**

3.3.2003 Thambi & Co., of Madras sent to their agent M.s Issac & Co., Penang 300 Steel Chair at Rs.20 per chair on Consignment basis. Thambi & Co., drew on the consignee a 4 months draft for Rs.6, 000 which is duly accepted Issac & Co., reports on 30<sup>th</sup> June, 2003 that the entire consignment has been sold for Rs.9, 000. The consignee is entitled to receive a commission of Rs.250. On the due date the bill was duly honored by the acceptor. Show the journal and ledger entries in the books of the consignor and consignee and determine the outstanding amount between them.

Solution:

**IN THE BOOK OF THE CONSIGNOR (Thambi & Co.,)**

		L.F.	Dr.	Cr.
			Rs. P.	Rs. P.
2003 Mar. 3	Consignment A/c To Goods sent on Consignment A/c (being the cost of the goods consigned)	Dr.	6,000.00	6,000.00
Jun 30	Bills Receivable A/c To Issac & Co's A/c (being the four months bill received)	Dr.	6,000.00	6,000.00
	Consignment A/c To Issac & Co's A/c (being the freight and godown rent incurred by the consignee)	Dr.	900.00	900.00
Jun 30	Issac & Co's A/c To Consignment A/c (being the gross proceeds as per Accounts Sales)	Dr.	9,000.00	9,000.00
Jun 30	Consignment A/c To Issac & Co's A/c (being the commission payable)	Dr.	250.00	250.00
Jun 30	Consignment A/c To Profit & Loss A/c (being the profit on consignment transferred)	Dr.	1,850.00	1,850.00
Jun 30	Goods sent on Consignment A/c To Trading A/c (being the above account transferred to the Trading A/c)	Dr.	6,000.00	6,000.00
July 6	Cash A/c To Bills Receivable	Dr.	6,000.00	6,000.00

Passing of this entry requires the preparation of Consignment a/c charged to Consignment A/c.

**CONSIGNMENT A/C**

Dr.

Cr.

		Rs.			Rs.
2003 Mar. 3	To Goods sent on Consignment A/c	6,000.00	2003 June	By Issac & Co's A/c Sales Proceeds	9,000.00
Jun 30	To Issac & Co's A/cExp To Issac & Co's Commn. To Profit&Loss A/c (4)	900.00 250.00 1,850.00 <u>9,000.00</u>			<u>9,000.00</u>

**GOODS SENT ON CONSIGNMENT A/C**

Dr.

Cr.

		Rs.			Rs.
2003 June	To Trading A/c Transfer (4) (3)	6,000.00 <u>6,000.00</u>	2003 Mar 2	By consignment A/c (2)	6,000.00 <u>6,000.00</u>

**ISSAC & CO'S A/C**

Dr.

Cr.

		Rs.			Rs.
2003 Mar 3	To Consignment	9,000.00	2003 Mar30	By Bill Receivable A/c By Consignment A/c By Consignment A/c By Balance C/d	6,000.00 900.00 250.00 1,850.00 <u>9,000.00</u>
July 1	To Balance b/d (5)	<u>9,000.00</u> 1,850.00			<u>9,000.00</u>

NOTES

IN THE BOOK OF THE CONSIGNOR (Thambi & Co.)

		L.F.	Dr.	Cr.
2003			Rs. P.	
Mar.3	Thambi & Co's A/c To Bills Payable A/c (being 4 months bill accepted by us)	Dr.	6,000.00	6,000.00
Jun 30	Thambi & Co's To Cash A/c (being the freight and godown rent paid)	Dr.	900.00	900.00
Jun 30	Cash A/c To Thambi & Co's A/c (being the sale proceeds received)	Dr.	9,000.00	9,000.00
Jun 30	Thambi & Co's A/c To Commssion (being the commission receivable)	Dr.	250.00	250.00
July 6	Bills Payable A/c To Bank A/c (being the bill duly honored by us)	Dr.	6,000.00	6,000.00

THAMBI & CO'S A/C

Dr.

Cr.

		Rs			Rs.
2003			2003		
Mar. 3	To Bills Payable A/c	6,000.00	Jun 4	By Cash A/c	9,000.00
Jun 30	To Cash A/c	900.00			
	To Commission A/c	250.00			
	To Balance c/d	1,850.00			
		<u>9,000.00</u>			<u>9,000.00</u>
			July 1	By Balance b/d	

Illustration: 2

(Cost price is given & invoice is made out to show a certain per cent sales-unsold stock – Del Credere Comission – Bad Debts)

Bigben Co., forwarded on 1<sup>st</sup> July 2003, 100 clocks to Mr. Gopal of Salem to be sold on behalf of Bigben Co. The cost of one clock was Rs.30 but the invoice price was made out to show a profit of 25% on sales. Bigben Co., incurred Rs.200 on

freight and insurance. Mr. Gopal received the consignment on 14<sup>th</sup> July 2003 and accepted a 3 months bill drawn upon him by Bigben Co., for Rs.2, 000. The bill was met on the due date. Mr. Gopal paid Rs.80 as rent and Rs.50 as insurance.

By 15.12.2003 Mr. Gopal disposed of the stock as below 90 clocks for Rs.7,280.

Of the above Mr. Gopal was not able to recover the sale proceeds of 5 clocks of Rs.40 because of the insolvency of the debtors. Mr. Gopal is entitled to a commission of 5 percent on sales including a Del credere commission of 1 percent. Mr. Gopal rendered the account Sales on 15.12.2003 and remitted the balance on 20.12.2003.

Give journal and ledger entries to record the above transaction in the books of Bigben Co., and Gopal who close their accounts on 31<sup>st</sup> December.

### WORKING NOTES

#### 1) Invoice price:

Cost Price = Rs.30

Setting Price = Rs.100 (Let is be assumed Rs.100 as Invoice price)

Profit = Rs.25% on sales

Cost price = (Rs.100 – 25) = 75

If the cost price is Rs.75 the invoice price would Rs.100

When the price is kRs.30 the invoice price would?

$$= \frac{100}{75}$$

Invoice price = Rs.40

The value of 100 clocks sent is (100 x Rs.40) = Rs.4,000

**2) Stocks:**

Total clocks sent	=	100	
Less: Sold	=	<u>90</u>	
Stock of Clocks	=	<u>10</u>	
The value of unsold clocks	=	10	x Rs.40 = 400
		200	
Add: Proportionare Expenses	=	—	x Rs.10 = 20
			<u>Rs.420</u>

**3) Commission:**

Sale proceeds of 90 clocks	=	Rs.7, 280	
Commission 4% + Del Credere Commission 1%	=	5%	
		5	
Commission payable Rs.7, 280 x	—		
		100	

**4) Excess Value to be written back:**

(a) Goods sent: Invoice price	=	Rs.40	
Cost price	=	<u>Rs.30</u>	
Excess	=	Rs.10 x 100	
Clocks	=	Rs.1, 000	
(b) Stock Excess Rs.10 x 10 clocks	=	Rs.100	

## IN THE BOOKS OF BIGBEN &amp; CO.

		Dr.		Cr.	
		Rs.	P.	Rs.	P.
2003					
July 1	Consignment A/c To Goods Sent on Consignment A/c (being the goods sent on Consignment at invoice price)	Dr.	4,000.00		4,000.00
	Consignment A/c To Cash A/c (being the freight and insurance paid on consignment)	Dr.	200.00		200.00
July 14	Bills Receivable A/c To Gopal's A/c (being the 3 months bill received)	Dr.	2,000.00		2,000.00
Oct 17	Cash A/c To Bill Receivable A/c (being the bill duly honored by Gopal)	Dr.	2,000.00		2,000.00
Dec 15	Gopal's A/c To Consignment A/c (being the sale proceeds as per Account Sales)	Dr.	7,280.00		7,280.00
Dec 15	Consignment A/c To Gopal's A/c (being the rent and insurance paid by Gopal for consignment as per account Sales)	Dr.	130.00		130.00
Dec 17	Consignment A/c To Gopal's A/c (being the commission on consignment as per Account Sales)	Dr.	364.00		364.00
Dec 20	Bank A/c To Gopal's A/c (being the balance due received)	Dr.	4,786.00		4,786.00
Dec 31	Consignment Stock A/c To Consignment A/c (being the value of unsold goods bring into account At Invoice price)	Dr.	420.00		420.00
	Goods sent on Consignment A/c To Consignment A/c (being the excess value of the goods sent now written	Dr.	1,000.00		1,000.00

**NOTES**

Dec 31	back) Consignment A/c To Consignment Stock Reserve A/c (being the excess value of the goods sent now written back)	Dr.	100.00	100.00
Dec 31	Consignment A/c To Profit and Loss A/c (being the profit transferred to P/L A/c)	Dr.	3,906.00	3,906.00
Dec 31	Goods Sent on Consignment A/c To Trading A/c (being the above account transferred to Trading A/c)	Dr.	3,000.00	3,000.00

2003 Jul 1	To Goods sent on Consignment A/c	Rs. 4,000.00	2003 Dec.15	By Gopal's A/c Sales	Rs. 7,280.00
Dec 15	To Cash A/c Exp.	200.00	Dec.31	Proceeds'	
Dec.17	To Gopal's A/c Exp.	130.00		By Consignment Stock A/c	420.00
Dec.31	To Gopal's A/c	364.00		By Good's sent on	
	To Stock Reserve A/c	100.00		Consignment a/c	
	Excess now written of	3,906.00		Excess now written off	1,000.00
	To P/L A/c (1) (Balancing figures)				<u>8,700.00</u>
		<u>8,700.00</u>			

**GOODS SENT ON CONSIGNMENT A/C**

2003 Dec.31	To Consignment A/c Trading a/c Transfer (4)	Rs. 1,000.00	2003 July 1	By Consignment A/c	Rs. 4,000.00
		3,000.00			
		<u>4,000.00</u>			<u>4,000.00</u>

**GOPAL'S A/C**

2003 Dec.15	To Consignment	Rs. 7,280.00	2003 July14	By Bill Receivable A/c	Rs.
				By Consignment A/c	2,000.00
				By Consignment A/c	130.00
				By Bank A/c	364.00
				Balancing figure (4)	
					<u>4,786.00</u>
		<u>7,280.00</u>			<u>7,280.00</u>

## CONSIGNMENT STOCK A/C

2003 Dec.31	To Consignment A/c (1)	Rs. 420.00	2003 Dec.31	By Balance c/d (4)	Rs. 420.00
	(2)	420.00		(3)	420.00
1989 Jan.1	To Balance b/d (5)	420.00			

## STOCK RESERVE A/C.

2003 Dec.31	To Balance c/d (2)	Rs. 100.00	2003 Dec.31	By Consignment A/c (1)	Rs. 100.00
	(3)	100.00	1989 Jan.1	To Balance b/d (5)	100.00
					100.00

## IN THE BOOKS OF GOPAL

		L.F.	Dr. Rs. P.	Cr. Rs. P.
2003 July 14	Big Ben Co's A/c To Bills Payable A/c (being the 3 months bill accepted by us)	Dr.	2,000.00	2,000.00
Oct 17	Bill Payable A/c To Cash A/c (being the bill duly honored by us)	Dr.	2,000.00	2,000.00
Oct. 5	Cash A/c To Big Ben Cos's A/c (being the sale proceeds received)	Dr.	7,280.00	7,280.00
	Big Ben Co's A/c To Cash A/c (Being the rent and insurance paid for Big Ben Co.)	Dr.	130.00	130.00
	Big Ben Co's A/c To Commission A/c (being the Commission receivable)	Dr.	364.00	364.00
Oct 20	Big Ben Co's A/c To Bank A/c (being the balance sent by draft)	Dr.	4,786.00	4,786.00
	Commission A/c To Customer's A/c (being the amount irrecoverable adjusted against commission)	Dr.	200.00	200.00

**NOTES**

**BIG BEN CO'S A/C**

2003		Rs.	2003		Rs.
July 14	To Bills Payable A/c	2,000.00	Oct. 17	Cash A/c	7,280.00
Dec 15	To Cash A/c	130.00			
Dec 15	To Commission A/c	364.00			
Dec 15	To Bank A/c (4)	4,786.00			
	(3)	<u>7,280.00</u>			<u>7,280.00</u>

**BILLS PAYABLE A/C**

2003		Rs.	2003		Rs.
June	To Cash A/c	2,000.00	Dec 15	By Big Ben Co's A/c	2,000.00
		<u>2,000.00</u>			<u>2,000.00</u>

**COMMISSION A/C**

2003		Rs.	2009		Rs.
Dec 31	To Customer's A/c	200.00	Dec 15	By Big Ben Co's A/c	364.00
	To P/L A/c Transfer			(2)	
	(4)	164.00			
	(3)	<u>364.00</u>		(2)	<u>364.00</u>

(Invoice price is fixed at certain percent above the cost price Stock Destroyed i.e.. Abnormal Loss)

Rajan sent 10 motor cars to Suresh on consignment. The cost of each as Rs.8, 000 but was invoiced to Suresh at cost plus 25%. The expenses of Rajan were Freight Rs.800 Insurance Rs.1, 500.

Suresh sold 5 cars at Rs.12, 000 each and paid for storage and Insurance Rs.1, 700. He then accepted a bill for Rs.50, 000 at 3 months drawn by Rajan which the later immediately discounted with his bank at 6%. Suresh is to get 5% commission. One car was destroyed by fire. The insurance company accepted a claim for Rs.6, 000.

Show the necessary Ledger Accounts in the books of Rajan.

**Working notes:**

(a) Proforma Invoice price

Rs.

Cost of a Car	8,000	
Add: Profit 25% thereof	<u>2,000</u>	
	10,000	x 10 cars
Invoice Price	=	1, 00,000

**(b) Car destroyed:**

Cost of a car	8,000	
Add: Proportionate Expenses		
2300		
<u>10</u>		
x 1	230	
	<u>8,230</u>	
Less: Claim paid by Insurance Co.	6,000	
	<u>2,200</u>	
	Less	

P & L A/c is debited

**(c) Stock of 4 Cars**

Value of 4 Cars at Invoice Price of Rs.10, 000	=	40,000
	2300	
Add: Proportionate Expenses	<u>10</u> x 4	= 920
		<u>= 40,920</u>

(d) The difference between Invoice Price and the cost price is Rs.2, 000 per car. As such, the excess value on 10 cars Rs.20, 000 is now written back.

(e) Similarly, the excess value of 4 cars (Rs.8, 000) is now written back.

**NOTES**

**IN THE BOOKS OF RAJAN**

**CONSIGNMENT A/C**

	Rs.		Rs.
To Goods sent on Consignment A/c (a)	1,00,000.00	By Profit & Loss A/c (b)	2,230.00
To Cash A/c Exp.	2,300.00	By Insurance Co's A/c	6,000.00
To Suresh A/c Exp.	1,700.00	By Suresh's A/c Sale Proceeds	60,000.00
To Suresh's A/c Commn.	3,000.00	By Stock A/c (c)	40,920.00
To Consignment Stock Reserve A/c Excess now written off (e)	8,000.00	By Goods on Consignment A/c Excess now written off (2)	20,000.00
To Profit & Loss A/c (4)	14,150.00		
(3)	1,29,150.00	(2)	1,29,150.00

**GOODS SENT ON CONSIGNMENT A/C.**

	Rs.		Rs.
To Consignment A/c	20,000.00	By Consignment A/c	1,00,000.00
To Trading A/c Transfer	80,000.00	(2)	
(3)	1,00,000.00		1,00,000.00

**SURESH A/C**

	Rs.		Rs.
To Consignment A/c (Sales Proceeds)	60,000.00	By Consignment A/c	1,700.00
		By Bills Receivable A/c.	
		By Consignment A/c (commission)	50,000.00
		By Balance c/d	3,000.00
		(3)	5,300.00
	60,000.00		60,000.00
To Balance b.d (5)	5,300.00		

**STOCK ON CONSIGNMENT A/C**

To Consignment A/c	Rs.	By Balance c/d (4)	Rs.
(2)	40,920.00	(3)	40,920.00
To Balance b/d (5)	40,920.00		

**CONSIGNMENT STOCK RESERVE A/C.**

To Balance c/d (4)	Rs.	By Consignment A/c	Rs.
(3)	8,000.00	(2)	8,000.00
	8,000.00	By Balance b/d	8,000.00

**BILLS RECEIVABLE A/C**

To Suresh	Rs.	By Bank A/c	Rs.
	50,000.00	By Discount A/c	49,250.00
	50,000.00		250.00
			50,000.00

**EXERCISES**

1) D. Dehradun consigns to 'J' in Trichinopoly goods at a cost of Rs.40,000 paying an insurance charges Rs.4,000 and draws a bill on 'K' for Rs.40,000 at sixty days. Nineteenth of the consignment was sold by 'J' for Rs.70,000 and expenses of Rs.4,000 were incurred 'J' is entitled to a commission 10% on sales.

'J' sent a Bank Draft to 'D' for the net amount held on 'D' Account.

Show by means of Journal Entries how the above transaction would be recorded in the books of both 'D' and 'J'

2) M/s Dilip & Co., Bombay, sent on consignment to Nank & Co., Jamnagar, 100 cases to tea Costing Rs.50.each.

Freight & Insurance Rs.300 (paid by Dilip & Co.,)

Advertisement & other selling expenses Rs.600 (paid by Nanak & Co..)

Dilip & Co., draw a 3 months bill for Rs.3,000 on Nanak & Co., Nanak & Co.. send Account sales (together with the necessary remittance) showing that 70 cases have been sold for Rs.4,500. They are entitled to commission of 5% on gross proceeds.

The 30 cases remained in stock unsold.

Show the Journal Entries and Ledger Account in the book of Dilip & Co..

3) A Consignment of 1,00,000 Kgs. Of tea, costing Rs.4 per kg. is sent on consignment on August, 1, 1987 to an Agent, on

i) 3% Ordinary Commission on the gross Sale Proceeds.

ii) 1% Del Credere Commission

iii) Commission for local expenses.

**The following expenses are incurred:**

	By the Consignor	By the Consignee
	Rs.	Rs.
Freight & Insurance	2,000	
Dock Charges	800	
Godown Rent		800
Miscellaneous Expenses Including Local expense		1,400

Chests containing 2,000 kg. of tea were damaged in transit and the contents had to be destroyed on landing as having become unfit for sale.

70,000kg. of tea were sold at Rs.6 per kg. and on 31<sup>st</sup> December 1987 the date closing the accounts, the balance of the consignment remained unsold in stock in unopened chests.

Draw up the Consignment Account and Consignee Personal Account in the books of the Consignor showing the amount due from Consignee on December 31, 1987 when the accounts of the Consignment were closed.

4. On 15<sup>th</sup> March 2003, 'X' consigns 200 gramophones to 'Y' costing Rs.15 each. The Pro Forma Invoice is made out to him at a figure to show a gross profit of 20 percent on sales below which figure the consignee 'Y' is not permitted to sell. On 15<sup>th</sup> March, 1988 the consignee sells half the consignment at a profit on 25 percent on sales. The expenses were as follows:

Mar.5 Freight & Insurance Rs.50 (paid by consignor)

Mar.20 Landing Charges including import duties Rs.50 (paid by consignees)

## NOTES

The consignee is entitled to a commission of 5 percent on sales and one-sixth of the profit after charging up both commission and share of profits.

On 31<sup>st</sup> March 2003 'Y' remits a bank draft-the balance on his account having been agreed to settle his account.

Show the Ledger Entries in the book of 'X' the consignor.

Hint: Invoice Rate: Let the Selling Price be Rs.100. Less profit there of Rs.20 the cost price Rs.80. If the cost price is Rs.80 the selling price would be Rs.110. if the cost price is Rs.3,000 (15 x 200) the selling price would be Rs.3,750.

100

3,000 x  $\frac{100}{80}$  there is an excess of Rs.750 which, has to be written off at the end of the 80 period.

For which, reverse the entry for Rs.750.

100

2. Sale Proceeds: 3,000 x  $\frac{100}{75}$  i.e. 25 on Sales, Rs.4000

75

Half of this sold for Rs.200.

3. Stock Half of the goods remain unsold  $\frac{1}{2}$  of (Rs.3,750 + 50 (pro-exp))=Rs.1,926 which has an excess value of Rs.3.75. The amount has to be written off at the end of the year.

Commission: Y is entitled 5% on 2,000 i.e., Rs.100 and

162/3

Rs.350 x  $\frac{162/3}{100+162/3}$  = Rs.50

100+162/3

5. On 15<sup>th</sup> Dec.2003 Telefunken Limited of Bombay consigned 200 Ratio sets to their agent J. Raman of Madras costing Rs.300 each. The Pro-forma invoice was made out to them at a figure to shows a gross profit of 25% on sales. On 27<sup>th</sup>

Dec., the Consignee sold 75% of the consignment at a profit of 10% on the proforma price. Freight & Insurance paid by Telefunken Limited amounted to Rs.600 J. Raman paid the following expenses.

Carriage, godown & Insurance charges Rs.400

Advertisement & other selling expense Rs.500

The Consignee was entitled to commission at 5% +3% del credere on all sales made by him.

On 31<sup>st</sup> Dec. the Consignee remitted the balance is account of the Consignor by a bank draft.

Show Ledger accounts in the books of Telefunken Limited to record the above transactions.

6. Define Consignment, How does it differ from sales?

7. Explain: (a) Pro-Forma Invoice (b) Del Credere Commission (c) Account Sales.

8. Raman consigned to Krishnan goods worth Rs.10,000 in an invoice price of Rs.12,00. Expenses paid by Raman Rs.12,000. Advance sent by Krishnan Rs.7,000. Three fourths of the consignment was sold by Krishnan for Rs.18,000, Krishnan's expenses Rs.3,000 Commission payable to Krishnan 5% on sales.

Prepare necessary account in Raman's and Krishnan's books.

**What is Joint Venture?**

A venture by a partnership or conglomerate designed to share risk or expertise

## 2. JOINT VENTURE

### **Joint Venture:**

A. Joint Venture is a contract between two or more persons who agree to do a small piece of commercial undertaking jointly. It is a temporary partnership, limited to a particular venture in which the two or more persons concerned agree to contribute a specific amount of capital and to share profits or losses either in equal proportions, or in any other agreed proportions. In the absence of definite proportions, the parties will share profit or loss equally.

### **NATURE OF JOINT VENTURE:**

A joint venture may be in connection with a joint consignment of goods at underwriting of shares of debentures of a new joint stock company, a speculation in shares, the construction of a building jointly, purchase and sale of a particular plot of land or any other similar temporary or seasonal business enterprises. Once the joint undertaking is complete and over, the joint venture or partnership ends and no liability will then attach to any party.

### **Adventure of a joint Venture:**

Sometimes a party may be in a position to buy goods at a much lower cost and on far better terms than others. A second party may be in a position to sell the same at an exceptionally good price. Or, it may so happen that merchandise is though cheap at one place by one party and sent to another place where it can be sold at a higher price by the second party. A third party may have financial resource but may not be in a position either to buy at lower price or to sell at higher price, combination of all these parties in a common venture may result in successful and remunerative business.

## RECORD OF ENTRIES

### No Separate Set of Books:

If may be arranged that one of the parties will alone manage the joint venture, that is, he alone will look after the buying and the selling on joint account. He may, for this service, be allowed certain commission, by other parties to the joint venture. Under such a circumstance, he will open a "Joint Venture Account with such and such person." In his books. The Joint Venture Account will be debited with the cost of goods purchased and with expenses incurred by him; his cash account will be credited. If he is entitled to commission, joint venture account will be debited and commission account, will be credited. When he sells goods on joint venture account. Joint Venture account will be credited and cash or debtor's account will be debited. Each party may remit his proportion of cost, which will be placed to the credit of the parties account, this amount plus the share of profit will then be repaid to that party. The joint venture account will then be balanced. The balance of this account will represent either profit or loss which will proportionately be credited or debited respectively to the other party is account. The amount due to other parties will then be remitted to them by the party recording the party recording the account of joint venture dealings.

But it may so happen than party of the joint venture might effect transaction independent of others. Under such a method each party would record in his own books the transactions that the has entered into on joint account. That is, in his own book, each will open one "Joint Venture Account with such and such person. "He will debit the joint venture account and credit cash for goods purchased and expenses incurred by him on joint venture. He supplies goods from his own stock, he will debit joint venture account and credit purchase account. When the venture is completed each party will send to the other details of the transactions effected by him and as they appear in the joint venture account in his own books. On receipt of such a statement the other party will make suitable entries as indicated below.

The joint venture account in each party's books will be debited with the cost of the goods purchased and expenses incurred by the other party or parties. The corresponding credit being given to the personal accounts of the other party or parties. Similarly, the other party's account will be debited with sale proceeds received by him, the corresponding credit being given to the joint venture accounts of the other party or parties. Similarly, the other party's account will be debited with sale proceeds received by him, the corresponding credit being given to the joint venture account. The joint venture account will now be closed in each party's books the balance indicated either profit or loss will be credited or debited proportionately to the other party's personal account and to his own profit and loss account (his share) . The balance on the personal account of the other parties will then indicate their relative position with each other.

### **EXAMPLE OF JOINT VENTURE**

#### **Illustration: 1**

#### **Where no Separate Set of Books are Needed**

A of Madurai and B of Bangalore enter into a joint venture to consign 100 bales of cotton piece goods to C of Ceylon to be sold by the latter on the joint risk A and B, sharing in proportion of  $\frac{3}{5}$  and  $\frac{2}{5}$  respectively. A sends 60 bales at Rs.1,300 each paying freight and other charges amounting to Rs.900. B sends 40 bales at Rs.1,250 each and pays for freight and other charges Rs.800. All the bales are sold by the consignee for Rs.1,50,000 out of which he deducts Rs.1,600 for his expenses and his commission at 3 percent. He remits a bank draft for Rs.70,000 to A and for the balance to B in a separate draft.

**Solution:**

**A'S LEDGER**

**Joint Venture Account with B**

Dr.	Rs. P.	Cr.	Rs. P.
To Purchases A/c	78,000.00	By Cash A/c	70,000.00
To Cash A/c (Exps.)	900.00	9received from C)	
To B's A/c – (Goods)	50,000.00	By B/s A/c (received from	
To B's A/c (Expenses)	800.00	C)	73,900.00
To B's A/c – (2/3) 5,680.00			
To P&L A/c-(3/4) 8,520.00	14,200.00		
	1,43,900.00		1,43,900.00

**A's ACCOUNT**

Dr.	Rs. P.	Cr.	Rs. P.
To Joint Venture A/c (Cash recd. from C)	73,900.00	By Joint Venture A/c Goods	50,000.00
		By Joint Venture A/c Expense.	800.00
		By Joint Venture A/c Profit	5,680.00
		By Balance c/d	13,900.00
	73,000.00		73,900.00
To Balance b/d	17,420.00		

	Rs.	Rs.
Total Sales by C		1, 50,000
Less his expenses	1,600	
Less his commission 3% of 1, 50,000	4,500	
		6,100
Balance		1,43,900
Less Amount sent to A		70,000
Amount received by B		73,900

**B'S LEDGER****Joint Venture Account with A**

Dr.

Cr.

	Rs. P.		Rs. P.
To A's A/c (Goods)	78,000.00	By A's A/c (received from C)	70,000.00
To A's A/c (Expenses)	900.00		
To Purchases	50,000.00		
To Cash (Exp) Rs.	800.00		
To A's A/c (3/5) 8,520		By Cash A/c (from C)	73,900.00
To P&L A/c(2/5) 5,680			
	14,200.00		
	<u>1,43,900.00</u>		<u>1,43,900.00</u>

**A'S LEDGER**

Dr.

Cr.

	Rs. P.		Rs. P.
To Joint Venture A/c (from C)	70,000.00	By Joint Venture A/c Goods	78,000.00
To Balance c/d	17,420.00	By Joint Venture A/c Expense.	900.00
	<u>87,420.00</u>	By Joint Venture A/c Profit	8,520.00
			<u>87,420.00</u>
		By Balance b/d	17,420.00

**Alternative Method:**

On receipt of details for transaction effected by other parties, each party may prepare, in his books, a "Memorandum Joint Venture Account" by combing all the information received from other parties. The Memorandum joint venture account is prepared only to find out the profit or loss made. It is not a part of accounts. As part of joint venture a/c is opened. This account is debited with expenditure incurred by a party on account of the Joint Venture. If the party receives any amount on account of Joint Venture, this account is credited. The share of profit (as ascertained by the memorandum joint venture account) is debited to this account and credited to Profit

Loss A/c. This account will then show the amount due to or by the other party and will be closed by remittance from one to the other party.

The above illustration is now worked out according to this method.

### Memorandum Joint Venture A/c

Dr. Cr.

	Rs. P.		Rs. P.
To A's A/c (Goods)	78,000.00	By A's A/c (received from C)	70,000.00
To A's A/c (Expenses)	900.00		
To B's A/c –(Goods)	50,000.00		
To B's A/c – (Expenses)	800.00	By Cash A/c (from C)	73,900.00
Profit			
A 3/5                   8,520	14,200.00		
To P&L A/c(2/5) 5,680	1,43,900.00		1,43,900.00

### A'S LEDGER

### B in Joint Venture A/c

Dr. Cr.

	Rs. P.		Rs. P.
To Purchases A/c	76,000.00	By Cash A/c	70,000.00
To Cash A/c (Expenses)	900.00	By Balance c/d	17,420.00
To Profit & Loss A/c	8,520.00		
	87,420.00		87,420.00
To Balance b/d	17,420.00		

### A'S LEDGER

### A in Joint Venture A/c

Dr. Cr.

	Rs. P.		Rs. P.
To Purchases A/c	50,000.00	By Cash A/c	73,900.00
To Cash A/c	800.00		
To Profit & Loss A/c	5,680.00		
To Balance c/d	17,420.00		
	73,900.00	By Balance b/d	73,900.00
			17,420.00

**Separate Books for Joint Venture**

A completely separate set of books is opened to record the joint venture transactions when buying and selling on account of joint venture is managed by one of the parties and all the transactions are recorded at the place of business. In this case the record of transactions does not differ in any way from ordinary partnership transactions. The parties to the joint venture usually contribute their share of money to carry out the joint venture dealings. This money is put in a Joint Bank Account. The parties personal accounts are credited and the Joint Bank Account is debited. The Joint Venture Account will be debited with the cost of goods purchased and expenses incurred and the Joint Bank A/c will be credited. Joint Bank Account will be debited with the sale proceeds and the Joint Venture A/c will be credited. Finally, if any stock remains unsold, it may be taken over by one of the parties. The party's A/c will then be debited and the Joint Venture A/c will be credited with the agree value. The Joint Venture A/c will be then be balanced and the profit or loss will be transferred to the parties' personal account. The amount due to each will be paid out from the Joint Bank A/c and thus the books of accounts will be closed.

**Illustration: 2**

**(Joint Bank A/c)**

X and Y undertake jointly to construct a building for a newly started joint stock company for a contract price of Rs.1,00,000 payable as to Rs.80,000 by installments in cash and Rs.20,000 in fully paid shares of the new company, a bank account is opened in the joint name. X contributing 25,000 and Y Rs.15,000 they are to share profit and losses in the proportion of 2/3 and 1/3 respectively.

There transactions were as follows:

Paid Wages	Rs.30,000
Bought materials	Rs.79,000 on credit from Z
Paid architect's fees	Rs. 2,000

The contract was completed and the price duly received Z's dues were duly paid off. The joint venture was closed by X taking up all the shares of company at an

agree valuation of Rs.16, 000 and Y taking up unused stock of materials Rs.3, 000 as mutually valued.

Prepared the necessary accounts to record the above transactions.

### Memorandum Joint Venure A/c

Dr.	Rs. P.	Cr.	Rs. P.
To X's A/c(capital contributed)	25,000.00	By Joint Venure A/c wages	30,000.00
To Y's A/c (capital contributed)	15,000.00	By Joint Venure A./c Archived Fees	2,000.00
To Joint Venure A/c (amount received from Contractee)	80,000.00	By Y's A/c for Materials	79,000.00
	80,000.00	By X's A/c (amount returned) (7)	1,000.00
	80,000.00	By Y's A/c (amount returned) (7)	8,000.00
	1,20,000.00		1,20,000.00

### Z'S LEDGER

Dr.	Rs. P.	Cr.	Rs. P.
To Joint Bank Account	79,000.00	By Joint Venure Account	79,000.00

### JOINT ACCOUNT

Dr.	Rs. P.	Cr.	Rs. P.
To Joint Bank a/c – Wages	30,000.00	By Joint Bank A/c-amount Received from contractee	80,000.00
To Z's A/c Materials	79,000.00	By Shares A/c	20,000.00
To Joint Bank A/c Architect's fee	2,000.00	By Y's A/c-materials taken over	3,000.00
To Shares A/c-Loss (D)	4,000.00	By Loss transferred to	
	8,000.00	X 2/3 8,000 (E)	
	4,000.00	Y 1/3 4,000 (F)	12,000.00
	1,15,000.00	(G)	1,15,000.00

## SHARES ACCOUNT

Dr.		Cr.	
To Joint Bank Account	Rs. P. 20,000.00	By X's A/c	Rs. P. 16,000.00
(A)	20,000.00	By Joint Venture A/c-Loss (C)	4,000.00
		(B)	20,000.00

## X'S ACCOUNT

Dr.		Cr.	
To Joint Venture A/c Loss	Rs. P.	By Joint Bank A/c	Rs. P.
To Shares A/c	8,000.00		25,000.00
To Joint Bank A/c (3)	16,000.00		
(2)	1,000.00		
	25,000.00		25,000.00

## Y's ACCOUNT

Dr.		Cr.	
To Joint Venture A/c Materials	Rs. P.	By Joint Bank A/c	Rs. P.
To Joint Venture A/c Loss	3,000.00		15,000.00
To Joint Bank A/c (7)	4,000.00		
(6)	8,000.00		
	15,000.00		15,000.00

**Solution**

**N.B.** Students are advised to pass Journal Entries in a rough sheet before preparing the ledger accounts. Figures & Alphabets in brackets indicate successive steps.

**Illustration: 3**

Abraham and Balu were partners in a Joint Venture, sharing profit and losses equally. Abraham supplied goods to the value of Rs.250 and incurred expenses amounting to Rs.20. Balu supplied goods to the value of Rs.200 and his expenses amounted to Rs.20. Balu sold the entire goods on behalf of the Venture and realized Rs.600. Mrs. Balu was entitled to commission of 5% on sales Mr. Balu settled his

account by Bank Draft, Give the Journal Entries the Books of Mr. Abraham and Mr. Balu:

**Solution:**

**IN THE BOOK OF ABRAHAM**

Particulars	L.F.	Dr.	Cr.
		Rs.P.	Rs.P.
Joint Venture A/c <span style="float:right">Dr.</span> To Purchases A/c (being the value of the goods sent to Balu)		250.00	250.00
Joint Venture A/c <span style="float:right">Dr.</span> To Cash A/c (being the expenses on joint venture basis)		20.00	20.00
Joint Venture A/c <span style="float:right">Dr.</span> To Balu's A/c (being the expenses incurred by Balu)		200.00	200.00
Joint Venture A/c <span style="float:right">Dr.</span> To Balu's A/c (being the expenses incurred by Balu)		20.00	20.00
Balu's A/c <span style="float:right">Dr.</span> To Joint Venutire A/c (being the goods sold by Balu on Joint Venture basis)		600.00	600.00
Joint Venture A/c <span style="float:right">Dr.</span> To Balu's A/c (being the commission @ 5% on the sale proceeds of goods due to Balu)		30.00	30.00
Joint Venutre A/c <span style="float:right">Dr.</span> To Balu's A/c To Profit & Loss A/c (being the profit on Joint Venture)		80.00	40.00 40.00
Bank A/c <span style="float:right">Dr.</span> To Balu's A/c (being the amount received by bank draft from Balu in full settlement)		310.00	310.00

This entry cannot be passed without rough this entry passed without preparing a

**NOTES**

Preparing a rough Joint Venture A/c account of Balu

250		Balu's A/c		
20	600	600	200	
200			20	
20		600	30	Bank Draft
30	600		40	is for Rs.310
<u>520</u>	<u>600</u>	<u>600</u>	<u>290</u>	

Profit is Rs.80 (Balu's A/c and Abraham A/c will show the same balance on opposite side Rs.310). This will be settled by means of a Bank Draft.

Particulars		L.F.	Dr.	Cr.
			Rs. P.	Rs.P.
Joint Venture A/c	Dr.		250.00	
To Abraham's A/c				250.00
(being the value of goods supplied by Abraham)				
Joint Venture A/c	Dr.		20.00	
To Abraham's A/c				20.00
(being the expenses incurred by Abraham)				
Joint Venture A/c	Dr.		200.00	
To Purchases A/c				200.00
(being the expenses on Joint Venture basis)				
Cash A/c	Dr.		600.00	
To Joint Venture A/c				600.00
(being the goods sold on joint venture basis)				
Joint Venture A/c	Dr.		30.00	
To Commission				30.00
(being the commission 5% on the sale proceeds Receivable)				
Joint Venture A/c	Dr.		80.00	
To Abraham's A/c				40.00
To Profit & Loss A/c				40.00
(being the profit on Joint venture)				
Abraham's A/c	Dr.		310.00	
To Bank A/c				310.00
(being the amount sent by bank draft to Abraham in full settlement)				

**EXERCISE**

1. Ashok and Bikas enter into a Joint Venture. They agree to share profits and losses as Ashok 75% and Bikas 25%. On 1<sup>st</sup> Jan 2003 Ashok sends Rs.50,000 to Bikas. The latter purchased particulars of such purchases are given below:

1,000 Ladies Garments	@ Rs.10 each
2,000 Silk Shirts	@ Rs.15 each
500 Silk Pyjamas	@ Rs.20 each

Ashok sells the two varieties (Ladies Garments and Silk Shirts) at double the price but in respect of Pyjamas he made Profit of Rs.5,000 only. His expenses amounted to Rs.2000.

Show the ledger accounts in the books of Ashok and Bikas.

2. Srinivasan in Calcutta enters in a Joint Venture with Ramasamy at Madras to ship Jute bales of Samuel to Singapore. Srinivasan consigns jute of the value of Rs.50,000 and pays freight and Insurance charges of Rs.2,500 and customs duty etc., freight of Rs.1,800 dock dues Rs.300 customs duty etc., of Rs.1, 200. Ramasamy send goods valued at Rs.40,000 and pays freight of Rs.1,800 dock dues Rs.300 customs duty Rs.900 and other expenses Rs.400. Srinivasan advanced to Ramasamy money amounting to Rs.10,000 on account of the venture. Ramasamy receives account sales and remittances received from Samuel in Singapore amounting to Rs.1,20,000.

Show how these transactions appear in the books of Srinivasan and Ramasamy in their respective ledgers.

2. Arasu, Senthil and Chandru entered into a Joint Venture and agreed to divide the profits as Arasu 60%, Senthil 30% and Chandru 10%.

## NOTES

Arasu. contributed Rs.30,000 Senthil Rs.20,000 and Chandru Rs.10,000 for carrying the transaction relating to joint venture A joint banking account was started.

They purchased by auction several new machineries for Rs.50,000

The ventures were successful in selling all the machineries for Rs.1,25,000 excepting one machine which had to be scrapped and it fetched Rs.750 only.

Arasu spent Rs.2,450 and the others two spent Rs.1,250 each in connection with the venture.

You are required to give the necessary entries to record the above transactions and close the accounts of the ventures.

Account Sales showing the following expenses paid Rs.600 (including Insurance) some goods were due to an outbreak of fire and the Insurance Co. paid to B., Rs.200 in settlement. Some goods were partly damaged and were repaired at a cost of Rs.400 of them remainder, a portion was sold for Rs.8,000 for Cash, another on credit for Rs.2,000; out of the credit sales. 250 proved irrecoverable & enclosed a debit note for his commission at 5% with a cheque for the balance due. On the due date; B's acceptance was honoured. Show the journal entries, the consignment Account and B's Account in A's books.

4. a) What is Memorandum Joint Venture Account?

b) Distinguish between Joint Venture and Consignment?

5. Arun and Varun undertook jointly to construct a building for a contract price of Rs.3,00,000. A Joint Bank Account was opened by them in their joint names. Arun paid into it Rs.1,00,000 and Varun Rs.50,000. Profit and Loss is to be distributed in ratio of 2:1. The details of transaction are given below:

	Rs.
Wages	80,000
Materials purchased	1,80,000

Materials supplied by Arun	10,000
Materials supplied by Varun	8,000
Arun paid the Architect's fee	4,000

After the completion of contract, the price was duly received. There was stock of unused materials which were valued at Rs.10,000 and this was taken over by Varun.

Prepare 'Joint Venture etc A/c', 'Joint Bank a/c', Arun's a/c and Varun's a/c.

6. Shankar and Simpson enter into a Joint Venture sharing profit in the ratio 3:2. Shankar is to purchase timber in Kerala and forward it to Simpson at Madras. Shankar purchased timber worth Rs.16,000 paid for Rs.1,600 as expenses. Simpson received the consignment and immediately accepted. Shankar's draft for Rs.1,2800. Shankar got it discounted for Rs.12,560. Simpson disposed off the timber for Rs.25,600. He had to spend Rs.560 for fire insurance and Rs.480 for rent. He is entitled to 5% commission on sales. Give the necessary ledger account in the books of both the parties.

### 3. ACCOUNT CURRENT

#### Meaning of Account current

Account current is a statement in debit and credit form recording the transactions between two periods in chronological order.

#### Definition:

An account current is a statement, in debit and credit form, of the various transactions that have taken place between two parties during a particular period interest being usually calculated on each item at an agree rate and included in the account. It is nothing but a copy one's account in the other's ledger with the addition of interest, the calculation of interest being shown in an additional column.

The account current is usually rendered;

1. by a Consignee to this consignor;
2. by an Agent to his Principle;
3. by one Partner in a Joint venture to the other;
4. by a Banker to his Client;
5. by a Lender to the Borrower, and
6. by Head Office to its Branches

An account current, when rendered, is styled by the name to the person to whom. It is rendered in addition to the name of the person who renders it. The name of the party rendering the account is mentioned after the name of the party to whom it is rendered e.g., 'A Baby in account current with R.Gopi'. Here Gopy prepared the account current and sends into A Baby

#### Methods of Calculating Interest:

There are three ways of calculating interest. They are as follows:

1. **By Tables:** Interest is calculated by tables from the due date of each transaction to the end of the period of the account on each item separately. The

calculation can be done independently or the amount of interest of the particular amount for the number of days in question can be taken from interest tables. Interest columns on both sides of the account will then be totaled and the balance will be called out to the principal amount.

2. **By Product:** Under this method the amount of each item is multiplied by the number of days from the date, to the end of the period and the products are placed in the product column especially provided on each side of the account. At the end of the period the products on each side to the account are added up and balance. Interest is calculated on the balance of the product for one day and placed in the amount column on that side whose product is greater. The interest is ascertained by the following formula;

	Balance of Products x Rate
Interest	<hr style="width: 80%; margin: 0 auto;"/>
	365 x 10
	Or
	Balance of Products x Double the Rate
	<hr style="width: 80%; margin: 0 auto;"/>
	73,000 (i.e., 365 x 100 x 2)

**NB:** If the accounting year happens to be a leap year, the 366 days must be taken instead of 365 days.

3. **By Interest Number:** This is merely a variation of the product method. Each product is divided by 100, and the quotient called interest number, is entered in the special column. The number columns are then balanced and interest on the balance of the number the above formula is extended into the account.

**Calculation of days:**

In recognizing the number of days for interest, the date to the transaction is usually not taken into account. This means either the day on which the transaction is effected or the day to which the account is made up is not included. For example, a

**Methods of calculation interest**

1. Forward Method
2. Product Method
3. Periodical balance Method

## NOTES

transaction takes place on the 15<sup>th</sup> January and the account current is rendered on the 30<sup>th</sup> June. The number of days for which the interest to chargeable will be counted as follows: 16 days of January (16<sup>th</sup> – 31<sup>st</sup> January) + 28 days of February + 31 days of March + 30 days of April + 31 days of May + 30 days of June = 166 days. Note here 15<sup>th</sup> January the date of the transaction, is omitted but 30<sup>th</sup> June the date of the account current is included. But, for opening balance the opening date is included.

**Note:** If the date, on which payment is due, falls after the closing date. The Interest for this period after the date of closing deducted from its side. Suppose on 15<sup>th</sup> April, Bills Receivable for three months is received. The bill will fall due on 18<sup>th</sup> July. The account closes on 30<sup>th</sup> June. The Interest for 18 days (1<sup>st</sup> July to 18<sup>th</sup> July) will be deducted from the interest on the credit side of the account of the acceptor. The acceptor will deduct the interest from the debit of the payee's account. This interest is technically allied.

### “RED INK INTEREST”

The products are worked out in the usual manner but the figures are recorded with red ink which indicates that the amount of interest is not to be added but deducted.

#### Illustration: 12

The following transactions look place between Babu and Mohan from 1<sup>st</sup> January to 30<sup>th</sup> June 2003.

2003	Rs.
January 1 Sold goods to Mohan	1,120
January 10 received his acceptance at 6 months for	500
February 15 Cash received from Mohan	600
March 2 Bought goods from Mohan	2,750
March 3 accepted Mohan's draft 1 month for	1,000
April 11 cash paid to Mohan	1,000

#### Meaning of Red Ink interest

It means sometimes due date of the transaction fall beyond the settlement date, i.e., the date on which account current is prepared.

April 30 Goods sold to Mohan due end of May	1,200
May 11 Bought goods from Mohan	750
May 31 sold goods to Mohan due 10 <sup>th</sup> June	1,100
June 15 Bought goods from Mohan	1,500

Make out an account current to be rendered by Babu to Mohan on 30<sup>th</sup> June 2003 interest into account at 5% per annum.

**Solution**

**MOHAN IN ACCOUNT CURRENT WITH BABU**

Dr.					Cr.				
Date	Particular	Amount Rs. P.	Days to 30/6	Interest Rs. P.	Date	Particular	Amount Rs. P.	Days	Interest Rs. P.
2003 Jan 1	To Sales A/c	1,120.00	180	27.60	2003 Jan.10	By B/R (Due 13.7)	500.00	-13	-80
Mar. 3	To B/P A/c (Due 6 <sup>th</sup> April)	1,000.00	85	11.64	Feb.15	By Cash a/c	600.00	175	11.00
Apr.11	To Cash A/c	1,000.00	80	10.96	Mar 12	By Purchases	2,750.00	120	45.20
Apr.30	To Sales A/c (Due 13/5)	1,200.00	30	4.94	May 11	By Purchases A/c	750.00	50	5.13
May 31	To Sales A/c (Due 10/6)	1,100.00	30	4.52	Jun 15	Interest A/c (4)	1,500.00	15	3.08
Jun 30	To Balance c/d	685.00	(3)	5.46	Jun 30		5.16		
	(6)	6,105.46	(2)	63.61		(5)	6,105.46	(1)	63.61
					July. 1	By Balance b/d (8)	685.46		

**Working Notes**

1. The transaction on January 10, 2003 (credit side) involves a bill, the payment of which becomes due on 13.7.1983 that is 13 days beyond the end of the period of accounting.

This is a minus item of 13days. The product (-13x500) = -6,500. This is usually written in red ink and the interest on this item is known as Red Ink Interest.

## NOTES

2. The transaction on March 3, 2003 (debit side) involves a bill the receipt of which becomes 30.6.03 and not from due on 6.4.03. As such, the number of days has to be calculated from 6.4.03 to 30.3.03.

3.3.03

1

3.4.03

3

6.4.03

3. The transaction on April 30, 2003 (debit side) involves one month concession for the amount due. As such the number of days calculated from 31.5.03 to 30.6.03 and not from 30.4.2003.

4. The transaction on May 31, 2003 (debit side) involves a concession of 10 days for the amount due. As such, the number of days has to calculate from 10.6.03 to 30.6.03 and not from 31.5.03.

5. Balance of Product (debit side) 39,900 is arrived at as follows:

Product		Product
2,01,600		81,000
85,000		3,30,000
80,000		37,500
36,000		22,500
<u>22,000</u>		<u>4,71,000</u>
4,24,600	Less	6,500
<u>39,900</u>	Difference between 4,64,500 and 4,24,600	
4,64,500		

6. From 1.1.03 to 30.4.03 those are 180 days for calculation of interest in all cases except in the case of the opening balance (wherever there is on) for which the interest period is 181 days this is so because the opening balance is figure coming over from the last date of the previous period namely 31.12.2002.

7. In the Illustration given above it has been assumed that the rate of interest to be charged or credited has been uniform throughout the entire accounting period. In practice, one rate say 5% per annum, may be fixed for the charges to be debited to Mohan's A/c and another rate say 4% per annum may be fixed for the credit allowed to Mohan's A/c. These will involve further arithmetical calculations. If we use these for our illustration the answer would be.

Product		Product
4,24,600		4,64,500
<u>10</u>		<u>8</u>
42,46,000		37,16,000
	Balance of Products	<u>5,30,000</u>
<u>42,46,000</u>		<u>42,46,000</u>
	5,30,000	
Interest	<u>73,000</u>	= Rs.7 Rs. Rounded off
	Balance of Products (5,30,000) x Double the rate (5x2=10)	
(4x2=8)		
Interest =	<u>73,000 (i.e. 365 x 100 x 2 )</u>	
<b>N.B. Multiplication by 2 is done for quick calculation</b>		

## 4. AVERAGE DUE DATE

### Meaning of Average Due Date

Average due date, also called equated date, is the arithmetic average of due dates of so many transactions. It is a date on which if payment is made by one installment in lieu of several payments due on different dates then no party suffers a loss.

The average due date is the mean or equated date on which a single payment be made in place of several payments due for payments on different dates.

The average due date method of payment is generally found suitable in the statement of bills and contract accounts and for the calculation of interest on partner's drawings and on the realization of book debts in partnership liquidation and in other similar instances.

### Working of Process

The ascertainment of the average due date is based upon the same principle as the "Product Method" in account current. The products of the amount payable on different dates and the days are totaled. If this product is divided by total amount due, the number of days to average date would be the result.

1. Take any convenient date, preferably first due date of the transactions, as a starting point.
2. Calculate the number of days from the starting point to the due date number of transactions.
3. Multiply the amount of each transaction by its number of days from the starting point (Fractions of rupee under 50p. are to be ignored 50p. and above may be counted as another rupee).
4. Add up these various products
5. Add up the amounts of various transactions
6. Divide the total of the products by the total amount of the transactions.

7. The result will be the number of days of the average due date from the starting point. (if there is a fraction of less than  $\frac{1}{2}$ , it is to be ignored: fraction of and above should be counted as 1)

**Illustration: 13**

A merchant has purchased goods, the due dates for the payment of which are as follows:

On March 2 Rs.300 due date of payment April 8, 2003

On April 15 Rs.200 due date of payment May 18, 2003

On May 10 Rs.275 due date of payment June 13, 2003

On June 10 Rs. 400 due date of payment July 8, 2003

He wishes to give a bill for the total amount due, the bill to be drawn on the average due date. Ascertain this date.

**Solution**

**Total 8<sup>th</sup> April 2003 as the starting date**

Amount (1)	Due Date (2)	Days from Starting date (3)	Product (1) x (3) (4)
Rs. 300	8/4	0	
Rs. 200	18/5	40	8.000
Rs. 275	13/6	66	18.150
Rs. 400	8/7	91	36.400
<u>Rs. 1.175</u>			Total <u>62.550</u>

**NOTES**

The average due date is  $\frac{62,550}{1175} = 53$  days from the 8<sup>th</sup> April i.e. 22 days of April 31 days of May i.e. the 31<sup>st</sup> May 2003.

If we base our calculation on the last due date as the starting point, the answer will give the number of days that the average due date is previous to the starting point.

If we select an intermediate date as the starting point; we must then take the difference of the two lots of products, i.e., those previous to the starting date and those subsequent to it. If the products above the starting point are greater the average due date will be prior to the starting point, but if the products below the starting point are greater, then the average due date will be subsequent to the starting point. The result in all cases will be the same. For instance if we take the above example and take 8<sup>th</sup> July 2003 as the starting point.

The calculation will be as under:

Amount (1)	Due Date (2)	Days from Starting date (3)	Product (1) x (3) (4)
Rs. 300	8/4	91	27,300
Rs. 200	18/5	51	10,200
Rs. 275	13/6	25	6,875
Rs. 400	8/7	0	0
Rs. 1,175			Total 44,375

Average due date =  $\frac{44,375}{1,175} = 38$  days prior to 8<sup>th</sup> July i.e., 31<sup>st</sup> May.

1,175

7 Days in July, 30 days in June, 1 day in May – the 31<sup>st</sup> May 2003

Taking

## LESSON – 5

### DEPRECIATION

The main objective of a business man is earning profits. For ascertaining this profit, a businessman compares the revenues and the expenses which are more he earns a profit, otherwise, he incurs a loss. The expenses considered for matching purposes are grouped under three heads. They are the cost of various services like wages, salaries, cartage, freight etc. Secondly, the consumption cost of readily consumable assets like goods, stationery etc. Thirdly, the cost of using fixed assets like land building furniture etc. This lesson deals with the method for calculating the expense which results from the utilization of fixed assets.

Certain assets like buildings, plant and machinery are bought and used in the business for longer time. They are not meant for resale. They will add to the profitability and working capacity of the organization. They slowly lose their values once they being to be used in the production process. Such a decrease in the value of an asset is an expense so, it is charged to profit and loss account. This loss in the value of the asset takes place till the asset is completely worn out. This gradual continuing and permanent definition in the value of the assets is known as depreciation.

At the end of the effective life of an asset, the asset ceases to earn revenue (i.e.) the capital value has expired and the assets will have to be replaced. A Provision has to be made for the loss incurred through using the asset for earning profits. This charge against the profit is called depreciation. If an asset was hired instead of purchased the asset, the true profit cannot be ascertained until a suitable charge for the use of the asset has been made.

Depreciation is that part of the cost of the fixed asset consumed during a period by the firm. Therefore, it has been a cost for services consumed in the same way as cost for such items as wages, lighting, heating etc. Depreciation is an expense

#### Meaning of Depreciation

Decrease in value of an asset due to obsolescence or use.

## NOTES

and will need charging to the profit and loss a/c before ascertaining net profit or net loss.

The term depreciation is derived from the Latin words – demeaning down and premium meaning price is business it is used to denote loss of value which arises through wear and tear or some other form of material deterioration of the afflation of time.

Depreciation may be defined as the permanent, continuous and gradual decrease in the quality, quantity or intrinsic value of an asset due to wear and tear, obsolescence, efflux ion of time, exhaustion, fall in market value or by accidents.

The word depreciation has been explained by eminent authors on the subject in different ways. Spicer and Pegier define depreciation ‘as the measure of the exhaustion of the effective life of an asset from any cause during a given period’. In the words of Carter, “Depreciation is the gradual decrease in the value of an asset from any cause”.

According to L.C. Cropper, “Depreciation is the diminution in the financial value of an asset owing to wear and tear, efflux ion of time, obsolescence or similar cause, suggestion being rather that of gradual deterioration than sudden loss or diminution in value.

These explanations for depreciation make us to understand that it is a gradual continuing and permanent diminution in the value of an asset. The net result of an asset’s depreciation is that sooner or later the asset will become useless.

All assets which are more or less constantly in use naturally diminish in value due to their wear and tear in the business. Fixed assets are acquired not for resale. Expenditure on acquiring such assets which will be held over several years will the object of earning revenue is treated as capital that expenditure. Such expenditure includes the price paid and the installing cost. Again it is also to be noted that expenditure in one business, may be stock in trade for another. For example, machines are normally fixed assets but they are stoek in trade for a manufacturer of

machines. Thus certain properties like Land and Buildings, Plant and machinery, Furniture and Fixtures are bought and used in a business a part from the goods which is dealt with in the business. These assets are purchased for the purpose of permanent use in the business and for resale. They lose their values once they begin to be used in the productive process. Such a decrease in value of the asset is just like an expense which is charged to Profit and Loss Account. Such a loss in the value of the asset takes place gradually till the asset is completely worn out. This gradual decline in value is known as 'Depreciation' and is charged to the Profit and Loss Account for the period of use only. Thus if an asset is purchased on 1<sup>st</sup> of July and the books are closed on 31<sup>st</sup> December, only six months depreciation should be written off in the first year.

### **Causes for Depreciation**

The following are the main causes for depreciation

**1. Physical deterioration:** When an asset is reduced in value due to the change in the physical nature. Such reduced value in the asset is called depreciation. This is caused mainly from wear and tear when the asset is in use and from erosion, rust, rot, and decay from being exposed to wind, rain, sun and other elements of nature e.g. A motor lorry depreciates in value by use.

**2. Economic factors:** Sometimes, even though the asset is in good physical condition it is put off use because of the new innovations that are developed. This reduction in value arises due to obsolescence and inadequacy. Old machinery though in good physical condition may be rendered obsolete by the introduction of a new model which produces more than the old machinery. Inadequacy refers to termination of the use of an asset because of the growth and changes in the size of the firm. But obsolescence and inadequacy do not mean that they are scrapped, some other firm may have the same e.g. When diesel engines are introduced the steam engines lost their values to a greater extent.

**3. Time factor:** There are certain assets which a fixed period of equal life such as lease, patents and copy rights. At the end of such periods they become

### **Causes of Depreciation:**

1. Internal causes
2. External causes

## NOTES

### Meaning of Exhaustion

Assets are wasting character and lose their value because of extraction of the materials from it.

valueless or their values are reduced e.g. The license granted to screen the feature films for a certain period; at the end of the period such movies cannot be screened without renewal of such legal right.

4. Exhaustion: Some assets are of wasting character, they lose their value because of extraction of the materials from it. E.g. Mines, quarries, oil wells can be cited. They lose some of the values after the raw materials in them are extracted for further use.

5. Accidents and fall in market value: Some assets may lose their value because of the damages caused through accidents e.g. The value of the LIC building at Mount Road came down in value due to the recent fire accident there. The accident causes diminution in the value and working capacity of such assets, this may also be cited as causes for depreciation.

There are certain other assets which lose their values because of the changes in market prices, e.g., the value of the investment in corporate securities depend upon the market value of such securities, when the market value falls their values will also be reduced.

### Different concepts of Depreciation:

Although commonly the word depreciation refers to the allocation of the cost of a fixed asset over many years, yet different terms have been developed in the accounting usage for different types of assets, when denote the meaning of depreciation.

**Depreciation:** The term depreciation is used to denote the expired utility value of an asset. This word is mainly used with reference to building, machinery or equipment etc.

### What is Depletion?

The act of decreasing something markedly

**Depletion:** This word is used to denote the method of measuring and recording the exhaustion of natural resources such as mineral deposits, oil wells, quarries, forests etc. Depletion differs from depreciation, in that depletion refers to the removal of natural resources i.e. the shrinkage or lessening of an estimated

## NOTES

available quantity. While the word depreciation denotes the reduction in the service capacity of a fixed asset.

**Amortization:** The word amortization is generally used to denote the process of writing down the long term investments in intangible assets such as good will, patents, leaseholds, trademarks, copy rights etc.

**Obsolescence:** This term refers to the reduction in the value of an asset caused by new inventions change of style, legislation, or other causes having no physical relation to the object affected. This is different from wear and tear and exhaustion which refers to the functional loss arising out of a change in the physical condition of an asset.

**Dilapidation:** Some times when the leased property is returned to the landlord he may demand that the asset be in as good condition as when it was leased out. For this, purpose the lessee allocates a section of his profit to provide for any dilapidation that may be needed to put right the property. For accounting purposes the expected amount of dilapidation is added to the cost of leased property.

### Reasons for providing depreciation:

**1. At Ascertain the correct profit:** Even though depreciation is not a visible expense, it should be taken into account while calculating the profit. So when all the other costs are deducted to find out the profit, it is justifiable and property to deduct the cost of depreciation also to find out the real profit. Though depreciation is not paid to outside parties, the fall in the book value of the assets reflects the cost of earning revenues from the use of such assets during the currently year. Hence like other costs it should be charged to profit and loss account. It must be provided for even though when the business incurs loss.

**2. To ascertain true value of assets:** Balance Sheet is a statement which shows the true and fair view of the business on a particular day in which the value of different assets is also shown. Assets lose some of their values due to use. It is an accepted fact for depreciation that if their values are overstated and the balance sheet

### Meaning of Amortization:

It means the reduction of the value of an asset by prorating its cost over a period of years.

### Meaning of Obsolescence

Obsolescence is the process of becoming obsolete; falling into disuse or becoming out of date.

## NOTES

### Factors in Measurement of Depreciation

1. Total cost of asset.
2. Estimated useful service life or economic life
3. To estimate turn-in value

will not present a true and fair view of the business. So for reflecting the true financial condition, it is necessary to show the different assets at their depreciated values.

**3. To replace the asset:** If the provision for replacement and depreciation are not made every year, the firm will find it very difficult and even sometimes may be forced to go for outside funds. To get relief from this dangerous difficulty funds, may be provided out of the profits of every year for that replacement of the worn out asset.

**4. Rent concept of depreciation:** If we do not possess the asset we require, we may hire out such assets from outsiders and we pay rent as hire charges. This rent is normally charged to the profit and loss account it does not make so much difference when we own the asset. The only difference is that we own it. So by bringing such expenses to profit and loss account even for our own assets.

From the above discussion, it is clear that depreciation should be provided on the replacement cost of the asset rather than at the historical cost. But there are certain arguments, against this basis of charging depreciation, they are:

1. The essence of providing depreciation is that it is a process of allocation not to valuation. So depreciation is not dependent on the replacement value of the asset.
2. Depreciation is a cost incurred during the current year. Even when the asset is replaced or not at a later date. So the argument that it is provided for replacement does not hold the point moreover depreciation is the recovery spread over the life of an asset of the prepaid cost incurred by its acquisition.
3. As there is no suitable index to measure the replacement value to the asset it is not agreeable to the income-tax authorities.

4. The assets are quite often replaced by new and improved type of an asset due to inventions and discoveries. So the depreciation funds provided will not be sufficient to replace the existing assets.

To overcome the above difficulties the Association of certified Accountants have suggested to divided the depreciation into two parts. One is to provide for the basic cost of asset and other supplementary charges to provide for the difference between the basic cost and replacement value.

According to section 205 of the companies (amendment) Act of 1967.

1. Dividends cannot be declared without providing for the depreciation and also a company is not permitted to declare dividends when it has arrears of depreciation in its account books.
2. The Central Government on the public interest can permit a company to declare dividends even when it has not written off the depreciation fully.
3. Students must note that the law does not make it compulsory for company to provide for depreciation on fixed assets. All that it requires is that dividends must not be declared without providing for depreciation. So when the company is not declaring dividend need not provide for depreciation also. But provision of depreciation on circulating asset is essential.

### **Estimation of Depreciation:**

When the accountant speaks of depreciation, he often refers not to the actual diminution in value, but rather to the arbitrary amount charged as an expense in the accounts to cover the depreciation that he expects to be raised, and the adequacy of this amount will depend upon the skill with which the actual depreciation is estimated.

There are two steps involved in such estimation-first is the calculation of amount of total depreciation. The second step deals with the spreading of the

## NOTES

calculated depreciation over the useful economic life of the assets. In the first step the following factors are considered.

**a) Total cost of the asset:**

The cost of the fixed asset includes the invoice cost, less any cash discount, plus all costs essential to bring the asset to a usable condition. This includes such item as freight....shipping charges, transport insurance, and installations cost. Interest and finance charges on the money borrowed for purchasing a fixed asset should not be included.

**b) The estimated scrap value or residual value:**

The salvage value or the scrap value is the saleable value of a particular asset after the end of its economic life. This value should be calculated after deducing the disposal costs and the removal cost of such assets.

**c) Probable service life or working life:**

This life period can be calculated either in terms of time or output (Units or other operating measures, such as mileage for a truck)

**d) Possible annual charges for repairs:**

Total depreciation for assets is calculated by using the following formula.  
 $\text{Original Cost} - \text{Scrap value} = \text{depreciable value of an asset.}$

The subsequent part of this lesson deals with the manner and method of allocating the amount thus arrived at.

### **METHODS OF RECORDING DEPRECIATION:**

There are two methods of recording the depreciation in the Book of accounts.

First method: (when the provision for depreciation account is not maintained)

1) Debit Depreciation account

Credit Asset account

(Entry for providing depreciation)

2) Debit profit and loss account.

Credit Depreciation account

(Entry closing depreciation account)

Second method: (When the provision for depreciation account is maintained)

1) Debit Depreciation account

Credit Provision for depreciation account

(Entry for providing depreciation)

2) Debit Profit and Loss account

Credit Depreciation account

(Entry for closing the depreciation account)

As the depreciation is credited to the provision account directly the asset account will appear on the cost price. This cost price of the asset will change in the books only when the asset is discharged or sold or when fresh purchases are made.

#### **METHODS OF PROVIDING FOR DEPRECIATION:**

There are different methods for providing depreciation, which is to be written off during economic life of an asset. These methods are mainly accounting customs which may be used by taking into consideration their individual peculiarities. The depreciation arrived under these methods would be different because the factors used to determine the depreciations varies from one method to another method. The method adopted for calculating depreciation should be such as would distribute the charge fairly over its working life.

## NOTES

### Meaning of Fixed Installment Method

Under this method, the same amount of depreciation is charged every year throughout the life of the asset.

### 1. Fixed Installment Method: (Straight Line Method or Original Cost System or

Fixed percentage on Original Cost method)

Under this method a fixed percentage of the original values of the asset is written off every year as depreciations so as to reduce the original value of the assets to nil or to the scrap value of the asset at the end of the economic life of the asset.

The annual charge is computed by the formula

$$\text{Depreciation} = \frac{\text{Original value of the asset} - \text{Scrap value}}{\text{Number of years of life}}$$

Here the term original cost includes all the cost incurred to install and erect such an asset and other costs incurred to bring it as a working asset. Scrap value is arrived at after deducting the disposing cost or the selling costs involved in disposing the worn out assets.

Suppose an asset is purchased for Rs.5,600 and its residual value at the end of the life period is Rs.600. The working life of the asset is 10 years. Depreciation on the above asset is calculated as follows:

$$\text{Depreciation} = \frac{5,600 - 600}{10} = \text{Rs.500}$$

For every year Rs.500 would be charged to the profit and loss account debit side.

This method is simple and easy to understand. If the charge of depreciation is plotted on a graph annually, and the points joined together then the graph will give a straight line that is why this method, is called a straight line method. It is not

misleading because the asset is shown in the Balance Sheet as its true value after deducting the depreciation.

This method does not take into consideration the seasonal fluctuations, booms and depressions. If in one year the machine is used for three shifts and in another year for only one shift under this method the depreciation arrived at would be same and similar which is strange and unreasonable.

Though the usefulness of the machine is more during the initial years and less during late years, the depreciation provided is the same in all the years, it also becomes difficult to calculate depreciation on additions made during the years.

The total charge on the asset is not equal from year to year though the depreciation is same in all the years. For example repair and maintenance costs together with depreciation are much less than what it is in the later years. So under this method the burden on the profit and loss account is more during later years.

It is generally accepted as being suitable for such asset whose life is definite like patents. Loose holds. Trademarks etc. This method is also appropriate for assets having small intrinsic value such as Furniture, Fixtures and Short Lease etc. In spite of the above drawbacks this method is followed in most of the western countries. But in India Income-tax authorities do not recognize this method so in our land it has only little following: Unlike other methods, this method reduces the value of the assets as Zero at the end of the economic life of the asset.

**Illustration 1:** A company purchased an asset for Rs.30,000 in 1<sup>st</sup> Jan. 2001. For installing that the company spent Rs.3,000. The useful life of the asset is 3 years. At the end of the third year the residual value of the asset is Rs.3,500. The disposal cost comes to Rs.500. Calculate the depreciation for three years under Straight Line Method. Show also the Journal and Ledger entries for the three years.

NOTES

JOURNAL

Date	particulars		Dr.		Cr.	
			Rs.	P.	Rs.	P.
31.12.01	Depreciation A/c To Assets A/c (being the depreciation provided for)	Dr.	10,000.00			10,000.00
31.12.02	Depreciation A/c To Assets A/c (being the depreciation provided for)	Dr.	10,000.00			10,000.00
31.12.03	Depreciation A/c To Assets A/c (being the depreciation provided for)	Dr.	10,000.00			10,000.00

DEPRECIATION ACCOUNT

Rs.P.			Rs.P.		
31.12.01	To Assets A/c	10,000.00	31.12.01	By Profit and Loss A/c	10,000.00
31.12.02	To Assets A/c	10,000.00	31.12.92	By Profit and Loss A/c	10,000.00
31.12.03	To Assets A/c	10,000.00	31.12.93	By Profit and Loss A/c	10,000.00

ASSETS ACCOUNT

Rs. P			Rs. P.		
1.1.02	To Cash A/c	30,000.00	31.01.01	By Depreciation A/c	10,000.00
	To Cash A/c (erecting expenses)	3,000.00		By Balance c/d	23,000.00
		33,000.00			33,000.00
	To Balance b/d	23,000.00		By Depreciation A/c	10,000.00
		23,000.00		By Balance c/d	13,000.00
	To Balance b/d	13,000.00			23,000.00
		13,000.00		By Depreciation A/c	10,000.00
				By Cash A/c	3,000.00
					13,000.00

**Working Notes:**

$$\text{Depreciation} = \frac{33,000 - 3,000}{3} = \text{Rs.10,000 every year}$$

**2. Diminishing Balance Method:** (Reducing Installment Method or Declining Balance Method or Written Down value Method or Fixed percentage on Diminishing Balance Method)

Under this method a constant percentage is applied on the book value of an asset. Although the percentage remains the same the amount of depreciation drops year after year because the percentage is based on the diminishing balance. In the second year depreciation will be calculated on the diminished value i.e., the value arrived at after deducting the depreciation of the first year from the original cost. This procedure is continued throughout the life of the asset. For example, if an asset is purchased for Rs.10, 000 to be depreciated 10% p.a. on Rs.10, 000 i.e. Rs.1, 000 in the second year 10% on Rs.9,000 (written down value arrived at after deducting the depreciation from the original value) i.e. Rs.900 in the third year 10% on Rs.8,100 (i.e. Rs.9,000 – Rs.900) Rs.810 and so on. The rate of depreciation is calculated under this method by the following formula.

$$r = 1 - \sqrt[n]{\frac{S}{C}}$$

r = rate of depreciation

n = number of years of useful life

s = scrap value

c = original cost

**Meaning of Diminishing Balance Method**

Under this method a constant percentage is applied on the book value of an asset.

## NOTES

Under this method the rate arrived at will be such which will leave the final balance to be equal to the scrap value of the asset. For example, a machine costs Rs.10,000 and has an expected life 4 years. It has an estimated residual value of Rs.625. The requisite percentage can be found out as follows:

$$r = \sqrt[1-4]{\frac{625}{1000}} = 5 \text{ or } 50\%$$

Under this method the amount of depreciation becomes less year after year and will be rather heavy in the beginning.

The main advantage of this method is in the fact that the decreasing depreciation charge in the later year of an asset's life tend to compensate the increasing maintenance cost of the asset, more or less constant. This method is recognized by the income tax authorities in India. As soon as the asset is put of use its value for sale purposes falls down. This method recognizes the above as much depreciation as possible in the initial years.

One of the drawbacks of this method is that the asset is never reduced to Zero. So this method is not useful for those assets whose residual value is nil. Moreover it is impossible to calculate the depreciation rate when the residual value of the asset is assumed a Zero, Furthermore, this method ignores interest. When the money is invested in an asset the loss ultimately not only the money spent on acquiring the asset but also the interest that could have been earned out of such investment. Therefore a proper method of depreciation should also take into account interest also.

This method is particularly suitable for the assets like plant, machinery, boiler, motor lorry, motor car and buildings.

### Illustration: 2

: On July 1, 1999 a company purchased second-hand machines for Rs.30,000 and spent Rs.10,000 on reconditioning and installing it. The company every year

writes off 10% as depreciation under diminishing balance method. The accounts are closed 31<sup>st</sup> December every year. Show the Machinery Account for the next three years.

**Solution:**

**MACHINERY ACCOUNT**

Dr.

Cr.

	Rs.	P.		Rs.	P.
1.7.89 To Cash A/c	40,000.00		31.12.99 By Depreciation A/c	2,000.00	
			By Balance c/d	38,000.00	
	<u>40,000.00</u>			<u>40,000.00</u>	
1.1.00 To Balance b/d	38,000.00		31.1.00 By Depreciation A/c	3,800.00	
			By Balance c/d	34,780.00	
	<u>38,000.00</u>			<u>38,000.00</u>	
1.1.01 To Balance b/d	34,200.00		31.12.01 By Depreciation A/c	3,420.00	
			By Balance C/d	30,780.00	
	<u>34,200.00</u>			<u>34,200.00</u>	
1.1.02 To Balance b/d	30,780.00		31.12.02 By Depreciation A/c	3,078.00	
			By Balance c/d	27,702.00	
	<u>30,780.00</u>			<u>30,780.00</u>	
To Balance b/d	27,702.00				

## NOTES

### Sale of Assets:

When asset is sold, there may be a profit or loss. This is ascertained by comparing realized sum with that of the book value of the asset. The book value of the asset is the original cost of asset less depreciation provided year after year, from the date of its purchase to the date of its sale. Usually, the profit or loss on sale of the asset will be taken to the Profit and Loss Account. Sometimes instead of crediting the depreciation amount to the asset account, a Depreciation provision account would have been opened and credited. In that case, a Sale of Plant Account is opened and the original cost of the asset (disposed) is transferred and debited to this account. Similarly, the accumulated depreciation provision is also transferred and credited to this account. The cash realized is also credited to the Sale of Plant Account and the resultant figure is transferred to the Profit and Loss Account.

### Illustration: 3

A manufacturer bought machinery worth Rs.1,00,000 including boiler worth Rs.10,000. Depreciation was provided under the reducing balance method for the past three years at the rate of 10%. During the beginning of the fourth year the boiler was damaged and it was sold for Rs.3,000. Show the Machinery Account for 4 years.

### Solution:

<b>MACHINERY</b> A/C At the beginning of	To Cash A/c	Rs. 1,00,000	At the end the 1 <sup>st</sup> year	By Depreciation/c By Balance c/d	Rs. 10,000 90,000
	1 <sup>st</sup> Year				
2 <sup>nd</sup> Year	To Balance b/d	1,00,000	2 <sup>nd</sup> Year	By Depreciation A/c. By Balance c/d	1,00,000 9,000 81,000
3 <sup>rd</sup> Year	To Balance b/d	90,000	3 <sup>rd</sup> Year	By Depreciation A/c By Balance c/d	90,000 8,100 72,900
4 <sup>th</sup> Year	To Balance b/d	81,000	4 <sup>th</sup> Year	By Depreciation A/c By Profit & Loss A/c By Cash A/c By Balance c/d	81,000 6,561 4,290 3,000 50,049
5 <sup>th</sup> year	To Balance b/d	72,900			72,900
	To Balance	59,040			

**Writing Note:**

	Rs.
Values of the boiler sold in First year	10,000
Less: Depreciation	1,000
Value of the boiler in Second Year	<u>9,000</u>
Less: Depreciation	<u>900</u>
Value of the boiler in-Third Year	8,100
Less: Depreciation	<u>810</u>
Value of the boiler when sold	<u>7,290</u>

Less on sale of the boiler = Rs.7,290 – 3,000 = Rs.4,290.

This Rs.4,290 is debited Profit and Loss A/c and credited to Machinery A/c

Depreciation on machinery = Rs.72,900-7,290=Rs.65,610 10% on 65,610=Rs.6,561.

**Illustration: 4**

A company purchased a second hand machinery on 1<sup>st</sup> January 1999 for Rs.37,000 and immediately spent Rs.2,000 on its repairs and Rs.1,000 on its erection. On 1<sup>st</sup> July 2000 it purchased another machinery for Rs.10,000 and on 1<sup>st</sup> July 2001, it sold of the first machine purchases in 1999 for Rs.28,000 and purchases another machine for Rs.25,000. On 1<sup>st</sup> July 2002 the second machinery purchased for Rs.10,000 was sold off for Rs.2,000.

Depreciation was provided on the machinery at the rate of 10 percent on the original cost annually. On 31<sup>st</sup> December 2000 however, the company changed the method of providing depreciation and adopted the written down value method, rate of depreciation being 15 percent.

Give the Machinery Account for 4 years commencing from 1<sup>st</sup> January 1999.

Calculations are to be made to the nearest rupee.

**MACHINERY A/C**

1999		Rs.	1999		Rs.
Jan. 1	To Bank A/c To Cash A/c (Repairs and erection)	37,000 3,000	Dec. 31 Dec. 31	By Deprecation A/c By Balance c/d	4,000 36,000
		<u>40,000</u>			<u>40,000</u>
2000			2000		
Jan. 1	To Balance b/d	36,000	Dec. 31	By Depreciation (1) A/c	6,150
July 1	To Bank A/c	10,000		By Balance c/d	39,650
		<u>46,000</u>			<u>46,000</u>
2001			2001		
Jan. 1	To Balance b/d	39,850	July 1	By Bank A/c	28,000
July 1	To Bank A/c	25,000		By Depreciation A/c(2)	2,295
				By Profit and Loss A/c(3)	305
				By Depreciation A/c (4)	3,263
		<u>64,850</u>		By Balance c/d	30,987
2002			2002		
Jan. 1	To Balance b/d	30,987	July 1		2,000
			July 1	By Bank A/c	590
		30,987	July 1	By Depreciation A/c	5,272
			July 1	By Profit and Loss A/c	3,469
			July 1	By Depreciation A/c	19,656
		<u>30,987</u>		Balance c/d	30,987

**Working Note:**

(1) On Rs.36,000 @ 15 Percent for 1 year	54,000
On Rs.10,000 @ 15 Percent for ½ year	750
	<u>6,150</u>
(2) Depreciation:	
Original cost of the machine on 1.1.99	40,000
Less: Depreciation for 1 Year @ 10 percent	4,000
WDV as on 1.1.00	36,000
Less Depreciation for 1 year @ 15 percent	5,400
WDV as on 1.7.01	30,600
Less Depreciation for ½ year @ 15 percent	2,295
WDV as on 1.7.02,	<u>28,305</u>

## (3) Loss on sale of Machinery

Written Down Value as on 1.1.01	28,305
Less sale price	28,000
Loss on sale transferred to P&L A/c	305

## (4) Depreciation:

On Rs.9,250 (Rs.1,000-750) @ for 1 year	1,388
On Rs.20,000 @ 15% for ½ year	1,875
	3,263

## (5) Depreciation and Loss on sale of Machinery:

Cost of Second Machine on 1.7.00	10,000
Less Depreciation (a) 15@ for ½ year	750
	9,250
Written Down value on 1.1.01	9,250
Less Depreciation @ 15% for year	1,388
Written Down value on 1.1.02	7,862
Less Depreciation on Rs.7,852 @ 15% for ½ year	590
Sale price of the Machinery	2,000
	2,590
Loss on Sale of Machinery	5,272

## (6) Depreciation

On Rs.23,125 (Rs.30,987 – Rs.7,862) @ 15% for year Rs.3,469

**3. Revaluation Method:**

There are certain assets of small items, maintaining accounts for each of them may be too much, and for such assets this method is used. Moreover, this method is also used for assets which do not depreciate uniformly throughout its life period. Under this method the beginning value and the end value of the asset is compared and net difference is taken as depreciation. When the terminal use of an asset is more

**NOTES**

than the opening value the difference is treated as appreciation and credited to capital reserve. For example 1<sup>st</sup> January 2003 if the loose tools were Rs.15,000 and at the end of the year wear valued at Rs.10,00. In this case, the difference i.e., (Rs.15,000 – 10,000) is treated as depreciation.

This method is very much useful for the assets like Loose Tools, Packing Materials, Bottles, Jugs, Patterns, Copy rights, Model, Live stock, Corks, Crates and Trademarks etc. This method is also ideal for special utility assets for use in a specific project and whose utility at the end of the year is problematic

**Illustration: 5**

A firm commences its business in 2000. The value of cranes bought and their estimated values are given below:

	2001	2002	2003
Cranes bought (Rs.)	8,000	4,000	6,000
Estimated value as on 31 <sup>st</sup> Dec	6,500	8,000	7,900

Prepare cranes account from 1981 to 1983.

**Solution:**

**MACHINERY A/C**

		Rs.			Rs.
2000			1999		
Jan 1	To Bank A/c	8,000	Dec. 31	By Depreciation A/c	1,500
			Dec. 31	By Balance c/d	6,500
		8,000			8,000
2001			2001		
Jan 1	To Balance b/d	6,500	Dec. 31	By Depreciation A/c	2,500
Dec 31	To Bank A/c	4,000		By Balance c/d	8,000
		10,500			10,500
2002			2002		
Jan 1	To Balance b/d	8,000	Dec. 31	By Depreciation A/c	7,000
Dec 31	To Bank A/c	6,000		By Balance b/d	7,000
		14,000			14,000
2003					
Jan 1	To Balance b/d	7,000			

**4. Production Unit Method:**

Under this method depreciation is provided for at a fixed rate per cent of production which is calculated by the following formula.

$$\text{Depreciation per Unit} = \frac{\text{Total value of Asset}}{\text{Estimated number of units to be produced}}$$

Thus the rate arrived at will be multiplied by the number of unit produced in a year to arrive at the depreciation for the year.

This method is the first attempt to equate service will depreciation during the period in which asset is used. This means depreciation is not charged during the period in which the asset is not used. In other words depreciation arising out of the lapse of time is not taken into account. This method would be relevant only when the units produced are identical. Moreover this method may be of much use only for assets like machinery and plantation.

**5. Production Hour Method:**

Under this method depreciation is provided at a fixed rate per hour of production calculated by dividing the value of the asset by the estimated number of working hours of its life. Fixed rate per hour will be multiplied by the actual hours worked in a particular period to get the amount of depreciation for the period.

The main difference between the production unit method and production hour method is that the former measures production in terms on unit where as the later measures It in terms of the hours spent. But both methods are production based methods. As the production hour method takes into account the hours spend on production, this method can be used for measuring the depreciation of dissimilar products and un identical product.

**Production Unit Method**

Under this method depreciation is provided for at a fixed rate percent of production.

**Meaning of Production Hour Method**

Under this method depreciation is provided at a fixed rate per hour of production calculated by dividing the value of the asset by the estimated number of working hours of its life.

## NOTES

### Depletion Method

Under this method depreciation is calculated on one unit of the output by dividing the total value of the asset by the total number of units expected to be produced.

### What is global method of depreciation?

Under this method depreciation is provided at a fixed percentage to the aggregated value of various assets of the business.

### 6. Depletion Method:

This method is useful for assets which can be correctly estimated such as mines, quarries, oil wells etc. Under this method depreciation is calculated on one unit of the output by dividing the total value of the asset by the total number of units expected to be produced. The method of calculation of depreciation is similar to production unit method. Suppose a mine is purchased for Rs.2,00,000, containing 1,00,000 tonne of one. In this case, the depreciation cost per tone is  $Rs.2 = \frac{2,00,000}{1,00,000}$

1,00,000

If in the first year the production is 30,000 tonnes means the depreciation will be Rs.60,000 (i.e. Rs.2x30,000). Just like this depreciation is calculated for the remaining years also.

### 7. Renewal method:

Under this method the total cost of the asset is kept in accounts unaltered. The Cost of renewing such assets are charged to Profit and Loss Account as depreciation charges. This method is used for assets having renewable value.

### 8. Global method:

Under this method depreciation is provided at a fixed percentage to the aggregated value of various assets of the business. No distinction is made between different types of assets. Though, it is very easy method, it is not accepted by majority because of its unscientific approach.

### 9. Single Charge Method:

Instead of deciding about the percentage of depreciation, under this method the total desirable depreciation amount to be provided is decided up on earlier. As like the Global method this is not accepted by many because it does not calculate

depreciation after taking into account any of the causes for depreciation. It is purely arbitrary and unscientific.

### 10. Efficiency Hour Method

By taking into account the hours of production and the units produced it tries to measure the efficiency of production. When more products are manufactured in less time the depreciation provided under this method will also be less. The efficiency of man and machines will be more during the initial period. So in that period depreciation would be below compared to depreciation in later years. Under this method weightage is given to the efficiency. So this method may be combined with other production based methods for effective measurements of production.

### 11. Replacement system of depreciation:

This system is frequently used by public utility concern. This system does not record the depreciation until the asset is replaced when the asset is replaced at that time the amount equivalent to the new asset (i.e. cost of the new asset less residual value of the discarded asset) is charged as depreciation in the account books.

#### Illustration: 6

Madras Electric railway system decides to replace 10 of its electric posts valued at Rs.1,500. The replacement cost of the 10 poles is Rs.2,000. The residual value of the 10 electric posts is Rs.300. Show the entries that would be needed to record the above depreciation.

#### Solution:

Calculation of the depreciation charges.

	Rs.
Cost of 10 new poles	2,000
Less: The scrap value	300

## NOTES

Depreciation Charges 1,700

### Journal entry

		Rs.	Rs.
Depreciation A/c	Dr.	1,700	
Cash A/c (Salvage value)	Cr.	300	
	To Cash A/c		2,000

(for record both the purchases of new and discarding of the old posts)

### 12. Group Depreciation Method:

Sometimes depreciation is provided on groups of homogenous assets as a unit. For example, 10 cars owned by the company may be depreciated as one unit through group depreciation method.

1. Depreciation is calculated on the basis of average depreciation rate which is computed after taking into account the value of all the assets in the group, their scrap value and their life period.

2. When additions are made they are debited to one asset account. As there is no account by individual assets the loss or profit made on the sale of an asset cannot be recorded.

3. Depreciation amount is calculated by taking into account average depreciation rate and the total book value of the particular group of assets.

4. Upon the retirement of a unit which is a part of the group a) The sale price of the unit is debited to cash account and credited to group asset account. B) The different between the cost price and the sale price is assumed as accumulated depreciation and is debited to accumulated depreciation account and credited to group asset account.

### 13. Annuity Method:

In the above methods depreciation alone is provided without taking into consideration the interest on the capital sunk (outlay involved) in the acquisition of the asset because of the same amount of capital was employed in some other investment, then it would have earned a certain rate of interest. Here, the annuity Method takes into account the interest lost on the acquisition of an asset.

Under this method the asset a/c is debited with the interest calculated on the book value at the commencement of the year and the interest a/c is credited. At the same time, a fixed amount is debited as depreciation every year, taking into consideration of the cost of the asset, the life of the asset, the interest thereon etc., until the book value of the asset is reduced to zero or its residual value at the end of its usefulness to the business. As the calculations for providing depreciation under certain amount of difficulty, a Depreciation Annuity Table has been specially constructed for this purpose. This indicates the annual sum that can be written down annually, for providing depreciation on the asset along with a certain rate of interest on the capital sunk in the asset.

The following is the Annuity table which indicates the annual sum which can be paid annually if there is Rs.1 in the beginning and if it earns a given rate of interest.

**ANNUITY TABLE**

Year	5%	6%	7%	8%	9%	10%	11%	12%
1	1.0500	1.0600	1.0700	1.0800	1.0900	1.1000	1.11100	1.1200
2	.5376	.5455	.5529	.5606	.5685	.5760	.5839	.5917
3	.3671	.3741	.3811	.3880	.3951	.4021	.4092	.4164
4	.2820	.2886	.2952	.3019	.308	.3155	.3223	.3292
5	.2309	.2374	.2439	.2505	.2571	.2638	.2706	.2774
6	.1970	.2034	.2098	.2163	.2229	.2296	.2364	.2432
7	.1728	.1792	.1855	.192	.1987	.2054	.2122	.2191
8	.1547	.1610	.1675	.1740	.1807	.1874	.1943	.2013
9	.1407	.1470	.1535	.1601	.1668	.1736	.1806	.1877
10	.1295	.1359	.1424	.1490	.1558	.1627	.1698	.1770

## NOTES

As this system, taken into account the interest on the capital involved in the asset, it is considered as the most exact precise and scientific method. It can be advantageously applied in respect of long leases which generally involve considerable capital outlay. It is not suitable for adoption in the case of plant and machinery as there arises frequent calculation on account of additions and dismantling of them.

### What is Annuity?

Income from capital investment paid in a series of regular payments.

### Calculation of Depreciation under Annuity System:

If rupee one is to be written off along with interest therefore at 6% in 5 years annual depreciation required is Rs.0.2374. Thus, if Rs.10,000 are to be written off in 5 years 6% the annual depreciation would be Rs.0.2374 x 10,000 Rs.2,374.00 Thus it can be calculated as under:

For Re.1	Depreciation required is Rs.	0.2374
For Rs.10	Depreciation required is Rs.	2.374
For Rs.100	Depreciation required is Rs.	23.74
For Rs.1000	Depreciation required is Rs.	237.40
For Rs.10,000	Depreciation required is Rs.	2,374.00

Under the annuity system, since the interest lost is also taken into consideration before providing depreciation the amount to be written off as depreciation is larger than the sum that would have been charged under the Straight Line Method or the Reducing Balance Method. But there is no effect on the Profit and Loss Account ultimately as interest amount is debited to the asset account and credited to Profit and Loss Account.

As the interest is calculated on the diminishing balance, year after year, it will go on declining but on the other hand, the depreciation written off annually will remain as a constant figure and this result in increase in the net charge to the P & L a/c annually.

**14. Depreciation fund Method or Sinking Fund Method:**

In the foregoing method, viz., Fixed installment method, Reducing Balance Method and Annuity Method, only the loss in book value of the assets taken into account by providing depreciation as to provision is made for the replacement of the asset. The amount of depreciation may be dispersed of assets making it difficult to find ready cash at the time of replacement of an old one. Under this system to overcome this difficulty, the amount written off as depreciation is kept aside invested in gilt-edged securities. Interest earned on the securities is also invested on similar securities. When the life of the asset expires the securities are sold and with the sale proceeds, a new asset is purchased. The amount that is set aside as depreciation and invested each year is, such that, with compound interest will be sufficient to provide a sum equal to the cost of the asset, less "residual value if any at the time when it becomes useless to the business.

**15. Machine Hour Rate Method:**

This is more or less like the above method. Here, instead of calculating the depreciation basing on the life of machinery, to be more accurate, It is estimated in hours. Therefore, an accurate record is kept to show the number of hours each machine is put to use, and depreciation is calculated accordingly. The cost of machines which indicates the purchase price. Acquisition charges and installation expenses less any residual value is divided by the working hours to get the hourly rate of depreciation. For example, if a machine valuing Rs.50,000 guaranteed for 10,000 hours of work is put to use for 3000 hours, then the depreciation to be written off will be.

$$\begin{array}{r} 50,000 \\ \text{—————} \times 3,000 = \text{Rs.15,000} \\ 10,000 \end{array}$$

**Under this method Depreciation account is debited and the Machinery Account is credited at the end of each period. The depreciation account is closed by transferring it to Profit and Loss account.**

**What is sinking fund?**

A fund accumulated regularly in a separate account and used to redeem debt securities.

## NOTES

### What is Mileage?

The ratio of the number of miles traveled to the number of gallons of gasoline burned

This method is considered to be more scientific and precise than the first two methods discussed already.

### 16. Mileage Method:

This method is employed by transport organizations. Here, the organization which used to operate a large number of vehicles adopts this type of depreciation. Under this method, the depreciation of a particular vehicle is considered not on the basis of its estimated life but on the basis of the probable mileage that can be covered by such a vehicle. For example, a passenger bus costing Rs.1,50,000 is expected to run 3,00,000 miles and after which it is worthless means, then the depreciation will be charged at a rate of 50 paise per mile of its run. This is similar to the Machine House Rate Method.

### Exercise

1. On 1.1.2000 Gopal purchased a machine for Rs.60,000. On 1.7.2000 another machine was bought for Rs.20,000.

On 1.7.2001 the first machine was sold for Rs.50,000. On 1.10.2001 he bought a new machine for Rs.30,000.

On 1.5.2002 a fourth machine was purchased for Rs.24,000. On 1.10.2002 the second machine was sold for Rs.10,000.

Gopal charged annually 10% depreciation on the original list of the machines.

Prepare Machines account in Gopal's Ledger for the four years from 2000 to 2003.

2. A lease is purchased for a term of 5 years by payment of Rs.1,25,000. It is proposed to depreciate the lease by the annuity method changing 10% interest. If annuity of Rs.1 for 5 years at 10% is 0.263797 show the lease account for the full period.

3. A trader purchases a machinery for Rs.5,000 and its useful life is estimated to be for 5 years. He decides to write off the Asset by Annuity method presuming the rate of interest at 5%p.a. The Annuity Tables show that the annual amount necessary to write off Rs.1 in 5 years at 5% p.a. is Re.0.230975. Show the Asset Account for the first 3 years only.

## LESSON – 6

### ACCOUNTS OF NON-TRADING CONCERNS

Certain organizations like Athletic and Sports Clubs, Hospitals, Libraries, Clubs, Charitable and Educational Institutions do not carry any trade and hence do not earn a profit. But these organizations are established to promote the interest of the public by the supply of wants or needs and usually receive their incomes by way of donations from the public, subscriptions from the member and grants from the Governments, Generally, the following books are kept by a non-trading concern.

**What are minutes book?**

Minutes books are a book in which minutes have been written.

1. Register of Members
2. Minutes Book for recording the proceeding of meeting
3. A Cash receipts journal with separate columns for Donation, Entrance Fees, Subscription, Receipts for Special programmes or Funds, Special receipts for Billiard, Tennis, Swimming Pool, etc., Bank and Miscellaneous.
4. A Cash payments journal with separate columns for Salary Wages, Sports, Materials, Equipments, Honorarium, Entertainment, Water Electricity, etc., and Bank
5. A journal mean for recording transactions which cannot find a place in the above.

Thought a full-fledged accounts staff is not maintained because of the expenses involved, still the office bearers maintain accounts in such a way that at the end of the year they may be able to explain what has been the organization's income and how it has been utilized.

The final Accounts of such organizations are prepared at the end of the year which comprise of

1. Receipts and Payments Accounts and
2. Income and Expenditure Account

### **1. RECEIPTS AND PAYMENTS ACCOUNT**

This is compiled at the end of the year from the cash receipts and cash payments journal (also collectively called Cash Book). Thus, the Receipts and Payments under different heads are shown here. For instance, the subscription received every month from the members on different dates appears in the cash journal whereas the total subscription received during the year appears in the Receipts and Payments Account. Therefore the Receipts and payments Account, shows a summary picture of the various receipts and payments the details of which can be had from the cash journals.

#### **Features of the Receipts and Payments Account**

1. It is real account, and thus the Receipts are recorded on the debit side and payments are recorded on the credit side of this account.
2. The Receipt and Payments Account is a summary of the Cash Book.
3. It starts with the balance in the beginning and end with the balance at the end which means balances of cash in hand and at Bank either under Fixed Deposit or in Current Account, in the beginning and at the end respectively.
4. It records all cash receipts and cash payments without any distinction of capital or revenue items. Similarly it records all cash receipts and cash payments irrespective of the fact whether they relate to the previous (say 2002) present (2003) or Future (2004) year.
5. Only actual receipts and payments are recorded. As such on recognition is given by this account for the outstanding amounts of receipts and payments, either in the beginning or at the end of the period.

## NOTES

6. This account does not reveal the final results as to whether the total income is more than expenditure or vice versa but only exhibits the cash position.

### **2. INCOME AND EXPENDITURE ACCOUNT**

As the Receipts and Payments Account reveals only the cash position at the end of the year, this account namely, Income and Expenditure Account is prepared in order to ascertain whether there is excess of income over expenditure vice versa. It is summary of income and expenditures of the complete year. It resembles a Profit and Loss Account of a trading concern. In case of non trading organizations the term "Income and Expenditure Account" is used to describe the revenue account which discloses Excess of Income over Expenditure.

#### **Features of the Income and Expenditure Account**

1. Income and Expenditure Account is a nominal account.
2. As it resembles a Profit and Loss Account of a non-trading organization, expenditures are recorded on the debit side and incomes are recorded on the credit side.
3. Only revenues items are recorded under this account. For example, if there is a payment for the purchases of an asset, then it will be shown under the asset side of the Balance Sheet. On the other hand Rent, Salaries used, Wages, and Subscriptions etc., will appear in the income and expenditure account.
4. As in the case of Profit and Loss Account, in this account also the expenses and income are so adjusted as to
  - (i) Include all figures relating to the current year whether actually paid or not and received or not; and
  - (ii) Exclude all figures relating to previous or future periods.

5. The difference between the two sides represent either a surplus or deficit for the year concerned and this will be transferred to the Capital Fund in the Balance Sheet.

The points of difference between the Receipts and Payments Account and Income and Expenditure Account are as follows:

RECEIPTS AND PAYMENTS A/C	INCOME AND EXPENDITURE A/C
<ol style="list-style-type: none"> <li>1. It is a Real Account</li> <li>2. It is a condensed summary of Cash Book.</li> <li>3. It starts and closes with Cash Balance</li> <li>4. It contains all receipts on the Debit side (Left hand side) and all payments on the Credit side (Right hand side)</li> <li>5. It records receipts and payments of both capital and revenue nature.</li> <li>6. It records receipts and payments relating to the current, preceding and succeeding period.</li> <li>7. It does not take into consideration the outstanding incomes.</li> <li>8. Difference between the two sides represents closing Cash and Bank balance or sometimes overdraft Bank balance.</li> <li>9. It is not accompanied by a Balance Sheet.</li> </ol>	<p>It is a Nominal Account.</p> <p>It is like a Trading and Profit and Loss Account i.e., Revenue A.c, Being the Revenue Account no such balance appears here.</p> <p>It contains income on credit side (Right hand side) and expenses on the Debit side (Left hand side)</p> <p>It records only revenue items It records items of the current period only whether received or not and paid or not.</p> <p>It takes into consideration outstanding items (both expenses and income) of the current year only and ignores items pertaining to the past or the future period.</p> <p>The difference represents either excess of income over expenditure (Profit) or excess of expenditures over income (Loss which is transferred to the Capital Fund)</p> <p>It is accompanied by a Balance Sheet.</p>

**(A) CAPITAL RECEIPTS AND REVENUE RECEIPTS:**

Money received through sales of assets or receipts of permanent nature which are not meant for meeting current expenditures are considered as Capital Receipts. Other receipts (which are not to be capitalized) are treated as revenue receipts.

**(B) CAPITAL PAYMENTS AND REVENUE PAYMENTS:**

Amount spent on purchasing assets or incurred to improve the existing assets thereby the earning capacity of which is increased, then these payments are considered as Capital Payments. With the exception of drawings and investments, all other payments are considered as Revenue Payments.

**(C) RECEIPT AND INCOME:**

A receipt is different from income; Receipt refers to the cash actually received irrespective of the period for which it belongs. So it may pertain to the present, past or future period. Similarly, the cash actually received may be of a capital or revenue nature. Therefore actual cash received for any period is a "Receipt". But "income" refers to the money earned, irrespective of the fact, whether it is received or not. If it is earned in the past, it is referred as income of the past.

**(D) PAYMENT AND EXPENDITURE**

Cash paid actually is considered as a payment irrespective of the period for which it related. Thus it may relate to current, past or future period. Besides it may be to acquire an asset or to pay any expense such as salaries, rent etc. But expenditure denotes all expenses incurred irrespective of the fact, whether paid or not.

**(E) CAPITAL EXPENDITURE AND REVENUE EXPENDITURE**

Any expenditure incurred by way of acquiring or improving the permanent asset in the current financial year, it is considered as capital expenditure. It may result in increasing the capacity, efficiency or economy in the operational expenses.

Revenue expenditure refers to expenditure incurred for meeting current day to day expenses irrespective of the fact whether they are paid or not.

**Capital Fund:**

The accumulated excess of income over expenditure, any capital receipts or other receipts which are capitalized are considered as capital fund of that organization. This is similar to capital account of a Trading concern. The capital fund is referred with different terms like Accumulated Fund, Corpus Fund, and General Fund etc.

**ITEMS PECULIAR TO VARIOUS NON-TRADING CONCERNS**

**Legacy:**

When a sum is given to non-trading concerns as per the will of some person, it is called as Legacy. Since, it is a non-recurring nature it is not treated as income. However, legacy of small amount may be treated as income and shown on the credit side of the income and expenditure account.

**DONATIONS:**

A sum paid by an individual firm or a company by way of gift is considered as donation. Generally, it appears on the receipt side of the receipts and payment account in the year of its receipt. Such donations can be classified under two types viz. General Donation and Specific Donation. General donation of a large sum, particularly when it is of a non-recurring nature, is capitalized and taken to the liability side of a Balance Sheet. On the other hand general donation of a small amount is treated as income, since such income may be expected every year.

Specific donations refer to sums received for some specific purposes such as donation for library, donation for building etc. Such donations are directly taken to the liability side of the Balance Sheet so that it is used for the purpose of receipt only.

**What is capital fund?**

The accumulated excess of income over expenditure, any capital receipts or other receipts which are capitalized are considered as capital fund.

**What is Legacy?**

(Law) a gift of personal property by will.

**ENTRANCE FEES:**

As a receipt from members it appears on the receipt side of the receipt and payments account. Regarding its treatment, some are in favor of capitalizing the item as it is collected only once from a member and it is not of recurring nature. Besides, the payment amounts to a premium payment paid by a new member to the capital cost of the Institution incurred by the old members. But some people are in favor of treating it as an income, as the club, or institution receives it every year because of the changes in memberships for some reason or other. However, candidates are directed to treat legacies, donations and entrance fees as Income unless otherwise stated.

**SALE OF AN OLD ASSET:**

The amount received on sale of an asset will appear on the receipt side of the Receipts and Payments account of the year in which the asset is sold. Any loss or profit arising in the deal alone will be taken to the Income and Expenditure account. The value of remaining asset, if any, will be shown under the asset side of the Balance Sheet. And profit in the deal will appear on the income side of the Income and Expenditure account. For instance, out of the furniture of the book value of Rs.2,000, furniture of Rs.500 are sold for Rs.300 then the loss of Rs.200 will appear on the expenditure side of the Income and Expenditure account and only Rs.1,500/- will appear against furniture under the assets side of the Balance Sheet.

**SALE OF NEWSPAPER**

Any receipt due to the sale of old newspapers will appear on the receipt side of the receipts and payments account. As selling of old newspapers is a regular feature, it is treated as an income and is taken to the income side of the Income and Expenditure Account.

## **SALE OF SPORTS MATERIALS**

Any sale receipt on the disposal of used materials such as old bats, balls, nets etc., will appear on the receipt side of the Receipts and Payments account. Since it is a regular feature in case of clubs, it is treated as income and taken to the credit side of the Income and Expenditure account. The value of remaining sports materials, if any, will be shown under the assets side of the Balance Sheet.

## **EXPENSES INCURRED OUT OF FUND:**

Generally, expenses and incomes are taken to Profit and Loss Account at the end of year, in case of trading concern. Likewise in case of a non trading concern they are taken to Income and Expenditure account. However, if there happens to be a fund for a specific expense, then such expense is not taken to Income and Expenditure account but shown by way of deduction from the respective fund which appears under the liability side of the Balance Sheet. Thus, match expenses are met out of match fund, charity is paid out of charity fund and prizes are paid out of prize fund. In the absence of these funds match expenses, charities paid and prizes given will be taken to the Income and Expenditure Account.

## **PAYMENTS OF HONORARIUM:**

Any sum paid to an artist for giving a performance at the club or at the arrange place, is termed as honorarium. It will be taken to the expenditure side of the Income and Expenditure account.

Hints for preparing Income and Expenditure Account out of the given Receipts and Payments Account.

1. Exclude the opening and closing Cash and Bank balances.
2. Pick up only the items of revenue expenditure and revenue incomes and eliminate all the items of capital receipts and payments from the Receipts and Payments Account.

**What is Honorarium?**

A fee paid for a nominally free service.

## NOTES

3. Exclude income of the previous period or any income received in advance, but at the same time provide for the expenditure due and not paid.
4. Exclude expenditure on fixed asset and bring into account bad debts, if any, as these would affect the net income.
5. Treat Fees, Entrance Fees, Legacies, Donations, Subscriptions, Rent Receipts, Grants, etc., as income unless otherwise stated.
6. Treat Fees, Entrance Fees, Legacies, Donations, Subscriptions, Rent Receipts, Grants, etc., as income unless otherwise stated.
7. Treat Life membership fees as a capital item as they are receipts of non-recurring nature.
8. Where funds such as Match fund, Party Fund, Prize Fund etc., exist for specific purpose, they are shown under the liabilities side of the Balance Sheet and expenses under those heads are shown as deductions there itself.
9. Purchase of material and closing stock of them should be properly adjusted.

Generally, problems are asked in four different forms as under:

1. Receipts and Payments Account with accompanying notes may be given and you are asked to prepare the Income and Expenditure Account and the Balance Sheet.
2. Income and Expenditure Account with accompanying notes may be given and you are asked to prepare Receipts and Payments Account.
3. Sometimes, Receipts and Payments Account and Income and Expenditure Account may be given and you are asked to prepare Balance Sheet both in the beginning and at the end.
4. By providing a wrong statement, criticism and final accounts may be asked.

**Illustration: 1**

A summary of banking transactions of a club for the year 2002 is as follows:

**RECEIPTS AND PAYMENTS ACCOUNT**

**For the Year ending 31<sup>st</sup> December, 2002**

Dr.

Cr.

RECEIPTS	Rs.	PAYMENTS	Rs.
To Balance, 1 <sup>st</sup> Jan, 2002	150	By Rent	2,600
To Entrance Fees	275	By Stationery, Expenses etc.,	1,534
To Subscription 2001	100	By Wages	2,665
To Subscription 2002	8,450	By Billiards Table	1,950
To Subscription 2003	150	By Repairs and Renewals	403
To Locker Rents	250	By Interest	750
To Special Subscription for Governor's Party	1,725	By Balance on 31.12.2002	1,198
	<u>11,100</u>		<u>11,100</u>
To Balance by/d 1.1.03			

Locker Rent Rs.30 related to 2001 and Rs.45 still owing. Rent Rs.650 pertained to 2001 and Rs.650 still due. Stationery Expenses etc. Rs.156 related to 2001 and Rs.182 still owing Subscriptions unpaid 2002 Rs.234. Special Subscriptions for governor's party outstanding Rs.275.

From the above information you are required to make out an Income and Expenditure Account of the Club for the year ending 31<sup>st</sup> December 2002.

**NOTES**

**Solution**

**THE GYMKHANA CLUB**

**INCOME AND EXPENDITURE ACCOUNT FOR THE YEAR ENDING**

**31.12.2002**

Dr.

Cr.

EXPENDITURE	Rs.	Rs.	INCOME		Rs.
To Rent	2,600		By Entrance Fees		275
Less Relation to last year	650		By Subscriptions	8,450	
	1,950		Add Outstanding	234	8,684
Add Outstanding	650		By Locker Rents	250	
To Stationery etc.,	1,534		Less Relating to last year	30	
Less Relating to last year	156		Add Outstanding	220	
	1,378			45	265
Add Outstanding	182	1,560			
To Wages		2,665			
To Repairs etc.,		403			
To Interest		750			
To Excess of Income Over Expenditure		1,246			
		9,224			9,224

Notes:

(Billiards Tables – Assets Side

Balance 31.12.2002 Assets Side

Ignore the Opening Balance on 1.1.02

Subscriptions 2001 not related to the current period

Subscriptions 2003 received in advance – Liabilities Side

Special Subscription for Governor's Party – Liabilities Side)

**Illustrations: 2**

Given below is the Receipts & Payments A/c of the Indian Overseas Bank Gymkhana for the year ended 31<sup>st</sup> December 2002.

**RECEIPTS AND PAYMENTS ACCOUNT**

**For the Year ending 31<sup>st</sup> December, 2002**

Dr.		Cr.	
RECEIPTS	Rs.	PAYMENTS	Rs.
To Donation account	50,000	By Buildings	40,000
Reserve Fund		Expenses incurred	
Being Life members' Fee & Entrance Fee received		On Pentangular Matches	900
4,000 Pentangular Match Fund		... Furniture	2,100
being amount received for meeting expenses of the specific matches		Revenue Payments	
Revenue Receipts:	10,000	Salaries	1,800
Subscription (fees including 200 for 2003)	3,200	Cricket	600
Locker's Rent	100	Tennis	540
Interest on Securities	400	Insurance	
Cricket	400	(paid up to the year ending 30 <sup>th</sup> Sep.03)	360
Tennis	350	Gardening	170
Billiards	200	Printing etc.,	30
Sundries	90	Telephone	300
		Sunderies	100
		Investments (at cost)	18,000
		Balance	3,500
	4,400		
	68,400		68,400

Subscription fees outstanding for the year 2002 Rs.300. Salaries un-paid for December 2002 Rs.170.

Prepare from the details given an Income & Expenditure A/c and Balance Sheet as on 31<sup>st</sup> December 2002.

**NOTES**

**Notes:**

1. Capital Receipts and Capital Payments are shown separately by given titles towards Revenue Receipts and Revenue Payments.

2. If a Special fund for a specific purpose is maintained then expenses relating to that should be deducted from the fund in the Balance Sheet and should not be charged to Income and Expenditure A/c. See Pentangular Match fund and its expenses.

3. Prepare Income & Expenditure A/c and Balance Sheet usual.

**Indian Overseas Bank Gymkhana**  
**INCOME AND EXPENDITURE ACCOUNT**

**For the year ending 31<sup>st</sup> December 2002**

Dr.

Cr.

EXPENDITURE		Rs.	INCOME		Rs.
To Salaries	1,800		By Subscription	3,200	
Add Outstanding	170	1,970	Less Received in Adv.	<u>100</u>	
To Cricket		600		3,100	
To Tennis		540	Add Outstanding	<u>300</u>	3,400
To insurance	360		By Locker's Rent		100
Less Prepaid	<u>270</u>	90	By Interest on Securities		100
To Gardening		170	By Cricket		400
To Printing etc.,		30	By Tennis		350
To Telephone		300	By Billiards		200
To Sundries		100	By Sundries		50
Excess of Income Over Expenditure.		800			
		<u>4,600</u>			<u>4,600</u>

**Indian Overseas Bank Gymkhana**

**BALANCE SHEET**

As on 31<sup>st</sup> December 2002

Dr.

Cr.

LIABILITIES	Rs.	ASSETS	Rs.
Outstanding Creditors for Salaries	170	Cash Balance	3,500
Subscriptions received in advance	100	Investments	18,000
Pentangular Match Fund      10,000		Outstanding Debtors for Subscriptions	300
Less: Expenses incurred on Pentangular matches <u>900</u>	9,100	Prepaid Insurance	270
Capital Fund:		Buildings	40,000
Donations                  50,000		Furniture	2,000
Life member fees <u>4,000</u>			
54,000			
Add Excess of Income over      800	54,800		
	<u>64,170</u>		<u>64,170</u>

**ACCOUNTS OF NON-TRADING CONCERNS – PROFIT MOTIVE**

Certain professional people like Solicitors, Medical Practitioners, Chartered Accountants etc., used to have their own establishments. Such organizations are referred as concerns with profit motive. All these organizations used to prepare the financial statements at the end of the year. There is nothing special about these statements with the exception of one particular aspect, namely outstanding income of earned income. As these people, usually do not sue their clients, they ignore the outstanding of earned income in their accounting which results in accounting the transactions under "Cash basis" only, but it is important to note that all expenses are considered on "accrual basis". Thus outstanding of earned income is ignored and outstanding expenses are duly accounted. Obviously expenses are considered on mercantile principle. However, Income and Expenditure Account is preferred to Profit and Loss Account. It is more appropriate to call it is "Receipt and Expenditure". Account as income is ultimately considered on receipt basis" and all expenses are considered on accrual basis". Sometimes for this purpose they used to

## NOTES

create a reserve to the extent of that sum. Besides, for the sake of convenience Columnar Cash book, Purchase book, Charges book, Bills Book etc., are used in certain organizations.

### Who are solicitors?

Solicitors are a profession who solicits contributions, deposits or votes.

### Solicitors Accounts:

Solicitors usually receive money from their clients for various purposes like payment towards a law suit or other legal matters or an advance money to be paid to vendors etc., In order to keep a separate account of these receipts and payments with that of their own office cash, a separate Bank Account called "Clients Bank Account" will be opened. The cash, received from the clients is deposited in this account and all payments are made on behalf of their clients by cheques drawn on this account. Sometimes, the solicitors make payments on behalf of their clients from their office cash and to adjust this, necessary sum will be transferred from "Clients bank Account" to "Office Bank Account". In case of settlement of accounts with clients also such transfers may take place.

The solicitors usually maintain following books of accounts (a) A Cash Book (b) Petty disbursement Books (c) Bills of Cash book (d) Journal (e) Clients Ledger (f) Clients Disbursement Ledger and (g) General Ledger.

(a) Cash Book: It is assumed that all receipts are banked and payments are effected by means of cheques (except of small and sundry disbursements which may be made from Petty Cash balance). The cash book is provided with two bank columns on either side one for "Office Bank Account" and another for "Clients Bank Account".

Petty Disbursement Book: Resembling a Petty Cash Book. It will have an extra column for "Clients Disbursements".

Petty cash disbursement made on behalf of the clients will be entered under the column headed as "Clients:, "Disbursements". The postings from this column are made individually to the accounts concerned in the "Clients Disbursement Ledger". Similarly, the entries under the column headed as "Sundry Accounts" are posted

individually to the accounts concerned. The postings of other columns will be made with their monthly totals. As and when cheques are issued to the petty cashier for petty disbursement, the amount is earned under the "Amount Received" Column. Simultaneously an account headed as "Petty Disbursement Account" is opened in the General Ledger and it is debited with the amount of the cheque issued for this purpose. Its periodical intervals, while the total of the various nominal account are posted to their respective accounts the total petty cash expended will be credited to "Petty Disbursement".

### **CLIENTS DISBURSEMENT LEDGER**

In this ledger separate accounts are maintained for each matter. If one and the same client has given three or four different matters, then three or separate accounts are maintained in the clients Disbursements Ledger. These accounts are debited with the details finding a place under "Clients Disbursement Column" in the Petty Disbursement Book. These items are the actual out of pocket expenses incurred on behalf of the clients. This ledger provides the details as to what amounts, have been expended on account of each matter, only in case of certification or transfers, credit transfers, credit entries will appear in the ledger accounts.

A Bill in respect of any matter when tendered the debit side of that particular column in this "Clients Disbursements Ledger" is added up and the details of this account are entered in the Bill of cost. The account in the ledger is closed by giving reference to the particular Bill Number in which such expenses are included.

### **BILL OF COST BOOK**

The book will contain the details of bills issued for matter completed and the bill submitted at intermediate stage where it pertains to long matters.

Each bill is given with the consecutive number and entered in the Bills of Cost Book before it is being issued. The out of pockets column is written up with the figures obtained from the Clients' Disbursements Ledger. The amount of each bill finding a place in this book is debited to the concerned clients' account in the Clients

## NOTES

Ledger. The periodical total of the "Fees column" is credited to the Fees Account in the General Ledger. At the time of balance booking, "Fees Account" is transferred to the Profit and Loss account as the chief source of income.

### **CLIENTS LEDGER**

Each client is provided with an account in the ledger. Under the debit side, the money column is divided into three with the headings (1) Out of pockets (2) Fees and Total. The debit side is written up from the Bills of Cash Book. On receipt of cash from the client either by way of an advance or in part full settlement of the bills, the client's account is credited. Where rebate or allowance is made to a client a journal entry is passed by debiting Rebate or Allowance Account and crediting the Client's Account. At the time of balancing the broker's the debit and credit balances on the various account of the ledger, are shown as assets and liabilities respectively in the Balance Sheet.

All other nominal accounts, various assets and liabilities including capital accounts of partners will be found in the General Ledger and dealt with as usual.

Treatment of outstanding balances is client's disbursements ledger and incomplete matters.

- (a) **Client's Disbursement Ledger Balances:** In the client's Disbursement Ledger, at the time of balances, several accounts may show debit balances. They represent the out-of-pockets, expenses spent against those matters for which, bills are yet to be prepared. A total of all such balances is arrived and shown under the asset side of the Balance Sheet as "Out-of-pockets Recoverable" or "Clients' Disbursement Ledger Balances."
- (b) **Incomplete Matter:** Generally fees earned on incomplete matters for which no bills have been tendered, will not be taken into account at the time of the preparation of Final account. However, if there is change in the constitution

which results in an alteration in the profit sharing proportions of the partners. it becomes a necessity to adjust these earned fees on incomplete matters.

**Illustration: 12**

From the following ledger balances, extracted from the book of X, Y & Co., Solicitors on 31<sup>st</sup> March 2003 and prepare the Profit and Loss Account for the year ended 31<sup>st</sup> March 2003 and a Balance Sheet as at that date. The Partners who used to share profits and losses in the ratio of 4:5 have decided to change their profit sharing ratios as from that date.

	Rs.	Rs.
Salaries and Wages	16,200	
Rent and Taxes	3,400	
Postage and Telegrams	1,300	
Stinting and Stationery	2,800	
Library Book	6,500	
Office expenses	1,200	
Furniture and Fittings	4,500	
Client's Ledger balances	35,000	14,000
Client's Disbursement Ledger balances	5,000	
Creditors for Expenses		2,400
Bills of costs delivered		80,000
Petty Cash	600	
(Office) Bank Account Balance	5,500	
(Clients) Bank Account Balance	14,600	
X's Capital and Drawings	6,000	5,000
Y's Capital and Drawings	6,000	8,000
	1,09,400	1,09,400

Fees not made up on 31<sup>st</sup> March 2003 amounts to Rs.16, 925. Provide interest on Partner's Capital at 6% and depreciate Furniture and Fittings and Library Books at 10% and 5% respectively..

**X, Y & CO., SOLICITORS**  
**PROFIT AND LOSS ACCOUNT**  
For the year ended 31<sup>st</sup> March 2003

	Rs.	Rs.		Rs.	Rs.
Dr.					Cr.
To Salaries and Wages		16,200	By Fees:		
To Rent and Taxes		3,400	Bills Delivered	80,000	
To Postage and Telegrams		1,300	Add: Earned Fees	16,925	
To Printing and Stationery		2,800			96,925
To Office and Expenses		1,200			
To Interest on Capitals					
X	300				
Y	480				
		780			
To Depreciation:					
Furniture and Fittings	450				
10%	325				
Library Books 5%		775			
To Net Profit transferred	31,320				
to	39,150				
X		70,470			
Y		96,925			96,925

**BALANCE SHEET OF Dr. ALPHA**

As at 31<sup>st</sup> December 2002

LIABILITIES	Rs.	Rs.	ASSETS	Rs.	Rs.
Outstanding Expense		1,500	Cash in hand		1,000
Capital introduced	60,000		Cash at bank		
Add: Surplus	47,100		Equipment Cost	60,000	
	1,07,100		Add: Additions	10,000	
Less: Drawings	16,000	91,100		70,000	
			Less: Cost of equipment sold	8,000	
				62,000	
			Less: Depreciation	11,400	
				50,600	
			Library Books	5,000	
			Less: Depreciation	500	4,500
			Outstanding Fees	4,000	
			Less: Reserve	4,000	
		92,600			92,600

## EXERCISE

(1) The Madras Students Club has prepared the following Receipts and Payments Account for the year ended December 31<sup>st</sup> 2002.

RECEIPTS	Rs.	Rs.	PAYMENTS	Rs.
To Opening Balance			By Office expenses	1,200
At Bank		2,000	By Magazines & Journal	1,000
In Hand		150	By Help to needy students	1,000
To Subscription received:			By Bicycle purchases	250
2001	200		By Variety programme expenses	1,500
2002	3,000		By Closing balances:	
2003	300		At Bank	
		3,500	In hand	2,200
To Old Journals sold		200		140
To Old furniture sold		900		
To Variety programme tickets sold		1,000		
To Interest on Govt. securities at 4% per		40		
		<u>7,790</u>		<u>7,790</u>

The furniture sold had a book value of Rs.1,100 on 1<sup>st</sup> January 2002, the sale taking place on 1<sup>st</sup> July, 2002. On the same date, the University supplied furniture to the club costing Rs.2,000. The furniture is subject to depreciation at 10% p.a.

Subscriptions outstanding on 31<sup>st</sup> December 2001 were Rs.350 out of which Rs.50 were considered to be bad. On the same date subscriptions received in advance were Rs.200. Subscriptions still payable for 2001 is Rs.300.

The balance at bank is as per pass book. A cheque for Rs.100 issued for purchase of magazine and Journals in December 2001 was not presented before the end of the year.

You are required to prepare the Income and Expenditure Account of the Club for 2002 and its Balance Sheets as at 31<sup>st</sup> December 2002.

**NOTES**

2) Dr. White commenced practice on 1<sup>st</sup> January 2002. He furnishes the following Receipts and Payments Account for 2002.

**RECEIPT AND PAYMENTS ACCOUNT**

	Rs.		Rs.
To Cash Introduced	7,000	By Purchases: Drugs	4,000
To Receipts from Dispensing	15,000	By Furniture	3,000
To Visits	12,000	By Equipment	5,000
To Miscellaneous receipts	300	By Salary to assistant	2,400
		By Rent	1,800
		By Conveyance	900
		By Stationery	200
		By Journals	150
		By Lighting	450
		By Drawings	12,000
		By Balance c/d	4,400
	34,300		34,300

Accounts still receivable towards visits and dispensing are Rs.2,000 and Rs.500 respectively, Salary to assistant is outstanding to the tune of Rs.600. 50% of conveyance is for domestic purpose, Stock of drugs on hand is Rs.700; amount due towards their purchase is Rs.300. Furniture and Equipments are to be depreciated at 15%.

Prepare the Receipts and Expenditure account of Dr. White for 2002 and his Balance Sheet at its end.

## LESSON – 7

### SINGLE ENTRY

#### Is Single Entry A “System”?

Single Entry Book-Keeping is an incomplete method of Book-Keeping. The term “Single Entry” is applied generally to any system which does not provide for the two-fold aspect of transactions. In other words, Single entry is a “System Entry is a “System” which falls short of the Double Entry System. The alternative names are “Incomplete Records” and “Incomplete Double Entry”.

What is single Entry?

A simple bookkeeping system; transactions are entered in only one account.

#### Single Entry means

It means recording transactions not according to well defined principle but according to mere convenience. Here, only such accounts are kept as seem to be absolutely necessary.

As explained at the end of Lesson Single Entry is an unsatisfactory method of book-keeping which furnished only incomplete information about the various aspects of the business.

#### Single Entry Records

Under this method two entries are made for some transactions; for some others, only one entry is made and some transactions are not at all recorded.

For instance,

(i) Raman receives Rs.100 from Rahim. Raman will debit Cash A/c and credit Rahim's A/c when a transaction takes place between a Personal Account and Cash A/c, two aspects are recorded.

## NOTES

(ii) Raman pays Rs.75 by way of salary. Raman will credit Cash and no Salary A/c will be opened by him. When a transaction takes place between a Nominal a/c and Cash a/c only one aspect is recorded.

(iii) Raman's goods are destroyed by fire. No entry will be passed by Raman for this loss. Similarly, Purchases of an asset, say, Machinery on credit, will not be recorded at all, till payment is made. These transactions are not at all recorded.

That is why Pickles has defined Single Entry as 'an admixture of Single Entry, Double Entry and No Entry'. Another author has defined it as "nothing but Double Entry maintained in a haphazard and disjointed. Hence, it is imperfect and incomplete. Therefore, it is illogical to call it a system.

### **Defects of Single Entry**

The following are main defects or shortcomings of this system.

1. It is not a system at all. It is incomplete and unscientific. It ignores the two fold aspect of each transaction.
2. As two aspects of the transaction are not recorded, we cannot prepare a Trial Balance at the end of the accounting period.
3. As real accounts are missing, we cannot prepare a Profit and Loss Account in order to find out the result of the Business.
4. As real accounts are missing, we cannot prepare a Balance Sheet in order to exhibit the financial position the business on a particular date.
5. Errors and frauds are very common under this system and they are very difficult defect.
6. No detailed information is available for comparative purposes. Above all, the taxation authorities will not accept it for assessment purposes.

From the above, one can conclude that Single Entry is defective, incomplete, unscientific and unreliable.

Joint Stock Companies cannot keep books on the Single entry Method under law but sole traders and partnership firms adopt this system. However,, it is a not advisable to do on.

#### How to Ascertain Profit or Loss?

If the accounts are grossly incomplete i.e., they are incapable of being converted into double entry, the accountant can, at best, make only a haphazard estimate of the profit or loss made by the business by comparing the capital at the end of the trading period with that at the beginning. If the capital at the close is higher, the increase is the measure of profit. If the capital at the close is lower,

Suppose A's Capital as on 31<sup>st</sup> December, 2002 is Rs.40,000 while it was Rs.25,000 on January 1, 2002, it is clear that he has made a profit of Rs.15,000. This is correct subject to the adjustment of withdrawals made by 'A' and fresh capital introduced by him during the year 2002. If 'A' introduced fresh capital during the year, say Rs.6,000 increase noticed in the capital during the year to the extent of Rs.6,000 will not reflect profit and the profit will only be Rs.9,000. Similarly, if 'A' had withdrawn during the year to the extent of Rs.1,000 for this domestic use the profit would be more to that extent. The reason is obvious. Had he not withdrawn Rs.1,000 the capital at end would have been more by Rs.1,000. Continuing the above example, the profit would be Rs.10,000. The opposite of this reasoning would apply when there is a loss.

Hence, the rule of ascertaining the trading profit or loss under Single Entry is:

	Rs.
Capital at the end of the trading period	.....
Add withdrawals made during the year	.....
Less Additions to capital during the year	.....
Less Capital in the beginning of the year	.....

The formula to find out profit:

Take Capital at end, add Drawings  
 Deduct Additional Capital introduced and deduct  
 Capital in the beginning

**Example: 1**

The Capital at the beginning of the year is Rs.30,000 and that at the end is Rs.38,000. Calculate the amount of profit earned during the period.

Ans. Capital at end – Capital in the beginning  
 = Rs.38, 000 – Rs.30, 000

Profit = Rs.8, 000

**Example: 2**

The capital at the beginning of the year is Rs.60,000 and that at the end is Rs.57,000. Calculate the amount of profit earned or loss incurred during the period.

Ans: Capital at end - Capital in the beginning  
 = Rs.57,000 - Rs.60,000

Loss = Rs.3,000

(Note: Here the final capital is less than the initial capital therefore; there is a loss to that extent)

**Example: 3**

The capital at the beginning of the year is rs.40,000 and that at the end is 50,000. During the year Rs.3,000 has been withdrawn for personal expenses. Calculate the amount of profit.

Ans: Capital end + Withdrawals -- Capital in the beginning  
 = Rs.50,000 + Rs.3,000 -- Rs.40,000

Profit = Rs.13,000

**Example: 4**

The Capital at the beginning of the year is Rs.20,000 and that at the end is Rs.31,000; withdrawals at the rate of Rs.500 per month and additional capital introduced during the year is Rs.2,000. Calculate the amount of profit earned the period.

Ans. Capital end + Drawings – Capital in the – Additional Capital

= Rs.31, 000 + 6,000 – 20,000

Rs.11, 000 + 6,000 (Rs.500 x 12 months)

= Rs.17, 000

= Rs.17, 000 – 2,000

Profit = Rs.15, 000

**How to Ascertain Capital?**

Where accounts are kept by single entry, a statement is prepared to show the Assets and Liabilities of businessmen. It is known as,

**“Statement of Affairs”**

Assets are arranged on the right side and Liabilities are shown on the left side. The difference between the total of the assets and the total of the liabilities is shown as.

“Capital” (being excess of Assets over Liabilities)

## DIFFERENCES BETWEEN STATEMENT OF AFFAIRS AND BALANCE SHEET

The following are the main points of difference between a Statement of Affairs and Balance Sheet:

Statement of Affairs	BALANCE SHEET
1. It is drawn under the Single Entry System.	1. It is drawn under the Double Entry system.
2. It is drawn from the incomplete and unsystematic records.	2. It is out of the Ledger Balance as disclosed in complete and systematic records.
3. It cannot be relied upon since the preparation of Trial Balance is not possible.	3. It is arithmetically proved since it is drawn after the Trial Balance has proved the arithmetical accuracy.
4. It shows the financial position without any explanation.	4. It shows the financial position with some explanation.

### Illustration: 1

Janakiraman keeps his books by the "Single Entry" method. His position on 31<sup>st</sup> December, 2001 was as follows:

Cash Rs.10; Bank Rs.990; stock of goods Rs.7, 000; Sundry Debtors Rs.15, 000; Furniture Rs.3,000; Sundry Creditors Rs.3,000.

On 31<sup>st</sup> December 2002 his position was as follows:

Cash Rs.2,000; Bank Rs.10,000; Stock of goods Rs.10,000; Sundry Debtors Rs.20,000; Furniture Rs.3,000; Sundry Creditors Rs.6,000.

At 31<sup>st</sup> December 2002 he finds that he has withdrawn Rs.7,000 for his domestic use and has at various times introduced additional capital amounting to Rs.3,000.

At 31<sup>st</sup> December 2002 he finds that he has withdrawn Rs.7,000 for his domestic use and has at various times introduced additional capital amounting to Rs.3,000.

From the above, prepare a statement showing the profit or loss made by him for the year ended 31<sup>st</sup> December, 2002.

**Note:** Prepare a Statement of Affairs as at 31.12.2001. Prepare another Statement of Affairs as at 31.12.2002. Find the difference between the closing Capital and Opening Capital after adding drawings and deducting additional Capital.

**Solution:**

**STATEMENT OF AFFAIRS OF JANAKIRAMAN**

LIABILITIES	Rs.	ASSETS	Rs.
Sundry Creditors	3,000	Cash	10
Capital-being excess		Bank	990
Of assets over liabilities	23,000	Stock of goods	7,000
		Sundry Debtors	15,000
		Furniture	3,000
	<u>26,000</u>		<u>26,000</u>

Balance figure: Total of Assets	26,000
Less Liability	3,000
Capital	<u>23,000</u>
	<u>23,000</u>

**STATEMENT OF AFFAIRS OF JANAKIRAMAN**

**As at 31<sup>st</sup> December 2002**

LIABILITIES	Rs.	ASSETS	Rs.
Sundry Creditors	6,000	Cash	2,000
Capital-being excess of		Bank	1,000
Assets over liabilities	30,000	Stock of goods	10,000
		Sundry Debtors	20,000
		Furniture	3,000
	<u>36,000</u>		<u>36,000</u>

**NOTES**

**Statement showing Janakiraman's Profits for the years:**

	Rs.
Capital at the end 31.12.2002	30,000
Add: Drawing during the year	<u>7,000</u>
	37,000
Less: Addition to capital during the year <u>3,000</u>	
	34,000
Less: Capital at the beginning of the year <u>23,000</u>	
Net Profit made during the year	<u>11,000</u>

**Illustration: 2**

The following balance appears in Nagendiran's books which are kept under Single Entry basis. His position as on 1<sup>st</sup> January 2003 was as under:

	Rs.		Rs.
Creditors	40,000	Cash in hand	300
Bills Payable	300	Bill receivable	5,000
Bank Overdraft	10,000	Sundry Debtors	10,000
Capital	30,000	Stock-in-trade	20,000
		Plant & Machinery	40,000
		Equipments and Loose	5,000
	<u>80,300</u>	Tools	<u>80,300</u>

On 31<sup>st</sup> December 2003 the following was the state of affairs:

Cash in hand Rs.400, Cash at bank 2,000; Creditors Rs.35,000; Bills Payable Rs.3,000. Sundry Debtors Rs.22,000 Bill receivable Rs.2,000; Plant and Machinery is to be depreciated by 10% and Interest @ p.a is to be provided but not on drawings:

Mr. Nagendiran has been regularly taking Rs.600 per month by way of drawings and he was taken goods worth Rs.2,500 for his private use.

Ascertain the profit for the year ended 31<sup>st</sup> December, 2003 and prepare a balance Sheet as on that date.

Note: 1. Capital at the beginning of the year (1.1.2003 Rs.30,000 can be seen in the question itself). There is no necessity to prepare a Statement of Affairs as 1<sup>st</sup> January, 2003.

2. Prepare Statement of Affairs as at 31.12.2003

3. Ascertain the profit or loss made, (if the initial capital is higher than that of final capital, it will result in a loss)

4. Prepare a Balance Sheet

**Solution:**

**STATEMENT OF AFFAIRS OF NAGENDIRAN**

**As at 31<sup>st</sup> December 2003**

LIABILITIES	Rs.	ASSETS	Rs.
Creditors	35,000	Cash in hand	400
Bills payable	3,000	Cash at Bank	2,000
Capital – being excess of Assets over liabilities	33,400	Bills Receivable	2,000
		Sundry Debtors	22,000
		Plant and Machinery	40,000
		Equipments and Tools	5,000
	71,400		71,400

**Statement showing Nagendiran's Profit for 2003**

	Rs.
Capital at the end of 3.12.2003	33,400
Add: Drawings during the year (Rs.600x12)	7,200
Add: Stock of goods taken for private use	40,600
	2,500
	43,100
Less: Capital in the beginning (1.1.2003)	30,000
Apparent Profit	13,100
Less Depreciation @ 10% on Plant	4,000

**NOTES**

		9,100
Less: Interest on capital @5% on original balance of Rs.30,000	1,500	<u>1,500</u>
Net Profit		<u>7,600</u>

**NAGENDIRAN**

**BALANCE SHEET**

**As at 31<sup>st</sup> December 2003**

LIABILITIES	Rs.	ASSETS	Rs.
Creditors		Cash in hand	400
Bills payable	35,000	Cash at Bank	2,000
Capital :		Bill Receivable	2,000
30,000	3,000	Sundry Debtors	22,000
Add Net Profit		Plant and Machinery	40,000
7,600		Depreciation @ 10%	4,000
			36,000
37,600		Equipment and Tools	5,000
Add Interest on Capital 5%			
1,500			<u>67,400</u>
39,100			
Less Drawings	29,400		
7,200			
2,500	67,400		
9,700			

**Conversion into Double Entry**

If the books are maintained on Single Entry basis, they can be converted into double entry basis but with good deal of effort. Assuming that accounts of cash, bank, customers and suppliers have been maintained, the following steps will be necessary.

1. Take the statement of affairs at the end of the previous year, open all accounts, (except those already opened with proper balances).

2. Go through the cash book (or cash and bank accounts) Excepting transactions with customers and supplies (these transactions must have been posted already) others should be posted to proper accounts.

3. Analyze all personal accounts.

(a) Analysis of customers reveals the following:

	Entry now
Credit Sales	Credit Sales A/c
Bills Dishonored	Credit B/R A/c
Charges debited to them	Credit Charges A/c
Cash Received	
Discount allowed to them	Debit Discount A/c
Sales Returns	Debit Sales Return A/c
Bad Debts written off	Debit Bad Debts A/c
Bills Receivable received	Debit Bills Receivable A/c

(b) Analysis of account of suppliers will reveal the following:

	Entry Now
Credit Purchases	Debit Purchases A/c
Bills Payable Dishonored	Debit Bills Payable A/c
Cash Paid	
Purchase Returns	Credit Returns outwards A/c
Discount Received	Credit Discount A/c
Bills Payable Issued	Credit Bills Payable A/c

## NOTES

Where it is desired to convert the system of accounting from Single Entry to Double Entry, the following steps must be taken.

First of all, statement of affairs should be prepared at the commencement of the year. Generally, under Single entry system Cash, Bank and personal accounts are maintained. Therefore Cash and Bank balance in the statement of affairs must agree with the opening balance of cash in Cash Book and the opening balance of bank shown by the Bank A/c in the ledger. Balance of Debtors and Creditors must agree with the total opening balance of Debtors and Creditors in personal ledger. The other assets and liabilities must be brought into the books by means of an opening journal entry. The books are then brought on to the Double Entry principles.

Secondly, if other subsidiary books also have been kept, they should be totaled up, their contents analyzed and posted to revalue accounts. Total of the Sales Book should be credited to Sales A/c; total of the Bought Book should be debited to Purchases to the A/c; total of the Bills Receivable book should be debited to Bills Receivable A/c and that of bills payable to the credit of Bills Payable Accounts; Purchases Returns to the credit of Returns Outwards A/c and Sales Returns to the debit of Return Inwards A/c.

Thirdly, the impersonal items in the Cash Book, if unspotted should be posted to the respective impersonal accounts.

Next the personal accounts should be scrutinized. If there is any item not coming from any of the original records, then double entry must be completed by means of an analysis and journal entries. For Example, the irrecoverable amount would have been credited to Personal A/c but the corresponding debit entry to the Nominal A/c. Bad debts A/c would not have been made. This must be done now. |

Then if the Trader maintains Cash Book only the Personal A/c's of all will have to be analyzed carefully. The analysis may be made in the following form.

Thus, double entry is completed by posting all the unspotted items to the proper impersonal accounts. Now a Trial Balance can be prepared to test the arithmetical accuracy and Final accounts also can be prepared.

**Abridged Conversion:**

The procedure stated above will fully transform the books but will require good deal of effort and time. There is a short-cut way to obtain the final results. This short-cut way involves three Steps, viz.,

- (i) Preparation of a summary Receipts and Payments Account or a summary of the Cash Book. The credit side of this summary of the Cash Book will show the various expenses incurred and assets acquired. From the debit side one can know incomes earned and assets disposed off.
- (ii) Preparation of Total Debtors A/c and Total Creditors A/c to find out Credit Sales and Credit Purchases in the following form.

	Rs.		
To opening Balance	...	By Cash Received	Rs.
To Bills dishonored	...	By Bill received	...
To Sales	...	By Discounts & Allowance	....
(balancing figure)		By Returns inwards	....
		By Bad Debts (if any)	....
		By closing balance c/d	....
			....

**TOTAL CREDITORS A/C**

	Rs.		
To Cash	...	By Opening Balance b/d	Rs.
To Discount	...	By Bills payable dishonored	...
To Bills payable	...		...
To Returns outwards	...		...
To Allowances	...		...
To Closing balance c/d	...	By Purchases(balancing figure)	

**NOTES**

(iii) Preparation of Bill Receivable A/c and Bills payable A/c if necessary, to find out the closing balance in them.

**BILLS RECEIVABLE A/C**

	Rs.		Rs.
To Opening Balance (if any)	...	By Cash (being bills realized from the receipt side of the cash book)	...
To Debtors A/c (Bills receive during the year)	...	By Balance c/d	....
			....
			....
			....
			....
			....
			....

**BILLS PAYABLE A/C**

Rs.		Rs.
To Cash (being bills met of due date from the payment side of the each book)		By opening balance (if any)
To Balance c/d		By Creditors A/c (Bills issued during the year)

These three steps together with the statement of Affairs as at the beginning of the year will provide the necessary details to prepare the final accounts.

**Preparation of Trading and Profit and Loss A/c from Single Entry Records**

If Single Entry books have been converted into Double Entry books a trial balance can then be taken out. From the trial balance final account can be easily

prepared. However a Shortcut method is also possible. The shortcut will be available only if the summary of cash transactions is prepared.

Students will remember that for preparing the Trading Account the following information is necessary:

Opening's Stock
Closing Stock
Wages
Sales

In business firms, Credit Sales and Credit purchases are found by preparing total Debtors' Account and Total Creditors' Account respectively.

Cash Sales will be on the debit side of Cash Book, Credit Sales plus Cash Sales give you total sales. Examination of the credit side of the Cash Book will also reveal Cash Purchases. Wages, Carriage Inwards, etc., which will be debited to the Trading Account.

Thus, all information to prepare Trading Account becomes available and gross profit will be ascertained. This is put on the credit side of the Profit and Loss Account. Credit side of the Cash Book will reveal expenses. These after proper adjustments (for expenses prepaid or outstanding) will be debited to the Profit & Loss A/c. Debit side of the Cash Books will reveal incomes (such as sale of old newspapers). These will be put on the credit side of the profit and loss a/c. The Profit and Loss A/c should also be debited with any depreciation which has to be written off. Thus, net profit or net loss can be ascertained. This will be transferred to the Capital Account.

### **Preparation of Balance Sheet**

Preparation of Balance Sheet is easy. The previous Statement of Affairs will reveal the various assets. The asst adjusted for depreciation, disposal (see debit side of Cash Book) and new acquisition (see credit side of Cash Book) will be put in the

balance Sheet at the end of the year. The balance for Cash, debtors, Stock and Creditors will be given as at the end of the year. These will be put down in the Balance Sheet. Capital will be as per previous Statement of Affairs adjusted for net profit or net loss and drawings (see credit side of Cash Book).

#### The Compilation of Full Final Account from Incomplete Records.

In order to prepare full and detailed final account from incomplete records kept by single entry.

**Preparation of State of Affairs** as at the commencement of the period to find out the initial capital.

Secondly,

**Bringing the Value of Assets** Value of such assets as Plant, Furniture, Stock etc., should be made.

**Analysis Of Cash Book** If the Cash or Bank Balance (either opening or closing) is missing, a cash book should be prepared with the help of analytical summaries.

Fourthly,

**Analysis of Bills Purchases Sales B/R & B/P** the total of the various transactions e.g. Credit purchases, Credit Sales, receivable and Bills Payable should be prepared.

Fifthly

**Analysis of Adjustment** adjustment with regard to outstanding and prepaid as well as provision for and depreciation must be made.

Finally, the Trading and Profit and Loss Account and balance Sheet may be prepared in the usual manner. It will be a matter of normal routine thereafter.

**Illustration: 3****BALANCE SHEET OF AS AT 1<sup>ST</sup> JANUARY 2002**

LIABILITIES	Rs.	ASSETS	Rs.
Creditors		Cash	6,000
Bills payable on open accounts	6,000	Bills receivable	2,250
Capital		Debtors	5,850
	40,500	Stock	9,000
	13,500	Plant & Machinery	6,000
		Land & Buildings	9,000
			<u>38,100</u>
	<u>38,100</u>		

**CASH BOOK**

RECEIPTS	Rs.	PAYMENTS	Rs.
To Opening balance	6,000	By Wages	2,220
To Cash received from debtors	40,500	By Bills payable	10,980
To Bill receivable	13,500	By Creditors	22,050
		By Salaries	1,800
		By Office expenses	1,200
		By Drawings	4,500
		By Balance c/d	17,250
	<u>60,000</u>		<u>60,000</u>

You are required to prepare Profit & Loss A/c for the year ending 31.12.2002 and balance sheet as on that date after taking into consideration the following transactions:

	Rs.
Purchases	45,000
Discount allowed by creditors	150
Sales	57,000

**NOTES**

Discount Allowed	300
Bill receivable received during year	13,500
Bills Payable issued during the year	32,250
Stock on 31.12.2002	10,500

Depreciation Rs.600 on Plant and Machinery, Rs.450 on land and buildings; provide Rs.150 for discount on Debtors.

**Solution**

**Trading and Profit and Loss A/c for the year ending 31.12.2002**

Dr.			Cr.
	Rs.		Rs.
To Opening Stock	9,000	By Sales	
To Purchases	45,000		1,000
To Wages	2,220	By Closing Stock	10,500
To Gross Profit c/d	11,280		
	67,500		67,500

Dr.			Cr.
	Rs.		Rs.
To Salaries	1,800	By Gross Profit b/d	11,280
To Office Expenses	1,200	By Discount	150
To Discount Allowed	300		
To Reserve for Discount	150		
To Depreciation	450		
To Plant	600		
To Building	1,050		
To Net Profit	6,930		
	11,430		11,430

BALANCE SHEET AS AT 31<sup>ST</sup> DECEMBER 2002

Dr.

Cr.

LIABILITIES		Rs.	ASSETS		Rs.
Sundry Creditors:			Cash		17,250
Bills Payable		14,670	Bills Receivable		2,250
Open Accounts		4,950	Sundry Drs	8,550	
Capital A/c			Less: Reserve for		
Op. Balance	30,300		Discounts	150	8,400
Add: Profit	<u>6,930</u>		Stock		10,500
	37,230		Plant & Machinery	6,000	
Less: Drawings	<u>4,500</u>		Less: Depn.	600	
		32,730			5,400
			Land & Buildings	9,000	
			Less: Depn.	450	
					8,550
		<u>52,350</u>			<u>52,350</u>

To find out the closing balances, the following A/cs must be prepared:

## TOTAL DEBTORS A/C

	Rs.		Rs.
To Balance b/d	5,850	By Cash	40,500
To Sales	57,000	By B/R	13,500
		By Discount	300
		By balance c/d	8,550
	<u>62,850</u>		<u>62,850</u>
To Balance b/d	8,550		

**NOTES**

**TOTAL CREDITORS A/C**

To Cash	Rs. 22,050	By Balance b/d	Rs. 5,400
To B/P	23,250	By Purchases	45,000
To Discount	150		
To Balance c/d	4,950		
	<u>50,400</u>		<u>50,400</u>
		By Balance b/d	4,950

**BILLS RECEIVABLE A/C**

To Balance b/d	Rs. 2,250	By Cash	Rs. 13,500
To Debtors A/c	13,500	By Purchases	2,250
	<u>15,750</u>		<u>15,750</u>
To Balance b/d	2,250		

**BILLS PAYABLE A/C**

To Cash	Rs. 10,980	By Balance b/d	Rs. 2,400
To Balance c/d	14,670	By Creditors A/c	23,250
	<u>25,650</u>		<u>25,650</u>
		By Balance b/d	14,670

**Illustration: 4**

Kailasam who keeps his books by single entry had given you the following information for the year 2002.

**SUMMARY OF CASH BOOK (BANK COLUMN)**

RECEIPTS	Rs.	PAYMENTS	Rs.
To Opening Balance	2,175	By Creditors	13,500
To Debtors	19,200	By Bills payable	4,650
To Bills Receivable	6,000	By Salaries	3,250

To Commission	750	By Wages	6,000
To Cash sales	4,300	By Rent & Taxes	2,200
To Balance c/d	1,675	By Insurance	400
		By Carriage	125
		By Advertising	165
		By Drawings	3,760
	<b>34,100</b>		<b>34,100</b>
		By Balance b/d	1,675

**PARTICULARS ON OTHER ASSETS AND LIABILITES**

	1.1.2002	31.12.2002
	Rs.	Rs.
Stock on hand	9,350	11,700
Debtors	6,000	7,000
Creditors	4,500	750
Bills Receivable	2,000	2,500
Bills payable	500	100
Furniture	300	300
Building	6,000	6,000

A provision of Rs.725 is required for doubtful debts and depreciation @5% is to be written of a Building and Furniture. Rs.1, 500 are outstanding for wages and Rs.600 for salaries. Insurance has been prepaid to the extent of Rs.125. Legal expenses are outstanding to the extent of Rs.350.

In two different methods find out the profit or loss made by Kailasam during the year 2002 and prepare a Balance Sheet as at 31.12.2002.

**NOTES**

**Solution**

**FIRST METHOD:**

**STATEMENT OF AFFAIRS OF KAILASAM AS ON 1.1.2002**

Dr.

Cr.

LIABILITIES	Rs.	ASSETS	Rs.
Sundry Creditors	4,500	Cash at Bank	2,175
Bills Payable	500	Stock	9,350
Capital (balancing figure)	20,825	Debtors	6,000
		Bills Receivable	2,000
		Furniture	300
		Building	6,000
	25,825		25,825

**STATEMENT OF AFFAIRS OF KAILASAM ON 31.12.2002**

Dr.

Cr.

LIABILITIES	Rs.	ASSETS	Rs.
Sundry Creditors	750	Stock	11,700
Bills Payable	100	Sundry Debtors	7,000
Bank Overdraft	1,675	Less: Provision for bad	
Outstanding:		Debts	725
Wages	1,500	Bills Receivable	2,500
Salaries	600	Prepaid Insurance	125
Legal expenses	350	Furniture	300
Capital (balance figure)	21,610	Less: Depn.	15
		Building	6,000
		Less: Depn.	300
	26,585		5,700
			26,585

**STATEMENT OF PROFIT 2002**

	Rs.
Capital on 31.12.2002	21,610
Add: Drawings	3,760
	<u>25,370</u>
Less: Capital on 1.1.2002	20,825
	<u>4,545</u>
Profit Rs.	

**Second Method:**

To find out credit purchases and credit sales, prepare Total Creditors' a/c and Total Debtors' A/c. To find out Bills receivable received and Bills payable issued during the year Prepare bills Receivable A/c and Bill payable A/c.

**TOTAL CREDITORS A/C**

	Rs.		Rs.
To Cash	13,500	By Balance b/d	4,500
To B/P	4,250	Credit purchases (balance	
To Balance c/d	750	figure)	14,050
	18,550		18,550
		By Balance b/d	750

**TOTAL DEBTORS A/C**

	Rs.		Rs.
To Balance b/d	6,000	By Cash	19,200
To Credit Sales (balancing		By B/R	6,500
Figures)	26,000	By Balance c/d	7,000
	32,700		32,700
To Balance b/d	7,000		

**BILLS RECEIVABLE A/C**

	Rs.		Rs.
To Balance b/d	2,000	By Cash	6,000
To Debtors A/c		By Balance c/d	2,500
Bills received during the year	6,500		
(balance figure)	8,500		8,500
To Balance b/d	2,500		

NOTES

**BILLS PAYABLE**

	Rs.		Rs.
To Cash	4,650	By Balance b/d	500
To Balance c/d	100	By Creditors A/c-Bills issued during the year (balancing figure)	4,250
	4,750	By Balance b/d	100

**TRADING AND PROFIT AND LOSS A/C**

For the year ended 31<sup>st</sup> Dec., 2002

		Rs.		Rs.
To Op. Stock		9,350	By Sales: Cash	4,300
To Purchases		14,050	Credit	<u>26,700</u>
To Wages	6,000			31,000
Add : Outstanding	<u>1,500</u>	7,500		
To Carriage		125		11,700
To Cross Profit		11,675	By Closing Stock	<u>42,700</u>
		42,700		11,675
To Salaries	3,250		By Gross Profit	750
Add: Unpaid	<u>600</u>	3,850	By Commission	
To Rent & Taxes		2,200		
Legal Expenses		350		
Insurance	400			
Less: Prepaid	<u>125</u>	275		
To Advertising		165		
To Provision for bad debts		725		
To Depreciation				
To Furniture	15			
Building	<u>300</u>	315		
Net Profit		12,425		<u>12,425</u>

**BALANCE SHEET OF KAILASAM AS AT 31<sup>ST</sup> DEC., 2002**

LIABILITIES		Rs.	ASSETS		Rs.
Sundry Creditors		750	Stock		11,700
Bills Payable		100	Sundry Debtors	7,000	
Bank O/D		1,675	Less: Provision for bad Debts	<u>725</u>	6,275
Outstanding expenses:			Bills receivable		2,500
Wages	1,500		Prepaid Insurance		125
Salaries	600		Furniture	300	
Legal expenses	<u>350</u>	2,450	Less: Depn.	<u>15</u>	285
Capital:			Building	6,000	
Opening Balance	29,825		Less: Depn.	<u>300</u>	5,700
Add: Profit	<u>4,545</u>				
	25,370				
Less Drawings	<u>3,760</u>	21,610			
Total		26,585	Total		26,585

**Illustration: 5**

Gopi and Varadan are partners. They share profits and loss in the ratio of 3:2. The accounts are maintained on Single Entry System. On 1<sup>st</sup> January 2002 their position was as follows:

LIABILITIES		Rs.	ASSETS		Rs.
Sundry Creditors		12,500	Cash at Bank		2,500
Loan		5,000	Debtors		20,000
Capital:			Stock		5,000
Gopi	10,000		Plant and Machinery		7,500
Varadan	<u>7,500</u>	17,500			
		35,000			35,000

The position of the firm on 31.12.2002 was as follows: Creditors Rs.15,000; Stock Rs.10,000; Plant and Machinery Rs.10,000; Sundry Debtors Rs.24,000; Loan A/c Rs.2,900; Cash at Bank Rs.7,500

**NOTES**

**Additional Information**

Depreciate plant at 6%; create reserve on Sundry Debtor's at 2 1/2%; provide interest on loan (opening balance) and on capital of partners at 6%.

Drawings: Gopi Rs.750; Varadan Rs.600. Find out the profit or loss made by the firm during the year and write up the partners capital account.

**STATEMENT OF AFFAIRS AS ON 31<sup>ST</sup> DEC.2002**

LIABILITIES	Rs.	ASSETS	Rs.
Sundry Creditors	15,000	Cash at Bank	7,500
Loan	2,500	Debtors	24,000
Interest accrued on Loan	300	Less: Provision @2 1/2%	600
Capital: Excess of Assets Over liabilities	32,500		23,400
		Stock	10,000
		Plant & Machinery	10,000
		Less: Depreciation	600
	50,300		9,400
			50,300

**STATEMENT OF PROFIT**

	Rs.	Rs.
Excess of assets over liabilities i.e., Capitals Of the partners on 31.12.2002		32,500
Add: Drawings during the year		
Gopi	750	
Varadan	600	1,350
Less: Capitals on 1.1.2002		33,850
Gopi	10,600	
Varadan	7,500	17,500
Less: Interest on Capital:		16,350
Gopi	600	
Varadan	450	
3		1,050
Gopi — the share	9,180	
5    3		
Varadan 5 the shares	6,120	
Net Profit	.	15,300

Capital Account		
	Gopi Rs.	Varadan Rs.
Opening balance on 1.1.2002	10,000	7,500
Add: Interest	600	450
Add: Profit	9,180	6,120
	<hr/>	<hr/>
	19,780	14,070
Less: Drawings	750	600
	<hr/>	<hr/>
	19,030	13,470

### Ascertainment of Sales:

Sometimes, it may be difficult to find out total sales from the available records. In this case Cost of goods sold can be ascertained by adding Purchases to opening stock and deducting closing stock. The total sales will be ascertained by adding estimated Gross profit to the cost of goods sold.

### Illustration: 6

Opening Stock Rs.24,000; Closing Stock Rs.45,000; and Purchases Rs.1,50,000. Find out the cost of goods sold.

	Rs.
Opening Stock	25,000
Add: Purchases	1,50,000
	<hr/>
	1,75,000
Less: Closing Stock	45,000
	<hr/>
Cost of goods sold	1,30,000

If the rate of Gross profit is 25% on cost, the total Gross profit is

$$1,30,000 \times \frac{25}{100} \text{ i.e., } 32,500$$

The total sales will be  $1,30,000 + 32,500 = 1,62,500$

## NOTES

Alternatively, if the rate of Gross profit and Sales are given the cost of goods sold can be ascertained.

This will be useful to find out Opening Stock, Closing stock or purchases.

### Illustration: 7

Sales Rs.80,000; Rate of Gross profit is 25% on sales; Purchases Rs.70,000 and Closing stock Rs.15,000. Find out the opening stock.

	Rs.
Sales	80,000
Less: Gross Profit @ 25% on sales	<u>20,000</u>
Cost of goods sold	60,000
Add: Closing stock	<u>15,000</u>
	75,000
Less: Purchases	<u>70,000</u>
Opening Stock	<u>5,000</u>

### Illustration: 8

The books of Kalyani showed the following figures:

	1.1.2002	31.12.2002
	Rs.	Rs.
Creditors	5,000	10,000
Debtors	6,000	6,600
Provision for doubtful debts	300	400
Buildings	30,000	24,000
Furniture	14,000	14,200
Bills payable	2,400	3,400
Commission received in advance	100	200

Rent due but not received	300	1,400
Unpaid Salaries	1,500	1,600
General expenses owing	400	1,500
Stock	?	10,000

The analysis of the Cash Books showed in following:

RECEIPTS	Rs.	PAYMENTS	Rs.
To Op.balance b/f	7,400	By General expenses	1,000
To Sales (Cash)	16,000	By Salaries	2,400
To Rent received	1,400	By Bills Payable	10,000
To Commission Received	1,000	By Furniture	4,000
To Debtors	10,000	By Creditors	12,000
To Sale of old furniture's	100	By Investments	4,000
		By Balance c/d	2,500
	35,900		35,900
To Balance c/d	2,500		

The Stock is valued on the closing date but no stock was taken on 1.1.2002. The rate of Gross Profits it is 25% on sales. Prepare Trading and Profit and Loss A/c and Balance Sheet as a 31.12.2002.

	Rs.		Rs.
To Cash	10,000	By Opening Balance b/d	2,400
To Balance c/d	3,400	By Bills Payable issued during The year to creditors (balance Figure)	11,000
	13,400		13,400

**TOTAL CREDITORS A/C**

	Rs.		Rs.
To Cash	12,000	By Balance b/d	5,000
To B/P	11,000	By Purchases	
To Balance c/d	10,000	(balance figure)	28,000
	33,000		33,000

NOTES

**TOTAL DEBTORS A/C**

	Rs.		Rs.
To Balance c/d	6,000	By Cash	10,600
To Sales (balance figure)	10,600	By Balance c/d	6,000
	16,600		16,600

**STATEMENT OF AFFAIRS AS ON 1<sup>ST</sup> JAN. 2002**

LIABILITIES	Rs.	ASSETS	Rs.
Creditors	5,000	Cash	7,400
Bills payable	2,400	Debtors	6,000
Outstanding expenses		Less: Reserve for Bad	
Salaries	1,500	Debts	300
Expenses	400		5,700
	1,900	Rent due but not received	300
Commission received in advance	100	Stock	1,950
Capital: Excess of assets over liabilities	49,950	Furniture	14,000
	59,350	Buildings	30,000
			59,350

**TRADINGS A/C**

For the year ended 31<sup>st</sup> Dec. 2002

	Rs.		Rs.
To Opening Stock (balance figure)	1,950	By Sales Cash:	16,000
To Purchases	28,000	Credit:	10,600
To Gross Profit 25% on 26,600	6,650	By Closing Stock	10,000
	36,600		36,600

**PROFIT AND LOSS A/C**

**For the year ended 31<sup>st</sup> Dec. 2002**

	Rs.		Rs.
To Salaries	2,400	By Gross Profit	6,650
Add: Unpaid	1,600	By Rent received	1,400
	4,000	Add: Outstanding	1,400
Less: last year	1,500		2,800
	2,500	Less: last year balance	300
To General expenses	1,000		2,500
Add : Unpaid	500	By Commission received	1,000
	1,500	Add: Last Year	100
Less: last year balance	400		1,100
To Reserve for doubtful debts		Less: Advance	200
To Depreciation			900
To Building	6,000	Net Loss transferred to Capital	3,250
To Furniture	3,700	A/c	3,250
	9,700		13,400
	13,400		13,400

**Illustration: 7** (Bank Cr. Sales & Cr. Purchases missing)

The books of Sundararajan showed the following position on 1<sup>st</sup> January, 2003)

	Rs.		Rs.
Capital	4,800	Goodwill	1,854
Profit undrawn	3,483	Furniture	1,401
Creditors	921	Debtors	4,683
		Cash at Bank	1,266
	9,204		9,204

During the Six Months ended 30<sup>th</sup> June, 2003 the accounts of the business had been very imperfectly recorded but an analysis of the Bank Transactions revealed the following.

**NOTES**

	Rs.
Receipts from Customer	21,240
Drawings	8,160
Payments for Salaries	1,830
Payments to Creditors	9,036
Payments for rent	945
Sundry Expenses	384

No Account was taken of the Stock, but a schedule of Debtors totaled to Rs.5,670 and that of the Creditors Rs.1,0605

Prepare a bank Account, Trading and Profit & Loss Account and Balance Sheet as at 30<sup>th</sup> June 2003.

- Note:**
1. Initial Capital is given in the problem.
  2. Closing Bank Balance is missing. With the opening balance of Cash at bank, we must prepare a Bank A/c otherwise; the Balance Sheet at end will not tally.
  3. To find out the Credit Sales and Credit Purchases, we have to prepare Total Debtors A/c and Total Creditor's A/c respectively.
  4. Finally, prepare Trading and Profit and Loss Account and Balance Sheet as usual.

**Solution:**

**BANK ACCOUNT**

Dr.	Rs.	Cr.	Rs.
<b>To (Opening) Balance b/d</b>	1,266	By Drawings	8,160
<b>Receipts from customers</b>	21,240	By Salaries	1,830
		By Creditors	9,036
		By Rent	945
		By Sundry Expenses	384
		By (Closing) Balance b/d	2,151
	22,506		22,506

**TOTAL DEBTORS'**

Dr.	Rs.	Cr.	Rs.
To (Opening) Balance b/d	4,683	By Cash (Receipts from customer)	21,240
To Cr.Sales Balancing figure	22,227	By (Closing) Balance c/d	5,670
	26,910		26,910

**TOTAL CREDITORS'**

Dr.	Rs.	Cr.	Rs.
To Cash (paid to Creditors)	9,036	By (Opening) Balance b/d	921
To (Closing) Balance c/d	1,606	By Cr.Purchases-Balancing figure	9,720
	10,641		10,641

**SUNBARAJAN'S TRADING AND PROFIT & LOSS ACCOUNT****For the half year ending 30<sup>th</sup>, June 2003**

Dr.	Rs.	Cr.	Rs.
To Purchases	9,720	By Sales	22,227
To Gross Profit – Transferred To P &L	12,507		22,227
	22,227	By Gross Profit-Transferred From Trading A/c	12,507
To Salaries	1,830		
To Rent	945		
To Sundry Expenses	384		
To Net Profit-Transferred to Capital A/c	9,348		
	12,507		12,507

**NOTES**

**SUNDARARAJAN'S BALANCE SHEET AS AT 30<sup>th</sup> JUNE, 2003**

Dr.			Cr.	
LIABILITIES		Rs.	ASSETS	
Creditors		1,605	Cash at Bank	2,151
Profits undrawn		3,483	Debtors	5,670
Capital	4,800		Furniture	1,401
Add: Net profit	9,348		Goodwill	1,854
	<u>14,148</u>			
Less: Drawings	8,160	5,988		
		<u>11,076</u>		<u>11,076</u>

**Illustration: 8** (Initial Capital. Cr. Sales & Cr. Purchases missing)

Mr.K.C.Pani keeps his books under Single Entry System. The position of his Business as on 1<sup>st</sup> January, 2002 was as under:

Rs.

Sundry Creditors	17,000
Freehold premise	50,000
Stock	25,000
Sundry Debtors	20,000
Furniture	2,000

The following is the summary of his Cash Bank

Receipt	Rs.	Payments	Rs.
Sundry Debtors	15,000	Bank O/D 1.1.2002	10,000
Cash Sales	80,000	Expenses	50,000
		Drawings	3,000
		Sundry Creditors	20,000
		Cash in hand	2,000
		Cash at hand	10,000
	<u>95,000</u>		<u>95,000</u>

The following further information is available:

Closing Stock            30,000

Closing Debtors        25,000

Closing Creditors      12,000

Depreciate Premises by 20% and Furniture by 15%

Create a bad debts reserve by 2%

Cash include Rs.2,500 for House Rent of Mr.L.C.Pani.

Cash Sales include Rs.2,000 sale of his personal jewellery.

You are required to prepare a Trading and Profit and Loss Account for the year ended 31<sup>st</sup> December, 2002 and a Balance Sheet as on that date.

Show your detail working.

**Hints:** [1. Initial Capital is not given: So, prepare a Statement of Affairs as at 1.1.2002.

2. To find out Credit Sales, prepare Total Debtors A/c

3. To find Credit Purchases, prepare Total Creditors A/c

4. Ascertain the amount of drawings.

5. Ascertain the amount of Cash Sales. Add this along with the Credit Sales in the Trading A/c.

**NOTES**

**Solution**

**1. To Ascertain Initial Capital:**

**STATEMENT OF AFFAIRS OF K.C.PANI**

**As at 1<sup>st</sup> January, 2002**

LIABILITIES	Rs.	ASSETS	Rs.
Sundry Creditors	17,000	Freehold Premises	50,000
Bank O/F (1.1.02)	10,000	Stock	25,000
Capital being excess of Assets over Liabilities	70,000	Sundry Debtors	20,000
	97,000	Furniture	2,000
			97,000

**2. To ascertain Credit Sales:**

**TOTAL DEBTORS ACCOUNT**

Dr.

Cr.

LIABILITIES	Rs.	ASSETS	Rs.
To Opening Balance b/d	20,000	By Cash	15,000
To Credit Sales	20,000	By (Closing) Balance c/d	25,000
	40,000		40,000

**5. To ascertain Credit Purchases:**

**TOTAL CREDITOR'S ACCOUNT**

Dr.

Cr.

LIABILITIES	Rs.	ASSETS	Rs.
To Cash	20,000	By (Opening) Balance b/d	17,000
To (Closing) Balance c/d	12,000	By Credit Purchases – (Balance figure)	15,000
	32,000		32,000

NOTE:

**4. Drawings:**

	Rs.	
As per Cash statement	3,000	
Add: House Rent of Mr.K.C.Pani	2,500	- Remove this amount from expenses
Transferred from expenses		
	5,500	

**3. Cash Sales:**

As per Cash Statement	80,000
Less: Sale of Personal Jewellery	2,000
	78,000

**K.C. PANI'S**

**TRADING AND PROFIT AND LOSS ACCOUNT**

**For the year ending 31<sup>st</sup> December, 2002**

	Rs.	Rs.		Rs.	Rs
To Opening Stock		25,000	By Sales Cash	80,000	
To Purchases		15,000	Less: Personal		
To Gross Profit –			Sales of Jewels	<u>2,000</u>	
Transferred to P&L			Add: Credit Sales	20,000	98,000
A/c.		88,000	By Closing Stock		30,000
		1,28,000			1,28,000
To Expenses	50,000		By Gross Profit –		
Less: Transferred to			Transferred from		
Drawings	2,500	47,500	Trading A/c		88,000
To Reserve for bad					
Debts		625			
To Depreciation:					
Premises @ 10%	5,000				
Furniture @ 15%	300	5,300			
To Net Profit-					
Transferred to					
Capital A/c		34,575			
		88,000			88,000

**NOTES**

**K.C. PANI'S  
BALANCE SHEET**

**As at 31<sup>st</sup> December 2002**

	Rs.	Rs.		Rs.	Rs.
<b>Sundry Creditors</b>		<b>2,000</b>	<b>Cash in hand</b>		<b>2,000</b>
<b>Capital</b>	70,000		<b>Cash at Bank</b>		<b>10,000</b>
<b>Add: Net Profit</b>	34,575		<b>Sundry Debtors</b>	25,000	
	1,04,575		<b>Less: Reserve for Bad Debt</b>	625	24,375
<b>Less: Drawings 3,000</b>	3,000		<b>Closing Stock</b>		<b>30,000</b>
<b>House Rent <u>2,500</u></b>	5,500		<b>Freehold Premises</b>	50,000	
	99,075		<b>Less: Depreciation @10%</b>	5,000	45,000
<b>Add: Sale of personal Jeweler</b>	2,000	1,01,075	<b>Furniture</b>	2,000	
			<b>Less: Depreciation @15%</b>	300	1,700
		<b>1,13,075</b>			<b>1,13,075</b>

## EXERCISES

1. Sampath keeps his books by "Single Entry", is on 31<sup>st</sup> December, Year 2001 and Year 2002 respectively, his financial position was follows:

	2001	2002
	Rs.	Rs.
Cash at Bank	457	10
Cash in hand	36	30
Stock	1,926	2,851
Plant & Machinery	2,721	3,050
Bill Receivable	Nil	324
Sundry Debtors	1,242	2,197
Sundry Creditors	2,602	4,200
Office Furniture	248	261
Drawings	Nil	950

Prepare a statement from the above particulars showing Sampath's profit for the year ended 31<sup>st</sup> December, 2002.

2. From the particulars given below, prepare a statement showing the profit made by Rama for the year 31<sup>st</sup> December, 2002.

	31 <sup>st</sup> Dec.		31 <sup>st</sup> Dec.
	2001		2002
	Rs.		Rs.
Cash in hand	150		
Cash at Bank	1,500	Bank O/D	200
Stock	6,000		9,000

**NOTES**

Sundry	4,500	7,000
Fixtures & Fittings	900	700
Plant & Machinery	8,000	13,000
Sundry Crs.	10,000	13,000

3. Sri. K. Samy follows the single entry boo-keeping from the following figures make out a statement of affairs as 31.12.2002 and the net profit for the ending 31.12.2002.

	As at 1.1.2002	31.12.2002
	Rs.	Rs.
1. Crs.	60,000	45,000
2. B/P	5,000	7,000
3. Office Furniture	5,000	4,500
4. B/R	20,000	15,000
5. Sundry Drs.	45,000	53,000
6. B/R	10,000	7,000
7. Cash	15,000	8,000
8. Personal drawings by Sri Samy for year was Rs.4,500		
9. Cash paid in during the year was Rs.12,000		

4. R. Rama Rao keeps his books by single entry. His statement of affairs on 31<sup>st</sup> December, 2002 was as follows:

LIABILITIES	RS.	ASSETS	RS.
Sundry Creditors	56,100	Buildings	76,600
Bills Payable	21,000	Plant & Machinery	44,400
Capital	93,000	Stock	12,400
		Sundry Debtors	26,400
		Cash at Bank	10,200
		Cash in hand	1,500
	<u>1, 70,100</u>		<u>1,70,100</u>

His Ledger balances on 31<sup>st</sup> December, 2002 were as under; Building Rs.91,500; Plant & March, 49,500; Stock 26,250; Sundry Crs.68,700; building Payable 24,360; Sundry Drs.36,000; Cash at Bank 19,050; Cash in hand 2,160; Drawing 6,160.

Prepare a statement the Profit earned by him.

5. Kasturi Raman keeps his books by single entry his assets and liabilities are as follows:

1 <sup>st</sup> January 2002		31 <sup>st</sup> December 2002	
Rs.		Rs	
25	Cash-in-hand	10	
300	Cash at Bank	300	
500	Stock	590	
100	Utensils	120	
275	Sundry Debtors	330	
650	Sundry Creditors	560	

## NOTES

Prepare a statement showing profit for the year after writing off 10% for depreciation on Utensils and providing 10% on the Sundry Debtors to cover Bad Debts.

**Hints:** In the absence of information depreciation should be calculated on the opening balance Rs.120. However, Reserve for doubtful debts should be calculated on the current amount of Debtors Rs.(330) and not on Rs.275.

6. Rataniel, a grocer, keeps his books by single entry. On 1<sup>st</sup> January, 2002 his assets and liabilities were as follows:

Cash in hand	25
Cash at Bank	300
Stock at Cost	500
Furniture	100
Debtors	275
Creditors	660

During the year, he drew out of the business Rs.300 for his own private purpose. His assets and liabilities on 31<sup>st</sup> December, 2002 were as follows:

Cash in hand	10
Cash at Bank	430
Stock	450
Furniture	120
Debtors	330
Creditors	560
	178

Prepare statement showing Ratanlal's profit for the year after writing of 10% for depreciation furniture and providing 10% on the debtors to cover bad debts.

7. Ms. Nathan, a petty shop-keep an incomplete set of records. The position of the business at 31<sup>st</sup> December, 2002 revealed the following:

Freehold Premises	10,000
Plant & Machinery	6,000
Stock-in Trade	13,000
Sundry Debtors	17,500
Cash at Bank	3,000
Sundry Creditors	18,750

At 1<sup>st</sup> January; 2002 his capital was Rs.55,000. During the year he withdraw Rs.150/- per months for the whole year for his private expenses, expenses. Cash paid in by him during the year amounted to Rs.575.

Ascertain his profit or loss for the year.

8. Should all business maintain accounting records on double entry line or is there sometimes cash for incomplete records? If so, state briefly the debtors of such a 'system'.

9. Anandan whose accounts are recorded by Sigle Entry acquired a retail business on 1<sup>st</sup> Jan.2002 with Rs.2,000 lent to him by Makesh and Rs.4,000 of his own. Of the acquisition price Rs.500 was attributed to Goodwill, Rs.5,000 to furniture, and Rs.3,500 to stock and Rs.500 were retained as working capital of which Rs.400 were deposited with the State Bank of India. During the year, Anandan's loan amounted to Rs.33,000 of which Rs.21,800 were paid into this Bank and the remainder sum was utilized for each payments. The payments out of bank and cash during the year were purchases Rs.15,600. Trade Expenses Rs.720; Payment for domestic purpose Rs.240; Drawings Rs.7,400; Wages and Salaries Rs.2,140; Rent, Rates and Taxes (business share) Rs.500 and Rs.296 (personal). On 31<sup>st</sup> Dec.2002, stock was valued at Rs.3,750; Trade Debtors and Creditors were Rs.1,500 and

Rs.2.400 respectively. The balance at the bank was Rs.550. Furniture is to be depreciated @ 5% Reserve is to be created for doubtful debts of Rs.50 and interest is to be allowed @5% on Makesh's loan.

Prepare Cash A/c. Bank A/c and Profit and Loss A/c for the year ended 31<sup>st</sup> Dec.2002 and Balance Sheet as on that date.

**(Ans: Cash A/c balance Rs.11,004; Bank A/c balance; Rs.550; Net Profit – Rs.12,629, Balance Sheet Total – Rs.8, 729)**

10. A merchant keeps his accounts on the Single Entry System, for the year 2002 the following information was available regarding his business. Summary of Cash Book; Deposited into bank Rs.17,380; Received dividend in cash Rs.890; and drawings from bank Rs.1,500. Received from debtors Rs.2,400 paid to creditors Rs.430 in cash and Rs.15,500 by cheque. Paid wages Rs.3, 000. Miscellaneous expenses paid in cash Rs.2,150. Received Rs.20 as interest from the bank.

The following information is also available.

	1 <sup>st</sup> Jan.	31 <sup>st</sup> Jan.
	Rs.	Rs.
Opening Stock	1,200	1,500
Cash in Bank	1,600	2,000
Cash in Hand	60	40
Debtors	1,500	2,100
Creditors	2,400	2,600
Investment	6,000	6,000

Prepare Profit and Loss A/c for that year ended 31<sup>st</sup> Dec.2002 and the Balance Sheet as on that date. There were outstanding expenses to the extent of Rs.240.

**(Ans: Net profit – Rs.640; Balance Sheet Total Rs.11,640).**

## LESSON - 8

### BRANCH ACCOUNTS

Several large business establishments are having a number of branches in various places for their own reasons. The parent establishment is known as the "Head Office" and the offices set up later in different places are called "Branches". The accounting system adopted for each Branch depends on the size nature of function entrusted to the branch as well as the degree of control needed by the Head Office. From the accounting point of view. It is desirable to know the profit or loss of each branch so that if any of the branches is not yielding the desired or expected result, then immediate steps can be taken to rectify the state of affairs. Besides, the accounts are maintained in such a manner so that profit or loss made at branch can be easily ascertained and incorporated in the Head Office Books.

Accounts relating to transactions between Head Office and its branches are known of 'Branch Accounts'. The accounting varies with the nature of work entrusted to branches. For this purpose the branches are usually divided into five classes.

a) A Branch that receives goods from the head Office, acts solely a depot for a cash sales of the goods supplied. Here, the branch remits the cash collected to the Head Office and the expenses of the branch are met by the Head office.

b) A branch that received goods from the head offices, acts solely a depot for cash and credit sales of the goods supplied. The branch remits all cash collected to Head Office and the expenses are met by the Head Office.

c) A branch that acts as described above; but the goods supplies by Head Office to the Branches are marked at selling price.

#### What is Branch?

Branch means a division of some larger or more complex organization

## NOTES

d) A branch that trades independently of the Head Office i.e., the branches are allowed to make purchases themselves, and to make sale both for cash and credit. The results of the branch and the Head Office are integrated at the end of the financial period.

e) The Branch situated in a foreign country (Foreign branches).

### **1. BRANCHES AUTHORISED TO SELL FOR CASH ONLY:**

Where the branches act as retail shops and authorized to sell goods only for cash the money received by cash branch through sales is either remitted directly to the Head Office daily or remitted into a Local bank to the credit of the Head Office. The expenses of the branch such as Salaries Wages, Rent, etc., are met by the Head Office by means of remittances of cash or through bank. Petty cash payment is also made by the Head office (under imprested system) to enable the Branch Manager meet the necessary petty expenses.

#### **Accounts at Branch:**

Under this system, the branch is not required to maintain detailed account books. It has to maintain a Cash Book, petty Cash Book and Stock Book.

Daily, Weekly or Fortnightly statements will be sent to the Head Office by the branches showing the Daily sales, Cash Remittances during the period, cheque if any received from the Head Office and the payment effected there from; petty disbursements, details of balance of petty cash in hand etc. Besides, Stock at Branch is also supplied from time to time as required by the Head Office.

#### **Account of Head Office:**

In the Head Office Ledger, a separate account is maintained for each branch in which all the transactions between the Head Office and the branch are recorded. Usually the goods are invoiced at cost price when they are supplied to the branches and these goods cannot be treated as sold, and therefore recorded in a memorandum

book known as "Goods supplied to Branches Book". This book is so ruled to have a separate column for each branch as follows:

### GOODS SUPPLIED TO BRANCHES BOOKS

Date	Particular	Invoice No.	Total Amount	Bombay Branch	Delhi Branch	Nagpur Branch	Srinagar Branch
			Rs.	Rs.	Rs.	Rs	Rs.

Periodical totals (say, once in a month) are taken and debited to the respective branch a/c and the "Goods supplied to branches a/c" is credited with the total of goods supplied to various branches. At balancing time the latter account is closed and transferred to Trading a/c and shown as a separate time quite distinct from the sales as it is not actual sales but merely transfer of goods from one place to another.

From the particulars appearing on the credit side of the Cash Book, each Branch Account is debited for expenses paid by the Head Office. The Branch Account is credited with the remittances made by the Branch. To enable quick and easy posting, the Cash Book is drawn with extra columns to record separately the transactions pertaining to each department and the postings effected at periodical intervals (say, once in a month's) with the totals to the respective departments.

On receipts of statement from a Branch Manager, the Branch Account is credited with Branch stock and Branch Petty cash lying in the Branch. Then profit or loss made by the Branch is arrived and transferred to the General Profit and Loss Account, at the commencement of the next period. Branch Account is debited with Branch Stock and Branch Petty Cash as opening balances.

### PROFORMA JOURNAL ENTRIES IN THE HEAD OFFICE BOOKS

1. When the goods are supplied to the Branch by the Head office.	Branch Account     Dr. To Goods sent to Branch Account.
2. When the branch expenses are met by the Head Office.	Branch Account To Bank/Cash Account
3. When goods are sold by Branch	No Entry

**VOTES**

(including intimated)	
4. When Branch remits cash or deposits into Bank to the credit of Head Office.	Cash/Bank Account      Dr. To Branch Account                      Cr
5. When Petty cash is paid to the Branch by the Head office.	Branch Account      Dr. To Branch Petty Cash Account      Cr
6. At the Close of the period when there is unsold stock of goods with the Branch	Branch Stock Account    Dr. To Branch Account                      Cr
7. Petty Cash balance lying with the branch.	Branch Petty Cash account    Dr. To Branch Account                      Cr
8. On closing the Branch Account, if there is a profit it will be transferred to the General Profit and Loss Account.	Branch Account                      Dr. To General Profit and Loss Account
9. On closing the Branch Account, if there is a loss, then the entry will be.	General Profit and Loss Account    Dr. To Branch Account
10. At the beginning of the next year, for transferring the Branch Assets.	Branch Account      Dr. To Branch Stock Account      Cr To Branch Petty Cash Account

**Illustration: 1.** Swastik Products Ltd., had a Branch at Poona. From the following particulars, prepare Branch account and find out profit or loss made by the Branch, for the period ended 31<sup>st</sup> December 2002.

Stock at Branch on 1 <sup>st</sup> July 2002	6,000
Goods sent to Branch	50,000
Cash remittance to Branch for	
Salaries	5,000
Rent	1,500

Other expenses 750  
 Cash Sales effected by the Branch 75,000  
 (Remitted to H.O., immediately  
 Stock of unsold goods on 31<sup>st</sup> Dec.2002.

**LEDGER OF SWASTIK PRODUCTS LTD.,  
 POONS BRANCH ACCOUNT**

Dr.			Cr.		
2002 July 1	To Opening Stock	Rs. 6,000	2002 Dec.31	By Cash A/c (Cash Sales)	Rs. 75,000
Dec.31	To Goods sent to Branch A/c	50,000	Dec.31	By Branch Stock	4,500
"	To Cash A/c				
	Salaries	Rs. 5,000			
	Rent	1,500			
	Other Expenses	<u>750</u>			
Dec.31	To General Profit & Loss A/c(Profit Transferred)	7,250 <u>16,250</u>			
		79,500			<u>79,500</u>

**GOODS SENT TO POONA BRANCH ACCOUNT**

Dr.			Cr.		
2002 Dec.31	To Purchase A/c (Transfer)	Rs. 50,000 <u>50,000</u>	2002 Dec.31	By Poona Branch A/c	Rs. 50,000 <u>50,000</u>

**STOCK AT POONA BRANCH ACCOUNT**

Dr.			Cr.		
2002 July 1	To Balance b/d	Rs. 6,000	2002 July 1	By Poona Branch A/c	Rs.
2002 Dec.31	To Poona Branch A/c	<u>4,500</u>	2002 Dec.	(Transfer)	6,000
2003	To Balance b/d	4,500	2003	By Balance c/d	4,500

**NOTES**

Jan. 1			Jan. 1	By Poona Branch A/c	
					4,500

**GENERAL PROFIT AND LOSS ACCOUNT**

Dr.

Cr.

	Rs.	2002	By Poona Branch A/c	Rs. 16,250
--	-----	------	------------------------	---------------

**1. (B): BRANCHES AUTHORISED TO SELL GOODS FOR CASH AS WELL AS ON CREDIT:**

Under this type the branch is authorized to sell goods for cash as well as credit. In this case, the main accounting work is done only at the head office. The entries are more or less similar to those in the case of foregoing branch; the only addition to take into account here is the Debtors account.

**ACCOUNTS AT THE BRANCH:**

Under this type also the branches will maintain a Cash Book, Petty Cash Book and a Stock Book as in the foregoing case. Besides to keep the Debtors Account (as it is authorized to sell on credit, a Day Book and a Customers Ledger are also maintained by the branch. Cash remittances by the branch comprise of cash sales as well as the cash received from the debtors. At the end of the financial period, the Branch Manager will furnish the balance of debtors along with other details.

**ACCOUNTS AT HEAD OFFICE**

The Head Office will keep accounts of the branch much in the same way as in case of the accounts of the foregoing type of branch are kept. The Head Office will make entry only for cash received by it and no entry is made for credit sales at Branch in the Head Office books. Again, the Head Office records no entry for discounts

allowed, bad debts written off or returns made by the branch debtors. However, at the close of the financial year, on receipt to statement from a branch, Branch Debtors balance is taken into account as an asset. Similarly, if the branch has received a bill of exchange, it will be sent to Head Office. This is treated as an asset by the Head Office. The Branch account is prepared as usual, after taking into account the Branch Debtors, Branch Stock, Branch Petty Cash, etc., and the resultant figure is transferred to the General Profit and Loss Account.

In the beginning of the next financial year a reverse entry will be passed for transferring the Branch Debtors, Branch Stock, and Branch Petty Cash. The proforma journal entries for this type of branch are similar to those of the foregoing type. Besides for recording Branch Debtors and Bills Receivable, the following entries are passed in the Head Office books.

On receipt of statement from the Branch for incorporating the Branch Debtors in the head office books.	Branch Debtors Account Dr. To Branch Account Cr
On receipt of Bills Receivable from the Branch by the head office.	Bills Receivable Amount Dr. To Branch Account Cr
To Transfer the branch debtors in the beginning of the next year.	Branch Account Dr. To Branch Debtors Account Cr

**Illustration: 2**

From the following particulars relating to Indore Branch for the year ending 31<sup>st</sup> December 2001 prepare accounts in head office books:

	Rs.
Branch stock, 1 <sup>st</sup> January 2002	7,500
Branch Debtors, 1 <sup>st</sup> January 2002	6,000
Branch Petty Cash, 1 <sup>st</sup> January 2002	50
Good sent to Branch during the year	40,000
Cash sales during the year	25,000
Credit sales during the year	55,000

**NOTES**

Cash received from the debtors	47,000
Cash sent to Branch for expenses	
Rents	3,000
Salaries	8,000
Petty Cash	1,200
Stock at Branch on 31 <sup>st</sup> December 2002	6,500
Petty Cash at Branch on 31 <sup>st</sup> December 2002	60
Goods returned by the Branch	1,000

**HEAD OFFICE LEDGER**

**BRANCH STOCK**

Dr.

Cr.

Dr.			Cr.		
		Rs.			Rs.
2002 Jan.1	To Balance b/d	7,500	2002 Jan.1	By Transfer to Indore	7,500
2002 Dec.31	To Indore Branch A/c	6,500	2002 Dec.31	Branch A/c	6,500
2003 Jan.1	To Balance b/d	6,500		By Balance c/d	

**BRANCH DEBTORS ACCOUNT**

Dr.

Cr.

Dr.			Cr.		
		Rs.			Rs.
2002 Jan.1	To Balance b/d	5,000	2002 Jan.1	By Transfer to Indore by Branch A/c	5,000
2002 Dec.31	To Indore Branch A/c	13,000	2002 Dec.31	By Balance c/d	13,000
2002 Jan.1	To Balance b/d	13,000			

**MEMORANDUM DEBTORS ACCOUNT**

Dr. Cr.

	Rs.		Rs.
To Balance b/d	5,000	By Cash	47,000
To Credit Sales	55,000	By Balance c/d	13,000
	60,000		60,000
To Balance b/d	13,000		

The branch debtors on 31<sup>st</sup> December will be found by making a Memorandum Debtors Account as under:

**MEMORANDUM DEBTORS ACCOUNT**

Dr. Cr.

		Rs.			Rs.
2002 Jan. 1	Balance b/d	50	2002 Jan. 1	By Patna Branch A/c	50
2003 Dec. 31	To Patna Branch A/c	60	2003 Dec. 31	By Balance c/d	60
2003 Jan. 1	To Balance b/d	60			

**INDORE BRANCH ACCOUNT**

Dr. Cr.

		Rs.			Rs.
2002 Jan. 1	To Balance b/d		2002 Jan. 1	By Cash –	
	Stock           7,500			Cash Sales       25,000	
	Debtors         5,000			Received from	
	Petty Cash       50	12,500		Debtors           47,000	72,000
Jan. 1	To			By Goods sent to Br. A/c	1,000
Dec. 31	To Goods sent to Br. A/c	40,000		By Branch Stock A/c	6,500
Dec. 31	To Cash A/c			By Branch Debtors A/c	15,000
	Rent             3,000			By Petty Cash at Branch	
	Salaries         8,000			A/c	60
	Petty Cash       1,200	12,200			
Dec. 31	To Profit transferred to				

**NOTES**

	Profit and Loss A/c	27,810			92,560
		92,560			

**GOODS SENT TO BRANCH ACCOUNT**

Dr.			Cr.		
2002 Jan. 1 To Dec. 31 Dec. 31		Rs.	2002 Jan. 1 To Dec. 31		Rs.
	To Indore Br.A/c-returns	1,000		By Indore Br.A/c	40,000
	To Purchase A/c-transfer	39,000			
		<u>40,000</u>			<u>40,000</u>

A Trading and Profit and Loss Account for the branch can also be prepared in the ordinary manner and the profit revealed by it can be checked with the profit arrived at under the respective Branch Account in the Ledger.

**GOODS SENT TO BRANCH ACCOUNT**

Dr.			Cr.		
		Rs.			Rs.
To Opening Stock		7,500	By Sales		
To Goods recd. from			Cash	25,000	
Head Office	40,000		Credit	<u>55,000</u>	80,000
Less: returns	<u>1,000</u>	39,000	By Closing Bank		6,500
To Gross Profit		40,000			
		<u>86,500</u>			<u>86,500</u>
To Rent		3,000	By Gross Profit		40,000
To Salaries		6,000			
To Petty Cash Expenses		1,190			
To Net Profit		27,810			
		<u>40,000</u>			<u>40,000</u>

	Rs.
Petty cash opening balance	50
Petty Cash opening received	1,200
	<u>1,250</u>
Less: Petty cash balance at the end of the year	60
	<u>Rs. 1,190</u>

### 1.(c) GOODS SUPPLIED TO BRANCHES ARE MARKED AT SELLING PRICE

In the foregoing types it is assumed that the goods are supplied to the branch at cost. But, sometimes the Head Office may invoice the goods at selling price to the branch. By adopting this procedure the Head Office is benefitted in two ways. One benefit is that the Head Office can keep the cost price of the goods in confidence so that the branch may not know how much profit the Branch earns for the Head Office. The second but the most important benefit is that by making out the invoices at selling prices. Stock control at branch becomes easier. It enables the Head Office to have an effective check on the stock at branch. For instance, let us assume that goods worth Rs.25,000 (selling price) are sent to the branch and the branch makes sales to the extent of Rs.18,000. Then the value of closing stock at the branch should be Rs.7,000. This verified with a list of articles along with the quantity in stock furnished by the branch. If the totals agree, we can say, the stock at the branch is all right. However, in practice there will be some difference at the time of verification. It may be due to breakage or leakage or spoilage. Hence a list of such items is called for and after scrutiny, the value of them is deducted from the books figure of the stock. For this purpose a memorandum stock account is maintained by the Head Office, which is not a part of ledger. This system of stock control operates well only if the branch sells goods at fixed prices.

What is selling price?

Selling price is the price at which something is offered for sale.



Account. In the next trading period, the Stock at Branch Account and Stock Reserve Account will be transferred to the Branch Account.

**Illustration: 3**

Diana Appliances Ltd. Opens a branch at Madurai on last January 2002. Goods are invoiced to the Branch at cost plus 25% which is the selling price. From the following particulars relating to 2002 and 2003 ascertain the profit or loss made at Madurai Branch, during the said two years. You are also required to give journal entries for 2002 and show, how the relevant items will appear in company's Balance Sheet on 31<sup>st</sup> December 2002.

	2002	2003
	Rs.	Rs.
Goods supplied to the Branch	50,000	80,000
Sales at Branch-Cash- Credit	20,000	35,000
Cash received from the Debtors	18,600	45,000
Discount allowed to customers	17,000	38,000
Cash sent to Branch for expenses (including Petty Cash)	5,000	12,000
Goods returned by the Branch being at invoice Price	2,000	--
Stock at 31 <sup>st</sup> December at Invoice price	9,000	8,500
Petty cash at Branch on 31 <sup>st</sup> December	200	300

## DIANA APPLIANCES LTD.,

## JOURNAL

		Dr.		Cr.	
		Rs.	P.	Rs.	P.
2002	Madurai Branch Account . . . . . Dr. To Goods sent to Branch A/c (being the goods supplied to branch during 2002 at selling price)	5,000.00		5,000.00	
	Bank Account . . . . . Dr. To Madurai Branch A/c (being the cash received from the branch against cash and credit sales made there)	37,000.00		37,000.00	
	Madurai Branch Account . . . . . Dr. To Bank Account (being the amount remitted to branch towards expenses)	5,000.00		5,000.00	
	Goods sent to Branch Account . . . . . Dr. To Madurai Branch Account (being the goods returned by the branch at invoice price)	2,000.00		2,000.00	
Dec.31	Madurai Branch Debtors Account . . . . . Dr. Madurai Branch Stock Account . . . . . Dr. Petty Cash at Madurai Br.Account . . . . . Dr. To Madurai Branch Account (being the various assets at branch stock at invoice value at the end of the year brought into account)	1,000.00 9,000.00 200.00		10,200.00	
"	Goods sent to Madurai Branch Account . . . . . Dr. To Madurai Branch Account (being the difference between the invoice value and cost price of the goods sent to Madurai Branch less returns 1/5 <sup>th</sup> of Rs.48,000)	9,800.00		9,600.00	
2002 Dec. 31	Madurai Branch Account . . . . . Dr. To Stock Reserve Account (being the difference in the invoice value and cost price of the closing stock)	1,800.00		1,800.00	

	Goods sent to Madurai Branch Account Dr. To Purchase Account (being the balance in the former account closed and transferred to purchase Account)	38,400.00	38,400.00
	Madurai Branch Account Dr. To Profit and Loss Account (Being the profit made by the branch transferred to profit and loss account.)	2,000.00	2,000.00

### MADURAI BRANCH ACCOUNT

Dr.			Cr.		
		Rs.			Rs.
2002 Jan 1	To Goods sent to Madurai Branch A/c	50,000	2002 Jan. 1	By Cash Cash Sales 20,000	
To Dec.31	To Cash (Expenses)	5,000	To Dec.31	Recd. from Drs. <u>17,000</u>	37,000
Dec.31	Stock Reserve A/c	1,800		By Goods sent to Madurai Branch A/c Returns	2,000
	To Profit transferred Profit and Loss A/c	2,000		By Madurai Br. Debtors	1,000
				By Madurai Br. Stock. A/c	9,000
				By Petty cash at Br.	200
				By Goods sent to Madurai Br. A/c - adjustment	9,600
		58,800			58,800

### GOODS SENT TO MADURAI BRANCH ACCOUNT

Dr.			Cr.		
		Rs.			Rs.
2002 Jan. 1	To Madurai Br. A/c Returns	2,000	2002 Jan. 1		
To Dec.31	To Madurai Br. A/c Adjustment	9,600	To Dec.31	By Madurai Br. A/c	50,000
To Dec.31	To Purchases A/c	38,400			
		50,000			50,000

### MADURAI BRANCH DEBTORS ACCOUNT

Dr.			Cr.		
		Rs.			Rs.
2002 Dec.31	To Madurai Br. A/c	1,000	2002 Dec.31	By Balance c/d	1,000
2003 Jan. 1	To Balance b/d	1,000	2003 Jan. 1	By Transfer to Madurai Br. A/c	1,000

## MADURAI BRANCH STOCK ACCOUNT

Dr.

Cr.

2002 Dec.31	To Madurai Br.A/c	Rs. 9,000	2002 Dec.31	By Balance c/d	Rs. 9,000
2003 Jan. 1	To Balance b/d	9,000	2003 Jan.1	By Transfer to Madurai Branch A/c	9,000

## STOCK RESERVE ACCOUNT

Dr.

Cr.

2002 Dec.31	To Balance c/d	Rs. 1,800	2002 Dec.31	By Madurai Br.A/c	Rs. 1,800
2003 Jan. 1	To Madurai Br.A/c Transfer	1,800	2003 Jan.1	By Balance b/d	1,800

## PETTY CASH AT MADURAI BRANCH ACCOUNT

Dr.

Cr.

2002 Dec.31	To Madurai Br.A/c	Rs. 200	2002 Dec.31	By Balance c/d	Rs. 200
2003 Jan.1	To Balance b/d	200	2003 Jan.1.	By Transfer to Madurai Branch A/c	200

## MADURAI BRANCH STOCK ACCOUNT

Dr.

Cr.

2003 Jan.1.	To Balance b/d	Rs.	2003 Jan.1	By Cash	Rs.
	Debtors 1,000		To	Cash Sales	
	Stock 9,000		Dec.31	35,000	73,000
	Petty Cash 200	10,200		Reced.from	
Jan.1	To Goods sent to Madurai Br.A/c	80,000	Dec.31	Drs.38,000	7,100
					8,500
Dec.31	To Cash-Expenses	12,000		By Debtors at Br.A/c	
	To Stock Reserve A/c			By Branch Stock A/c	300
	(Required on closing Stock)	1,700		By Petty Cash at Branch A/c	1,800
	To Profit transferred	2,800		By Stock Reserve A/c (opening Stock)	
	To Profit & Loss A/c	1,06,700		By Goods sent to Madurai Br.A/c adjustment	16,000
					1,06,700

Memorandum stock account if prepared will appear as under:

**MEMORANDUM MADURAI BRANCH STOCK ACCOUNT**

Dr.

Cr.

2002 Jan 1 to Dec.31	To Goods sent to Branch	Rs. 50,000	2002 Jan.1 to Dec.31	By Sales Cash 20,000 Credit 18,600	Rs. 38,600
		50,000		By Goods Returned	2,000
				By Wastage (balancing figure)	400
2003 Jan 1 to	To Branch b/d	9,000		By Balance b/d	9,000
					50,000
Jan 1 to Dec.31	To Goods sent to Branch	80,000		By Sales Cash 35,000 Credit 45,000	80,000
				By Wastage	500
				By Balance c/d	8,500
		89,000			89,000

**Stock and Debtors System**

In the forgoing types, the main account maintained in Head Office to ascertain the Profit or Loss made at a Branch is the "Branch Account". But there is another method also to ascertain the profit or loss made at a branch and it is known as "Stock and Debtors System". Under the Stock and Debtors System no "Branch Account" is opened by the Head Office instead it keeps separate accounts relating to various types of transactions taking place at the branch. Under this type in addition to accounts relating to Branch Assets, other accounts such as Branch Stock Account, Branch Debtors Account, Branch Expenses Account, Branch Adjustment Account etc., are maintained by the Head Office. However, this method is useful only where the goods supplied to the branch are marked at selling price and the branch is not authorized to vary.

## NOTES

To ascertain the profit or loss of a branch under this method a new account namely, "Branch Adjustment" a/c is opened in respect of each branch. This account is credited with the difference in the invoice value of the goods supplied to the branch and the actual cost of it. The Branch Adjustment Account is debited with branch expenses, leakage, wastage, breakage etc. of the branch stock. Ascertain items like opening stock, (goods supplied to branch already seen) and closing stock are appearing with inflated value, certain adjustment entries are passed before ascertaining the profit or loss made at a branch. Later the resultant figure is transferred to the General Profit and Loss Account.

Specimen Journal Entries in the books of Head Office under the Stock and Debtors System.

1. When goods are supplied to the branch (which are marked at selling price)	Branch Stock A/c To Goods sent to Branch A/c.	Dr.
2. When goods are returned by the branch to the Head Office.	Goods sent to Branch A/c To Branch Stock	Dr.
3. When expenses are incurred for branch by H.O.	Branch Expenses A/c To Cash A/c.	Dr.
4. When cash sales are made at the branch	Cash A/c To Branch Stock A/c	Dr.
5. When credit sales are made at the branch.	Branch Debtors A/c To Branch Stock A/c	Dr.
6. When cash is received on account of branch debtors.	Cash A/c To Branch Debtors A/c	Dr.
7. When goods are returned by customers	Branch Stock A/c To Branch Debtors A/c	Dr.
8. When any allowances such as Discount is given to branch debtors (Similar entry will be passed for bad debts etc.)	Branch expenses A/c To Branch Debtors	Dr.
9. For the excess of selling price over cost charged on goods supplied to branch.	Goods sent to Branch A/c To Branch Adjustment A/c	Dr.
10. For adjusting the inflated price of the closing stock.	Branch Adjustment A/c To Stock Reserve A/c	Dr.

	(the sum should be equal to difference in the invoice value of the stock and cost price of stock)
11. For adjusting the leakage, breakage, wastage etc of the stock.	Branch Adjustment A/c                      Dr. To Branch Stock A/c
12. For transferring the branch expenses to the Branch Adjustment A/c.	Branch Adjustment A/c                      Dr. To Branch Expenses A/c
13. For adjustment the inflated price of opening stock if any.	Stock Reserve A/c                              Dr. To Branch Adjustment A/c (i.e. to carry forward the Stock Reserve Account created on the closing balance of the previous year)
14. Any credit balance left in the Branch Adjustment Account represents profit and will be transferred to General profit and loss account.	Branch Adjustment A/c                      Dr. To General Profit and Loss A/c (In case of loss, the above entry will be reserved).

The balance in the Goods sent to Branch Account will be transferred to the credit of the Purchases Account in case of trading concern and Trading Account in case of manufacturing concerns.

**Illustration: 4**

Z Ltd., of Bombay has a branch at Kanpur and in order to maintain strict control on stocks, invoices goods to the branch as selling price which is cost plus 25%. From the following particulars prepare the Branch Stock Account, Branch Debtors Account. Goods sent to Branch, Account and other necessary accounts to show the profit or loss made by branch:

	Rs.
Stock on 1 <sup>st</sup> January 2002 (Invoice price)	20,000
Debtors on 1 <sup>st</sup> January 2002	12,000

**NOTES**

Goods supplied to Branch (Invoice value)		80,000
Sales at Branch: Cash	40,000	
Credit	52,000	92,000
Cash received from Debtors		44,000
Discount allowed to customer		500
Leakage and breakage written off		3,000
Bad Debts written off		1,000
Cash remitted to Branch, towards		
Salaries	4,000	
Rent	3,500	
Sundry Expenses	500	
Goods returned by customers		8,000
Stock at Branch on 31 <sup>st</sup> Dec.2002		2,000

**IN THE BOOKS OF Z LTD.,**  
**KANPUR BRANCH STOCK ACCOUNT**

2002		Rs.	2002		Rs.
Jan. 1	To Balance b/d	20,000	Jan. 1 to	By Cash-Cash Sales	40,000
Jan. 1 to	To Goods sent to		Dec. 31	By Branch Debtors A/c	
Dec. 31	Branch A/c	80,000		Credit Sales	52,000
	To Branch Debtors			By Branch Adjustment	
	A/c Returns	2,500		A/c. Leakage	3,000
				& breakage	7,500
		1,02,500		By Balance c/d	1,02,500

**KANPUR BRANCH DEBTORS ACCOUNT**

2002		Rs.	2002		Rs.
Jan. 1	To Balance b/d	12,000	Jan 1 to	By Cash collected	44,000
Jan 1 to	To Balance Stock A/c		Dec. 31	By Branch Stock A/c	
Dec. 31	Credit Sales	52,000		Returns	2,500
				By Branch Expenses A/c	
				Discounts	500
				By Branch Expenses A/c	
				Bad Debts	1,000
		64,000		By Balance c/d	16,000
					64,000

**GOODS SENT TO KANPUR BRANCH ACCOUNT**

2002		Rs.	2002		Rs.
Jan 1 to	To Branch		Jan 1 to		
Dec. 31	Adjustment A/c.	16,000	Dec. 31	By Branch Stock A/c	80,000
Dec. 31	To Purchases A/c	64,000			
		80,000			80,000

NOTES

**KANPUR BRANCH EXPENSES ACCOUNT**

2002 Jan 1 to		Rs.	2002 Dec.31		Rs.
	To Cash			By Branch Adjustment	
	-Salaries	4,000		A/c Transfer	8,500
	-Rent	3,500			
	-Sundry Expenses	500			
	To Branch Debtors				
	A/c Discount	500			
		8,500			8,500

**STOCK RESERVE ACCOUNT**

2002 Dec.31		Rs.	2002 Jan. 1 Dec.31		Rs.
	To Branch Adjustment	4,000		By Balance b/d ○	4,000
	To Balance c/d	1,500		By Branch Adjustment	
				A/c (Reserve required on	1,500
				Closing stock)	
				By Balance b/d	1,500

**KANPUR BRANCH ADJUSTMENT ACCOUNT**

Dr.

Cr.

2002 Dec.31		Rs.	2002 Dec.31		Rs.
	To Stock Reserve A/c (1/5 <sup>th</sup> of Rs.7,500)	1,500		By Stock Reserve A/c Transfer	4,000
	To Branch Stock A/c (Leakage & Breakage)	3,000		Goods sent to Branch A/c	16,000
	To Branch Expenses	8,500			
	To General P&L	7,000			
	A/c Transfer of profit	20,000			20,000

As per Branch Adjustment Account is exhibiting the profit or loss of the branch, it is like a trading and profit and loss account. Hence, the Branch adjustment Account may be split into two parts-one to show the trading results or gross profit and the other to show the net profits. In the first part, the adjustments on opening stock, goods supplied to the branch and the adjustment or closing stock are taken into account. Again, and inflation part of spoilage or wastage is taken into account under

the first part, before ascertaining the gross profit. The gross profit or the gross loss is carried down to the second part of the Branch Adjustment Account. The Branch expenses and the cost of goods lost (Spoilage or wastage) are shown under the second part of the Branch Adjustment Account and difference in this account reveals the net profit on net loss. If this procedure is to be followed, the Branch Adjustment Account for 2002 for the above illustration will appear as follows:

### KANPUR BRANCH ADJUSTMENT ACCOUNT

Dr.

Cr.

		Rs.			Rs.
2002 Dec.31	To Stock Reserve A/c Required on closing Stock	1,500	2002 Dec.31	By Stock Reserve A/c	4,000
	To Leakage and breakage 20%	600		By Goods sent to Branch A/c	16,000
	To General Profit c/d	17,900			
		20,000			20,000
Dec.31	To Branch Exp.A/c	8,500		By Gross Profit b/d	17,900
	To Leakage & breakage Cost	2,400			
	To General P&L A/c Transfer of Net Profit	7,000			
		17,900			17,900

## 2. Branches Maintaining Independent Accounts or “Independent” Branches

In the foregoing types, we have seen that branches do not maintain accounts, but the accounts of them are maintained by the Head Office. This is generally so when branches are small. In case of big branches, particularly when they are engaged in manufacturing operations, they used to maintain accounts by themselves. Similarly certain branches are given extensive powers to do independent trading. As such the branch manager makes direct purchase of goods and incurs the necessary expenses for running business. Such branches also prepare the Trial balance as well as their own Trading and Profit and Loss Accounts. The branches also furnish the necessary particulars to the Head Office, to enable the latter to prepare and present

## NOTES

one consolidated Balance Sheet for the benefit of the shareholders and the outside world.

### Accounts at Branch:

In this type of complete set of records will be maintained by the branch. The goods received from the Head Office are recorded in a separate register called "Goods received from Head Office Account", Cash remitted either due to surplus or as and when required by the Head Office, are recorded in the Cash book. Sometimes the Head Office may send cash to the branch for various reasons. Those transactions are also passed through the cash book. To record all these transaction the branch will open a Head Office Account. In this account the goods from Head office, expenses incurred by the Head Office etc., are credited. This account is debited for cash remitted to the Head Office. The balance in this account show how much the branch owes to the Head Office.

The specimen journal entries which will appear in the Branch books are as follows:

1. When goods are supplied by the Head Office.	Goods received from Head To Head Office A/c The sum is the monthly total as appearing in the "Goods received from Head Office Book".	Dr.
2. When Cash received from the Head Office	Cash A/c To Head Office A/c	Dr.
3. For Supply of goods by the branch to the Head Office.	Head Office A/c To Good supplied to Head Office A/c.	Dr.
4. When cash I remitted by the Branch to the Office.	Head Office A/c To Cash A/c.	Dr.

### Accounts at Head Office

The Head Office will maintain, in its books separate "Branch Account" for each branch and the nature of this account will resemble a personal account.

Generally, supply of the goods to the branch, expenses incurred on behalf of the branch etc., is debited to the Branch Account. Cash received from the branch is credited to the branch account. The balance of this account reveals how much money the branch owes to the Head Office. In other words it exhibits the money the Head Office has invested at the branch.

There are some additional aspects such as accounts of fixed assets, depreciation on assets, cash in transit, goods in transit, and transfer of goods between branches etc., which require special treatment.

#### **Accounts of Fixed Assets:**

Accounts relating to fixed assets used by the branch will be maintained by the **Head Office even** if the asset is originally paid for by the branch, if the payment for **the asset is made by the branch**. The nature of entry in the branch books will be.

Head Office A/c                      Dr.

To Cash A/c

(Being the cash paid for the asset by the branch)

On receipt of advice from the branch, the Head office will record in its books as follows:

Branch Asset A/c                      Dr.

(Machinery or Furniture or Building)

To Branch A/c

(Being the incorporation of the asset in the Head Office books)

If payment for the asset is made by the Head Office, no entry will be recorded by the branch, in its books. The head office will record the transaction as follows:

Branch Asset A/c                      Dr/

(Machinery, Building etc)

## NOTES

To Cash A/c

(Being the asset bought for the branch and cash paid by the H.O.)

**DEPRECIATION OF FIXED ASSETS:** The accounts of branch fixed assets when they are maintained in the branch books, there is nothing special and recorded in the usual manner; but, where the account of such branch assets are maintained by the Head Office books will be:

Branch Account..... Dr.

To Branch Fixed Asset A/c

(Being the depreciation written off by debiting branch account for the reason, the branch used the asset)

In the books of the branch, the entry for recording this depreciation on the asset will be:

Depreciation Account      Dr.

To Head Office Account

The net effect of these entries results in debit to Branch profit and loss account and credit to the branch asset concerned.

**HEAD OFFICE EXPENSES:** For services rendered on behalf of the branch, the head office usually charges the branch at the end of the year with a reasonable amount, the entry will be.

Branch Account.....Dr.

To Profit and Loss Account

Sometimes, Salaries Account may be credited as only the office staff of the Head Office would have been engaged for the branch work. When salaries were paid

to the head office staff and cash credited only a proportionate charge is charged to the branch. The entry to be passed in the books of the branch will be.

Head Office Expenses Account, being an expense, will be debited to the branch Profit and Loss Account.

**ACCOUNTS OF CASH AND GOODS IN TRANSIT:** Generally the balance shown by the Branch Account in the books of the Head office and the Head office Account in the books of the Branch office must show one and the same balance; but sometimes, they disagree on account of the fact that the goods supplied by the Head office to the branch on the last day of the month might have reached the branch a few days later. Similarly cash remitted by the branch on the last day of the month, might have been received by the head office during the first week of next month. Under these circumstances, for a few days the two accounts referred will show different balances. This is due to the goods/cash in transit which has to be brought into account books of the date of closing of account. Adjustment entries have to have to be passed by the one which originally sent the goods or cash. If cash is sent by the branch and is still in transit, then the adjustment entry in the branch will be.

Cash in Transit Account Dr.

To Head Office Account.

(Being the cash sent to Head Office not yet received by the H.O)

Similarly, if goods are sent by the Head Office and are still in transit, then the adjustment entry in the Head Office books will be

Goods in Transit Account Dr.

To Branch Account

(Being the goods sent by Head Office to branch which have not yet reached the destination)

## NOTES

If the balances shown by the Branch Account and Head Office are the same, then there is nothing in transit. If they disagree we have to assume that there is something in transit and the necessary entry is passed.

### **Inter-Branch Transactions:**

Where goods are supplied within branches, the branch which supplied the goods has to treat the transaction as though the goods are supplied to the Head Office and the branch which received the goods has to treat it as though the goods are received from the head office. Assuming that "A" Branch as sent the goods to "B" Branch; then the entries to be recorded as follows:

In the books of "A" Branch

Head Office Account                      Dr.

To Goods supplied to Branch Account

In the books of "B" Branch

Goods Received from Head Office Account      Dr.

To Head Office Account

In the books of the Head Office

"B" Branch Account                      Dr.

To "A" Branch Account

The above Procedure facilities easy maintenance of accounts in each branch, otherwise, every branch has to maintain the account of all other branches and thereby the ledger becomes unwieldy in each branch. However, the head office will keep accounts of all branches and will record in the head office books as under.

“B” Branch Account           Dr.

To “A” Branch Account

(Being the goods supplied by ‘A’ branch to ‘B’ branch)

### **INCORPORATION OF BRANCH TRIAL BALANCE IN HEAD OFFICE BOOKS**

At the end of the financial period, the head office received the trial balance from the branch. Since to the outside world there is no difference between the head office and its branches, it has to prepare a consolidated balance sheet duly incorporating the branch trial balance in its books. This process is known as incorporation of branch trial balance in the head office books. Thus it involves the preparation of Branch Trading and Profit and Loss Account of the branch and a combined balance sheet of the branch and the head office. There are two ways of doing this.

**Under the first method, the Branch Trading and Profit and Loss Account is prepared in the regular method in the Head Office books. For this, the following entries are passed.**

**1. Branch Trading Account is debited with the Opening Stock, Purchases less Returns, wages, manufacturing expenses etc., and the Branch Account is credited correspondingly.**

**2. Branch Trading Account is credited with Sales less Returns and closing stock and the Branch Account is correspondingly debited.**

**3. Branch Trading Account will now be balanced and the gross profit or gross loss will be carried down to branch profit and loss account. For gross profit branch Trading Account is debited and branch profit and loss account is credited.**

**4. Branch Profit and Loss Account is debited with the usual items debited to Profit and Loss Account (such as Salaries, Rent, Depreciation, Discount allowed etc.,) and the Branch Account is credited.**

## NOTES

5. Branch Profit and Loss Account is credited with the items which are usually credited to Profit and Loss Account (such as discount earned gains made etc.) and the Branch Account is debited correspondingly.

6. Branch profit and Loss Account will now be balanced and the net profit or net loss is arrived at and then is transferred to General Profit and Loss Account. General Profit and Loss Account is credited if there is a profit. The entry will be reversed if there is a loss.

If it is decided to close the books of the branch completely and to incorporate the branch assets and liabilities in the head office with the intention of preparing a common balance sheet the following entries are passed.

7. Each individual Branch Asset Account such as Branch Debtors, closing stock, Cash in transit, Cash in hand etc., is debited the Branch Account is credited.

8. Similarly, with each individual liability of the branch, Branch Account is debited and the Branch Liability account is credited.

The Head Office Balance Sheet will include the branch assets and branch liabilities which may be either shown separately or merged with its own assets and liabilities. At the commencement of the next financial period, the entries relating to branch assets and branch liabilities are reversed. Alternatively, without passing entries according to Nos. 7 and 8, the Branch Account balance which is equal to the net assets (total of assets less liabilities) at the branch, may be shown in the Balance Sheet.

### **Illustration: 5**

The Head Office at Trichy sent goods worth Rs.9,000 to Dindigul Branch on 30<sup>th</sup> December 2002 but the Dindigul Branch received the same on 10<sup>th</sup> January 2003. The Dindigul Branch remitted to Trichy Head Office Rs.5,000 on 29<sup>th</sup> December 2002 but the money was received by the head office on 3<sup>rd</sup> January 2003. Make journal entries in the books of Head Office and Branch to incorporate the Goods/Cash in Transit.

**Hints:**

When cash is remitted by the branch to the Head Office, the Head Office account is debited by the branch, but it is not received by the Head Office, till after the closing period, naturally Branch account will not be credited by the Head Office. So, there will be a difference between the two balances. Therefore, in order to tally the Head Office a/c in its books with its own a/c in the Head Office books, an entry will be passed by the Branch by debiting cash in Transit a/c and crediting Head Office A/c. Cash in Transit will appear as asset in the balance Sheet and will be transferred to the debit of the Head Office account at the commencement of the next period.

Similarly, when goods are sent by the head office to a branch, branch accounts is debited by the Head Office. Having not received the goods till after the closing period, Branch will not give the credit to the Head Office account and as such there will be a difference between the two balances. Therefore, in order to tally the Branch account in its books with its own a/c in the Branch office books, an entry will be passed by debiting Goods in Transit account and crediting branch account. The Goods in Transit account will appear as an asset in the Balance Sheet and will be transferred to the debit of the Branch at the commencement of the next period.

**Solution:****Journal entry in the Head Office books to incorporate Goods – in Transit.**

		Dr.	Cr.
		Rs. P.	Rs. P.
2002 Dec.,	Good – in – Transit A/c To Dindigul Branch A/c (being the value of goods sent to Dindigul on 30 <sup>th</sup> Dec.,2002 was not received by the Branch till the closing period)	9,000.00	9,000.00

**Journal entry in the Head Office books to incorporate Cash – in Transit.**

		Dr.	Cr.
		Rs. P.	Rs. P.
2002 Dec.,	Good – in – Transit A/c To Dindigul Branch A/c	9,000.00	9,000.00

**NOTES**

	(being the value of goods sent to Dindigul on 30 <sup>th</sup> Dec., 2002 was not received by the Branch till the closing period)		
--	---	--	--

**Note:** The above entries will be reversed at the commencement the next period.

**Illustration: 6**

**TRIAL BALANCE OF DELHI HEAD.OFFICE AND ITS BRANCH AT  
MADRAS AS ON 31<sup>ST</sup> DECEMBER 2002**

	Head Office	Madras		Head Office	Madras
	Rs.	Rs.		Rs.	Rs.
Stock, 1 <sup>st</sup> Jan.2002	24,000	10,000	Sales	2,00,000	46,000
Purchases less returns	92,000	28,000	less returns	21,000	5,300
Goods received from HO		12,000	Creditors		
Wages	28,000	3,100	Goods sent to Branch	12,000	
Manufacturing Expe.	3,200	800	Head Office Account	60,000	15,000
Office Salaries	7,300	2,400	Capital	600	200
General Expenses	1,500	350	Discount earned		
Branch Account	20,500				
Cash in hand and at Bank	15,300	1,500			
Rent	3,000	1,000			
Machinery:					
Head Office	40,000				
Branch	16,000				
Furniture:					
Head Office	5,800				
Branch	2,200				
Carriage and freight	4,800	350			
	2,93,600	66,500		2,93,600	66,500

The Machinery and Furniture at the Head Office and the branch are to be depreciated at 10% and 5% respectively. The closing stock at Head Office is valued at Rs.25, 000 and Branch, it is valued at Rs.9, 000.

Prepare Trading and Profit and Loss Accounts in columnar form and consolidated Balance Sheet, Give Journal Entries required in Head Office Books to carry out the incorporation. Also show the Branch Account.

**Solution**

**HEAD OFFICE BOOKS**  
**JOURNAL**

Date	Particulars	L.F.	Dr. Rs. P.	Cr. Rs. P.
2002 Dec.31	<p>Madras Branch Account <span style="float: right;">Dr.</span>  To Branch Machinery Account  To Branch Furniture Account  <b>(being the depreciation on Branch fixed assets charged to Branch Account)</b></p>		1,710.00	1,600.00 110.00
	<p>Madras Branch Trading Account <span style="float: right;">Dr.</span>  To Madras Branch Account  <b>(being the incorporation of the following items from the Branch Account)</b>  <b>Trial Balance:</b></p>		54,250.00	54,250.00
	<p>Opening Stock <span style="float: right;">10,000</span>  Purchases <span style="float: right;">28,000</span>  Goods received from Head Office <span style="float: right;">12,000</span>  Wages <span style="float: right;">3,100</span>  Manufacturing Expenses <span style="float: right;">800</span>  Carriage and Freight <span style="float: right;">350</span>  <hr style="width: 100px; margin-left: auto; margin-right: 0;"/> <span style="float: right;">54,250</span></p>			
	<p>Madras Branch Account <span style="float: right;">Dr.</span>  To Madras Branch Trading A/c  <b>(being the incorporation of the following items from the branch Trial balance)</b></p>		55,000.00	55,000.00
	<p>Sales less returns <span style="float: right;">46,000</span>  Closing Stock <span style="float: right;">9,000</span>  <hr style="width: 100px; margin-left: auto; margin-right: 0;"/> <span style="float: right;">55,000</span></p>			
	<p>Madras Branch Trading Account <span style="float: right;">Dr.</span>  To Madras Branch Profit and Loss A/c</p>		750.00	750.00

NOTES

(being the transfer of Gross Profit and Loss Account)			
Madras Branch Profit and Loss Account Dr.		5,460.00	
To Madras Branch Account			5,460.00
(being the Branch Trial Balance:			
Office Salaries	2,400		
General Expenses	350		
Depreciation on Fixed			
Assets	1,710		
Rent	1,000		
	<u>5,460</u>		
Madras Branch Account Dr.		200.00	
To Madras Branch P&L A/c			200.00
(being the discount earned by Madras Branch taken to Branch P&L A/c)			
General Profit and Loss Account Dr.		4,510.00	
To Madras Branch P&L A/c			4,510.00
(being the Branch Loss transferred)			
Branch Debtors Account Dr.		7,000.00	
Branch Cash Account Dr.		1,500.00	
Branch Stock Account Dr.		9,000.00	
Branch Remittances in transit A/c Dr.		5,500.00	
To Madras Branch Account			23,000.00
(being the incorporation of Branch Assets from the Trial Balance)			
Madras Branch Account Dr.		5,300.00	
To Branch Creditors Account			5,300.00
(Being the incorporation of Branch liabilities in the Head Office books.)			

**MADRAS BRANCH ACCOUNT**

Dr.

Cr.

2002		Rs.	2002		Rs.
Dec.31	To Balance b/d	20,500	Dec.31	By Branch Trading A/c	
	To Branch Assets-Depreciation	1,710		Opening Stock Purchases	54,250
	To Branch Trading A/c Sales & Stock	55,000		Wages Carriage etc.	
				By Branch P&L A/c	
				Expenses	5,460

To Branch P&L A/c Discount	200		By Branch Assets	23,000
To Branch Creditors	82,710			82,710

### TRADING AND PROFIT AND LOSS ACCOUNT

Dr.

Cr.

	Head Office	Madras Branch		Head Office	Madras Branch
	Rs.	Rs.		Rs.	Rs.
To Opening Stock	24,000	10,000	By Sales less returns	2,00,000	46,000
Purchases less returns	92,000	28,000	By Goods Supplies To Madras	12,000	9,000
To Goods received from HO		12,000	By Closing Stock	25,000	
To Carriage and freight	4,800	350			
To Wages	28,000	3,100			
To Manufacturing Expen.	3,200	800			
To Gross Profit c/d	85,000	750			
	2,37,000	55,000		2,37,000	55,000
To Office Salaries	7,300	2,400	By Gross Profit b/d	85,000	750
To General Expenses	1,500	350	By Discount	600	200
To Depreciation Machinery at 10%	4,000	1,600	By Net Loss		4,510
To Rent	3,000	1,000			
Furniture at 5%	290	110			
To Net Profit	69,510				
	85,600	5,460		85,600	5,460

### BALANCE SHEET As at 31<sup>st</sup> December 2002

LIABILITIES	Rs.	Rs.	ASSETS	Rs.	Rs.
Sundry Creditors			Cash in hand and Bank:		
Head Office	21,000		Branch	15,300	16,800
Branch	5,300	26,300	Cash in transit	1,500	5,500
Capital Account			Sundry Debtors		
Balance 1.1.2002	60,000		Head Office	25,000	
Add: Profit during the year	65,000	1,25,000	Branch	7,000	32,000
(Head Office Profit			Furniture		

**NOTES**

69,510) Less Branch Loss 4,510)			Head Office	5,800	7,600
			Branch	2,200	
				8,000	
			Less: Depreciation Machinery	400	
			Head Office:	40,000	
			Branch	16,000	
				56,000	
			Less: Depreciation	5,600	50,400
		1,51,300			1,51,300

**Illustration: 7**

Following are Trial Balances of X Ltd and its Lucknow Branch as on Dec.21,2002.

	Head Office	Lucknow		Head Office	Luknow
	Rs.	Rs		Rs.	Rs.
Stock on 1 <sup>st</sup> Jan.2002	50,000	15,000	Sales	3,50,000	86,000
Purchases	1,23,000	31,000	Goods sent to Br.	12,000	
Wages	70,000	16,000	Creditors	20,000	5,500
Manufacturing Expenses	40,000	8,000	Head Office A/c		22,000
Rent	5,000	3,000	Purchases Returns	3,000	1,000
Salaries	25,000	6,000	Discount earned	800	200
General Expenses	9,000	4,700	Capital in Shares of Rs.10 each	1,50,000	
<b>MACHINERY:</b>					
Head Office	76,000	-			
Branch	45,000	-			
<b>FURNITURE</b>					
Head Office	6,000	-			
Branch	1,500	-			
Debtors	42,000	17,500			
Goods received from Head Office		12,000			
Cash in Hand and at Bank	15,300	1,500			
Branch Account	28,000				
	5,35,800	1,14,700		5,35,800	1,14,700

Stock on 31<sup>st</sup> Dec.2002 at the Head Office was valued at Rs.44,000 and at Lucknow it was valued at Rs.26,000. Rent outstanding in respect of 2002 was Rs.8,000 (for branch). Depreciation is to be provided on machinery and furniture at the rate of 15% and 20% respectively.

Prepare the Trading Profit and Loss Account in columnar form and consolidated Balance Sheet. Give also the journal entries required in the Head Office book, to carry out the incorporation of branch assets and branch liabilities. Also furnish Branch Account.

### HEAD OFFICE BOOKS

#### JOURNAL

Date	Particulars	L.F.	Dr. Rs. P.	Cr. Rs. P.
2002 Dec.31	Lucknow Branch Account Dr. To Branch Machinery Account To Branch Furniture Account (being the depreciation on fixed assets branch)		7,050.00	6,750.00 300.00
	Lucknow Trading Account Dr. To Lucknow Branch Account (being the construction of branch trading account from the branch trial balance items)		81,000.00	81,000.00
	Trial Balance:			
	Stock 15,000			
	Purchases less Returns 30,000			
	Wages 16,000			
	Manufacturing Expenses 8,000			
	Goods 12,000			
2002 Dec.31	Lucknow Branch Account Dr. To Lucknow Trading Account (being the construction of branch trading account from the branch trial balance items)		1,12,000.00	1,21,000.00
	Sales 86,000			
	Stock 26,000			

**NOTES**

Lucknow Trading Account	Dr.	31,000.00	
To Lucknow Profit and Loss Account (being the transfer of gross profit to the branch; profit and loss account)			31,000.00
Lucknow Profit and Loss Account	Dr.	21,550.00	
To Lucknow Branch Account (being the construction of branch profit and loss account with branch trial balance items)			21,550.00
Rent (including outstanding)	3,800		
Salaries	6,000		
General Expenses	4,700		
Depreciation	7,050		
Lucknow Branch Account	Dr.	200.00	
To Lucknow Profit and Loss Ac (being the discount earned at Lucknow, credited to branch and loss account)			200.00
Lucknow Profit and Loss Account	Dr.	9,650.00	
To General Profit and Loss Account (being the net Profit of Lucknow branch transferred to General Profit and Loss Account)			9,650.00
Branch Debtors Account	Dr.	17,500.00	
Branch Cash Account	Dr.	1,500.00	
Branch in Transit Account	Dr.	6,000.00	
Branch Stock Account	Dr.	26,000.00	
To Lucknow Branch Account (being the transfer of various branch assets to the head office books)			51,000.00
Lucknow Branch Account	Dr.	6,300.00	
To Branch Creditors Account			5,500.00
To Branch Expenses outstanding A/c (being the transfer of branch liabilities to the head office books)			800.00

## LUCKNOW BRANCH ACCOUNT

Dr.

Cr.

		Rs.			Rs.
2002 Dec.31	To Balance b/d	28,000	2002 Dec.31	By Lucknow Trading A/c	81,000
	To Br.Assets Depreci.	7,050		Op.Stock,Purchases etc., By Lucknow P&L A/c	21,550
	To Lucknow Trading A/c.	1,12,000		Expn., By Sundry Assets	51,000
	To Lucknow P&L A/c Discount	200			
	To Sundry Liabilities	1,53,550			1,53,550

## X LTD. TRADING AND PROFIT AND LOSS ACCOUNT

FOR THE YEAR ENDED 31<sup>ST</sup> DECEMBER 2002

	Head Office	Lucknow		Head Office	Lucknow
	Rs.	Rs.		Rs.	Rs.
To Opening Stock	50,000	15,000	By Goods sent to Branch	12,000	
To Purchases Less Returns	1,20,000	30,000	By Sales	3,50,000	86,000
To Good Received From H.O		12,000	By Closing Stock	44,000	26,000
To Wages	70,000	16,000			
To Manufacturing Expenses	40,000	8,000			
To Gross Profit-c/d	1,26,000	31,000			
	4,06,000	1,12,000		4,06,000	1,12,000
To Rent (paid and Outstand.)	5,000	3,800	By Gross Profit b/d	1,26,000	31,000
To Salaries	25,000	6,000	By Discount	800	200
To General Expens.,	9,000	4,700			
To Depreciation Machinery at 15%	11,400	6,750			
Furniture at 20%	1,200	300			
To Net Profit	75,200	9,650			
	1,26,800	31,200		1,26,800	31,200

## BALANCE SHEET

As at 31<sup>ST</sup> December 2002

LIABILITIES	Rs.	Rs.	ASSETS	Rs.	Rs.
Share Capital: 15000 share of Rs.10 each fully paid		1,50,000	FIXED ASSETS: Machinery H.O. Branch	76,000 45,000	

**NOTES**

<b>Profit and Loss A/c</b>				1,21,000	
<b>Profit at A.O.</b>	75,200			18,150	1,02,850
<b>At Branch</b>	9,650	84,850	Less: Depreciation		
<b>Sundry Creditors</b>			Furniture: H.O.	6,000	
<b>H.O.</b>	20,000		Branch	1,500	
<b>Branch</b>	5,500	25,500	Less: Depreciation	7,500	6,000
				1,500	
<b>Rent outstanding at</b>			Stock H.O.	44,000	
<b>branch</b>		800	Branch	26,000	70,000
			Debtors: H.O.	42,000	
			Branch	17,500	59,500
			Cash H.O.	15,300	
			Branch	1,500	
			In Transit	6,000	22,800
		2,61,150			2,61,150

**Second Method:** Under this method, the branch Trading and Profit and Loss Account is prepared only as Memorandum Account and as such only the net or profit loss made at the branch is records in the Head Office Books.

For recording the	Branch Account	Dr.
Net Profit of the branch	To General P& L Account	
For recording the	General P & L Account	Dr.
Net loss of the branch	To Branch Account	

Thus for solving the above illustration under the second method. Only the following entries are passed.

Lucknow Branch Account	Dr.	Rs.	Rs.
To Branch Machinery Account		7,050	6,750
To Branch Furniture Account			300
(being the depreciation branch fixed assets charged to Lucknow Branch)			
Lucknow Branch Account	Dr.	Rs.	Rs.
To General Profit and Loss Account		9,650	9,650
(being profit of branch, transferred to General Profit And Loss Account)			

Assuring that the assets and liabilities of the branch are not going to be incorporated, then no journal entries are passed in that circumstance the Lucknow Branch Account will appear as under;

**First Method:****BRANCH BOOK-JOURNAL**

Date	Particulars	L.F.	Dr.		Cr.	
			Rs.	P.	Rs.	P.
2002 Dec.31	Cash in Transit Account Dr. To Head Office Account (being the cash in transit, brought into account for adjusting the difference between the Branch Account in the Head Office books and the Head Office Account in the Branch book)		6,000.00			6,000.00
	Depreciation Account To Head Office Account (being the depreciation on branch fixed assets, the accounts for which are maintained by the head office)	Dr.		7,500.00		7,500.00
	Rent Account To Outstanding Expenses Account (being the outstanding Rent Adjusted)	Dr.		800.00		800.00
	Head Office Account To Opening Stock To Purchases To Goods Received from H.O.	Dr.	1,03,550.00			15,000.00 31,000.00 12,000.00

NOTES

	To Wages			16,000.00
	To Manufacturing Expenses			8,000.00
	To Rent			3,800.00
	To Salaries			6,000.00
	To General Expenses			4,700.00
	To Depreciation			7,050.00
	(being the transfer of various items(debit balances) to the Head Office Account)			
2002	Sales Account	Dr.	86,000.00	
Dec.31	Closing Stock	Dr.	26,000.00	
	Purchases Returns	Dr.	1,000.00	
	Discount	Dr.	200.00	
	To Head Office Account			1,13,200.00
	(being the transfer is credit items of revenue nature, to the Head Office Account)			
	Head Office Account	Dr.	51,000.00	
	To Closing Stock			26,000.00
	To Cash in hand at Bank			1,500.00
	To Cash in Transit			6,000.00
	To Debtors			17,500.00
	(being the transfer of various assets to the Head Office Account)			
	Sundry Creditors	Dr.	5,500.00	
	Expenses outstanding	Dr.	800.00	
	To Head Office Account			6,300.00
	(being the transfer of various liabilities to the Head Office Account)			

HEAD OFFICE ACCOUNT

Dr.

Cr.

2002	To Sundries (total of	Rs.	2002	By Balance c/d	Rs.
Dec.31	Debit revenue items)	1,03,550	Dec.31	By Cash in Transit	6,000
	To Sundries Assets	51,000		By Depreciation on	
				Branch fixed assets	7,050

				By Sundries total of (credit)revenue items	1,13,200
				By Sundries liabilities	6,300
		1,54,550			1,54,550

**SECOND METHOD:** Under this method, journal entries are passed adjust Cash in transit, Depreciation and Rent outstanding. They are similar to the first three entries passed under the first method. A Branch Trading and Profit and Loss Account is prepared and the result (viz., the net profit) is transferred to the Head Office as under:

**A) Short Answer Question:**

1. What are the different kinds of Branches?
2. What are the features of Dependent Branches?
3. Briefly explain the Debtor system of maintaining a Branch a/c?
4. What do you understand by stock and Debtors system?
5. What do you understand by a 'whole sale branch'?
6. Explain the reasons for sending goods to branches at Invoice price?
7. Briefly explain the meaning of goods in Transit and cash in Transit

**B) Long Answer question**

1. Distinguish between Branch accounts and Departmental Accounts.
2. Explain the features of different types of branches and the type of accounting followed in them
3. Explain the procedure to maintain accounts of a branch under stock and debtor system

## NOTES

4. How do you prepare combined final accounts of Head office and its Branch?

### Problems

1. Good luck ltd. opened a branch on 1.1.95 at Calcutta. The following information is supplied to you. Prepare Branch account.

Goods sent to branch	50,000
Sales: Cash	20,000
Credit	36,000
Cash Received from Debtors	32,000
Discount allowed to them	600
Cash sent to branch for expenses	7,000
Stock on 31-12-95	8,000
Debtors on 31-12-95	3,400

**(Ans: Profit: Rs. 6,400)**

2. From the following particulars relating to Madurai Branch, prepare Branch account in the books of Head office for the year ended 31<sup>st</sup> December 94

Stock	1.1.94	30,000
Debtors	1.1.94	12,000
Petty cash	1.1.94	200
Goods sent to branch		50,000

**NOTES**

Goods returned to H.O	600
Sales at branch cash	30,000
Credit	42,000
Sales return at branch	300
Bad debts written off	300
Branch expenses paid by H.O	3,000
Petty cash sent to Branch	500
Petty cash 31.12.94	300
Stock 31.12.94	12,500

**(Ans: Closing Debtors Nil, Cash collected from Debtors Rs. 53,400, Profit: 1,100)**

## DEPARTMENTAL ACCOUNTS

### Meaning of Departments and Departmental Accounting

**What are departments?**

An organization may produce or buy and sell several products or perform different services under the same roof or from the same premises.

An organization may produce or buy and sell several products or perform different services under the same roof or from the same premises. The modern practice is to divide the organization into independent departments; each of which may deal in a particular class of goods or render a specialized type of service. For example, a readymade garments firm may be divided into tailoring and selling departments, a departmental store may be divided into tailoring and selling departments, a departmental store may be divided into textiles, provision, durable goods departments etc.

When accounts are finalized at the end of the year, the usual method of trading and profit and loss account is not suitable for each organization. The owners or the management may desire to ascertain the trading results of each department and the overall result of the organization.

The method of accounting which is followed to obtain such results is known as Departmental Accounting.

### Need for Departmental Accounting

Accounts which reveal expenses, incomes, sales, stocks, gross profit and net profit separately for each department are needed:

- i) To compare the results of each department with the results of previous years and ascertain the trend.
- ii) To know the comparative results of different departments in the same year.
- iii) To assess the position of stocks in each department.

- iv) To identify areas of weakness for cost control and improvement of efficiency.
- v) To decide upon expansion, discontinuation and investment policies.

**Advantages of Departmental Accounting**

The following are the benefits derived by business firms through departmental accounting.

- i) **Ascertainment of profit:** Gross profit and net profit can be ascertained for each department separately on a reliable basis.
- ii) **Comparative Performance:** The results of different departments can be compared in terms of profit, expenses, inventories, percentage of growth, return on investment etc.
- iii) **Appraisal of personnel:** Individuals responsible for improved results or decline in performance can be identified. This is useful in implementing incentive system.
- iv) **Remedial measures:** Areas of poor performance can be identified for implementing remedial measures. If situation warrants, decisions to discontinue some products or closing a department may be taken accurately.
- v) **Policy formulation:** Management policies towards inventories, extending credit, additional investment etc., are facilitated.

**Advantages of Departmental Accounting**

- 1. Ascertainment of profit
- 2. Comparative performance
- 3. Appraisal of personnel
- 4. Remedial measures
- 5. Policy formulation

**Distinction between departments and branches**

- 1. **Location:** All the departments are located within single premises. Branches are located in different geographical areas, physically separated from the head office and one another.

## NOTES

2. **Growth:** Departments are confined to local business and can grow vertically within the same roof.
3. **Accounting:** All the accounting records are centralized and maintained within the same premises for all the departments. Branch keep records of their operations separately. The head office consolidates the accounts of all the branches.
4. **International operation:** Departments are confined to a single place unless similar organizations are opened elsewhere. Branches can be started anywhere in the world. So, there can be local and foreign branches.

### **Methods and Techniques of Departmental Accounting**

1. When accounts are finalized, departmental trading and profit and loss account is prepared in columnar form to find gross profit and net profit of each department.

A general profit and loss account is also prepared to find the overall profit or loss of the firm. The balance sheet is common and shown the position of the business as a whole.

#### **2. Maintenance of Records**

Organization with huge turnover and large number of transactions can maintain separate subsidiary books for each department. Medium and small sized firms can maintain purchase book, sales book and the returns books with appropriate columns for each department. Even the cash book can be similarly bifurcated. In the ledger separate accounts are opened for sales, purchases, wages etc. of each department. Closing stock can be separately ascertained at the time of stock taking.

3. **Departmental expenses:** In order to find out profit or loss of each department apart from sales, purchases, returns and stocks, various expenses must be charged to the departments appropriately.

**Business expenses are usually divided into two types-1.Direct expenses, 2. Indirect expenses.**

**Direct expenses:** Expenses which can be directly identified with or incurred for particular departments are called direct expenses. Examples are wages, carriage inwards, salary to the departmental staff, and insurance of stock.

**Indirect expenses:** Expenses which cannot be identified with a particular department, but incurred for their common benefit are called indirect expenses.

**Indirect expenses are further sub-divided into:**

- i) Expenses which cannot be apportioned
- ii) Expenses which can be apportioned

**Expenses which cannot be apportioned examples** (Debenture interest, income tax, dividends paid, director's fees, bank charges, legal expenses etc.)

**Expenses which can be apportioned examples** (Selling expenses, salaries, rent, depreciation, lighting, power, repairs, etc.)

**What are direct expenses?**

Expenses which can be directly identified with or incurred for particular departments are called direct expenses.

**NOTES**

The following table provides guidelines for logical apportionment of such expenses.

S.No	Expenses	Basis of apportionment
1	Selling expenses like sales commission , salesmen salaries, advertising, bad-debts, carriage outwards etc.	Sales Ratio or Turnover Ratio of departments.
2.	Rent and Rates, Repairs to Building, maintenance of premises, building insurance, depreciation etc.,	Floor area or space occupied by each department.
3	Depreciation of fixed assets like furniture, fixtures, machinery, fire insurance, repairs on such assets...	Value of each asset possessed by different departments.
4.	Lighting	Light points in the departments. If this not available, floor area occupied
5.	Power	Consumption as per meter. Otherwise, Horsepower of the machines and the working time in hours or days.
6.	Carriage Inward	Purchase value
7	Workmen amenities and welfare expenses	Number of workers in each department.
8.	Workmen's compensation Insurance, ESI, PF etc. payable by employer.	Wages of each debarment.
9.	Factory manager's salary	Time devoted to each department.
10.	Premium for loss of profits insurance	Profit of each debarment in the previous year.

**What is workmen's Compensation?**

Workmen 'compensation is death or injury suffered by a worker in the course of his employment.

**Illustration: 1**

Following is Trial Balance of Mr. Rajan on 31.12.1992

		Dr.	Cr
		Rs.	Rs.
Capital A/c			40,000
Drawings/c		1,500	
Opening Stock	Dept. A	8,500	-
	Dept. B	5,700	-
	Dept. C	1,200	-
Purchases	Dept. A	22,000	-
	Dept. B	17,000	
	Dept. C	8,000	
Sales	Dept. A	-	54,000
	Dept. B	-	33,000
	Dept. C	-	21,000
Sales Return	Dept. A	4,000	
	Dept. B	3,000	
	Dept. C	1,000	
Freight and Carriage	Dept. A	1,400	
	Dept. B	800	
	Dept. C	200	
Wages	Dept. A	800	
	Dept. B	550	
	Dept. C	150	
Furniture & fixtures		4,600	

**NOTES**

Plant and Machinery	20,000	-
Bills Receivable	4,200	-
Bills Payable	-	8,000
Motor Vehicles	40,000	
Sundry Debtors	8,000	
Sundry Creditors	-	7,000
Salaries	4,500	
Power and Water	1,200	
Telephone Charges	2,100	
Bad debts	750	
Rent and Taxes	6,000	
Insurance	1,500	
Printing and Stationery	2,000	
Advertising	3,500	
Bank overdraft	-	12,000
	<b>1, 75,000</b>	<b>1, 75,000</b>

Prepare Departmental Trading and Profit and Loss A/c and the Balance Sheet taking into account the following adjustments:

- A) Outstanding Wages: Dept. B = Rs.150, Dept. C = Rs. 50
- b) Salaries Payable = Rs. 500
- c) Depreciate plant & machinery and motor vehicles @ 10%
- d) Create a Reserve of 5% for bad and doubtful debts.
- e) Each Department shall share the expenses in proportion to their sales.
- f) Closing stock: Dept. A = Rs.3, 500, Dept.B = Rs.2. 000 & Dept C =Rs. 1500

**Solution:**

**Departmental Trading A/c of Mr. Rajan for the year ending 31-12.92**

	A	B	C		A	B	C
	Rs.	Rs	Rs.		Rs.	Rs.	Rs..
To Opening Stock	8,500	5,700	1,200	By sales	54,000	33,000	21,000
To purchases	22,000	17,000	3,000	Less: Sales Returns	4,000	3,000	1,000
To Freight & Carriage	1,400	800	200	Net Sales	50,000	30,000	1,500
To Wages due	800	700	200	By Closing stock	3,500	2,000	1,500
To power & water	20,200	7,440	11660				
	53,500	32,000	21,500		53,500	32,000	21,500

**NOTES**

Departmental Profit & Loss A/c of Mr. Rajan for the year ending 31-12-92

	A	B	C		A	B	C
	Rs.	Rs.	Rs.		Rs.	Rs.	Rs.
To Salaries (5000) (Including due)	2,500	1,500	1,000	By gross profit	20,200	7,440	11,660
To Telephone charges	1,050	630	420				
To Bad debts	375	225	150				
To Rent & taxes	3,000	1,800	1,200				
To Insurance	750	450	300				
To Printing & Stationery	1,000	600	400				
To Advertising	1,750	1,050	700				
<b>To Depreciation:</b>							
On Plant & Machinery	1,000	600	400				
On Motor vehicles	2,000	1,200	800				
To provision for debtors	200	120	80				
To Net profit	6,575		6,210	By Net Loss	-	735	-
	20,200	8,175	11,660		20,200	8,175	11,660

Note: All expenses dividend in Sales Ratio, as per instruction given.

Sales Ratio = A- Rs.50, 000. B – Rs.30, 000 C – Rs.20, 000 or 5:3:2

## Balance Sheet of Mr. Rajan as on 31-12-92

Liabilities			Rs.	Assets	Rs.	
Capital	40,000			Fixture & Furniture		4,600
Less: Drawings	1,500	38500		Plant & Machinery	20,000	
	-----			Less: 10% depreciation	2000	
Add: Net profit (6,575+6,210)		12785			-----	18,000
		-----		Motor vehicle	40,000	
		51285		Less: 10% depreciation	4,000	
Less: Net loss (Dept. B)		735			-----	36,000
		-----	50,550	Bills receivable		4,200
Salary due			500	Sundry Debtors	8,000	
Outstanding wages				less: 5% provision	400	
Dept B	150				-----	7,600
Dept C	50			Cash in hand		850
	----		200	Stock:		
Bills payable			8,000	Dept A	3,500	
Sundry creditors			7,000	Dept B	2,000	
Bank overdraft			12,000	Dept C	1,500	
					-----	7,000
			-----			-----
			78,250			78,250

**NOTES****Illustration: 2**

The proprietor of a large retail store wished to ascertain approximately the net profit of the X, Y and Z departments separately for the three months ended 31<sup>st</sup> March 1996. It is found impracticable actually to take stock on that date, but an adequate system of departmental accounting in use, and the normal rates of gross profit for the three departments concerned are respectively 40% 30% and 20% on turnover before charging the direct expenses. The indirect expenses are charged in proportion to departmental turnover:

The following are the figures for the departments:

	X Rs.	Y Rs	Z Rs.
Opening stock 1-1-96	10,000	14,000	7,000
Purchases	12,000	13,500	9,700
Sales	20,000	18,000	16,000
Direct expenses	2,000	1,500	700

The total indirect expenses for the period (including those relating to other departments) were Rs.5, 400 on the total turnover of Rs.1, 08,000

Prepare a statement showing the approximate net profit, making a stock reserve of 10% for each department on the estimated value on 31-3-96.

**Solution:**Trading and Profit and Loss account of X, Y and Z for the year ended 31<sup>st</sup> March 1996

	X Rs.	Y Rs.	Z Rs.		X Rs.	Y Rs.	Z Rs.
To opening stock	10,000	14,000	7,000	By Sales	20,000	18,000	16,000
To Purchases	12,000	13,500	9,700	By closing (bal.fig)	10,000	14,900	3,900
To Gross profit	8,000	5,400	3,200				
	<u>30,000</u>	<u>32,900</u>	<u>19,900</u>		<u>30,000</u>	<u>32,900</u>	<u>19,900</u>
To Direct exp	2,000	1,500	700	By gross profit	8,000	5,400	3,200
To Indirect exp	1,000	900	800				
To Stock reserve@10%	1,000	1,490	390				
To Net profit (bal.fig)	4,000	1,510	1,310				
	<u>8,000</u>	<u>5,400</u>	<u>3,200</u>		<u>8,000</u>	<u>5,400</u>	<u>3,200</u>

**NOTES****Exercise**

1. You are given the following particulars of a business having three departments:

	Purchases	Opening stock	Closing stock
Dept A:	1,500 units	200 units	100 units
Dept B:	1,000 units	300 units	160 units
Dept C:	2,000 units	150 units	200 units

Additional information:

- (a) Purchases were made at a total cost of Rs.92, 000.
- (b) The percentage of gross profit on turnover is the same in each case
- (c) Purchase and sale prices are constant for the last 2 years.
- (d) Selling per unit:

Dept A = Rs.20

Dept B = Rs.25

Dept C = Rs.30

You are required to prepare Departmental Trading Account.

2. The following purchases were made by a business house having three departments.

Department A	-----	1000 Units	}	at total cost Rs.100000
Department B	-----	2000 Units		
Department C	-----	2400 Units		

Stocks on 1st January were:

Dept.A	-----	120 Units
Dept.B	-----	80 Units
Dept.C	-----	152 Units

Sales were:

Dept.A	1020 units at Rs.20 each
Dept.B	1920 units at Rs.22.50 each
Dept.C	2496 units at Rs.25 each

The rate of gross profit is same in each case. Prepare departmental trading account.

## ACCOUNTING FOR INSURANCE CLAIMS

### Need for Fire Insurance

Fire in the business premises of any firm, can damage number of assets like stock, buildings, furniture, fixtures, machinery etc. In addition, the normal working of a firm affected for a number of days or months, resulting in loss of sales and loss of profits. It is very difficult for a business to replace all the destroyed assets and normalize its working without affecting its working capital position and cash position. During such difficult times, external help is like a boon to the business. All prudent business firms insure their stock and also other assets against the risk of fire. They take appropriate Insurance Policy from a recognized company by paying required premium. This enables the business to lodge claim against insurance company and receive sufficient funds to replace the lost assets.

Insurance companies investigate any claim made through experienced assessors they evaluate the causes for fire and the actual loss through the damage. Based on the assessor's report, insurance company settle the claim made against it for lost due to the fire.

### Types of Fire Insurance Policies

There are two major types of policies issued by insurance companies – loss of stock policies and loss of profits or consequential loss policies.

#### Loss of Stock Claims

Business units who have insured their godown or store against the risk of loss of stock by fire are eligible to lodge loss of stock claims when a fire causes loss of their stock

**What is an insurance claim?**

Demand for payment in accordance with an insurance policy.

**Types of Fire Insurance policies**

1. Loss of stock policies
2. Loss of profits (or) consequential loss.

**Salvage:** - Fire may destroy some items of stock completely. Some other portion of stock may be damaged and some items of stock may not be affected at all.

The damaged and undamaged stock are separately valued and are called salvage value are Stock Salvaged.

When claim is lodged for loss of stock, stock salvaged is subtracted from Stock on the date of fire and claim is made for the balance amount.

(A) Computation of claim to be lodged for loss of stock

They are the major points to be noted for calculating claim for loss of stock:

- (1) If a separate stock account is maintained by the firm, (which is possible if a Cost Accounting Department exists), stock on the date of fire can be taken from the ledger account of stock. After subtracting Salvaged Stock, claim can be lodged for the balance
- (2) In majority of firms, no ledger account is maintained for stock. So, value of stock on the Date of Fire must be found indirectly using Gross Profit Ratio as basis.

If the normal gross profit percentage of the firm to its sales is available; a Memorandum Trading Account can be prepared for the period from the beginning of the accounting year till the date of fire. Gross profit is shown as a percentage of sales. The balancing figure in the Memorandum Trading Account is Stock on the date of fire.

**What is salvage?**

Prevent being  
ruined, destroyed,  
lost, or harmed.

**Memorandum Trading Account for the period...**

Particulars	Amount Rs.	Particulars	Amount Rs.
To opening stock	xxx	By sales	xxx
To purchases	xxx	By stock on the date Of fire (bal.fig)	xxx
To Gross profit c/d (Sales gross profit ratio)	xxx		
	-----		-----
Total	xxx		xxx

**(3) Gross Profit Ratio**

When ledger account for stock is not maintained, gross profit ratio to sales is the vital link to compute the claim. The following relevant points for this ratio are noted.

$$(a) \text{ Gross profit ratio} = \frac{\text{Gross profit}}{\text{Sales}} \times 100$$

Previous accounting years gross profit and sales can be used for gross profit ratio.

- (b) If information about two or more previous years is given the average gross of all the years has to be taken.
- (c) If gross profit of previous years is not directly given, previous years trading account has to be prepared to find gross profit.
- (d) Abnormal practices followed in the previous years like under valuation of stock or over valuation of stocks must be adjusted to find normal gross profit
- (e) Any samples given out of purchases, goods drawings, suppression of sales etc., must be adjusted.

Advertising samples and goods drawings have to be reduced from purchases, sales suppressed should be added back to sales

**Illustration: 1**

Stock of Rs.80, 000 of M/s. Ram & Co has been insured for Rs. 70,000. Loss due to fire is assessed at Rs.20, 000. Calculate what claim M/s. Ram & Co will get from the insurance company.

**Solution**

$$\begin{aligned} \text{Claim} &= \frac{\text{Insured value}}{\text{Total value of goods}} \\ &= \frac{70,000}{80,000} \times 20,000 \\ &= \text{Rs. } 17,500. \end{aligned}$$

**Illustration: 2**

On 31<sup>st</sup> December 1995, a fire occurred on the premises of a firm which carried on the business of general merchandise. The following was ascertained from various books, which were saved from fire:

Sales from 1 <sup>st</sup> January to 31 <sup>st</sup> December, 1995	Rs. 12, 80,000
Purchases from 1 <sup>st</sup> January to 31 <sup>st</sup> December 1995	Rs. 8, 40,000
Stock on hand on 31 <sup>st</sup> December 1994	Rs. 2, 36,000

Gross profit for the past five years had averaged at 35% on sales.

The value of stock salvaged was agreed at Rs.25, 000. Prepare a statement showing amount of the claim on the insurance company. There was no average clause in the policy.

## Solution

## Calculation of claim

Trading account for the period ending 31<sup>st</sup> December 1995

To Stock	2, 36,000	By Sales	12, 80,000
To Purchases	8, 40,000	By Stock on the date of fire	2, 44,000
To G.P	4, 48,000		
	15, 24,000		15,24,000

## Claim

Stock on 31 <sup>st</sup> December 1995	2, 44,000
Less: Salvaged stock	<u>25,000</u>
	<u>2, 19,000</u>

## Illustration: 3

ABC & Co have taken out a fire policy of Rs.80, 000 covering its stock in trade. A fire occurs on 31<sup>st</sup> March 1996 and stock was destroyed with the exception of Rs.20, 680 worth. Following particulars are available from the books of account of the firm:

Stock as on 1 <sup>st</sup> Jan. 1996	30,000
Purchases to the date of fire	1, 30,000
Sales to the date of fire	90,000
Commission paid to the purchase Manager:	.
On purchases	2%
Carriage paid on	800

Average gross profit on cost 50%

The policy was subject to average clause. You are required to arrive at the (i) total loss of stock, and (ii) amount of claim to be made against the insurance company.

**Solution** **M/s ABC & Co**

**Trading account for the period ending 31<sup>st</sup> March 1996**

Dr			Cr
To Op. Stock	30,000	By Sales	90,000
To Purchases	1, 30,000	By Stock on the date fire	1, 03,400
To Commission on purchase	2,600		
To Carriage	800		
To Gross profit	30,000		
	1,93,400		1,93,400

Stock on the date of fire Rs. 1,03,400

Less: Salvage 20,680

Loss of stock 82,720

80,000

Claim on average basis =  $\frac{80,000}{1,03,400} \times 82,720$

Rs. 64,000

### Exercise

1. Calculate insurance claim from the following facts assuming the insurers met their liability under the policy on average basis:

A trader's stock valued at Rs.40, 000 was totally destroyed. It was insured for Rs.30, 000 subject to average. The balance of the stock left after fire, appeared in the books at Rs.24, 000. **(Ans. Claim Rs.18, 750)**

2. A fire on a trade's premises destroyed the greater part of his stock and fittings and considerably damaged building. The trader made a claim on the insurance company and received his claim in full as follows:

Buildings	38,750
Stock	2,788
Fittings	762
Loss of profits	3,568

What entries should be made in the trader's books regarding the damage done and how should the amounts recovered under the claim be dealt with?

3. On 1<sup>st</sup> April 1991, the godown of M/s viji paper Mills Ltd. Was destroyed by fire. The records of the company revealed the following particulars:

Stock on 1 <sup>st</sup> Jan 1990	75,000
Stock on 31 <sup>st</sup> December 1990	80,000
Purchases during 1990	3,10,000
Sales during 1990	4,00,000
Purchases from 1 <sup>st</sup> Jan 1991 to the date of fire	75,000

Sales from 1<sup>st</sup> Jan 1991 to the date of fire 1,00,000

In valuing closing stock of 1990 Rs. 5,000 were written off whose cost was Rs.4,800. Part of this stock was sold in 1991 at a loss of Rs.400 whose cost was Rs.2,400. Stock salvaged was Rs.6,200. The godown was fully insured.

Prepare a statement showing the amount of claim to be made against the insurance company.

**(Ans: Rate of Gross profit on sales 25%, Amount of claim Rs.74,000)**

4. A fire on October 1, 1994 destroyed the stock of a firm. The business records were saved and from them the following particulars were ascertained:

Stock at cost on April 30, 1993	44,300
Stock at cost on April 30, 1994	37,550
Purchases for the year to April 30, 1994	1,03,850
Sales for the year to April 30, 1994	1,52,500
Purchases from May 1, 1994 to September 30, 1994	37,350
Sales from May 1, 1994 to September 30, 1994	59,000

In valuing the stock on April 30, 1994 Rs.800 had been written off a particular line of goods which had originally cost Rs. 1,800 and which were sold in June 1994 for Rs.1,750. Except as regards this transaction the ratio of gross profit has remained unchanged throughout.

The value of stock salvaged from the fire was Rs. 5,105. You are required to calculate the amount of the claim to be presented to the insurance company in respect of the loss of stock.

**(Ans: Claim Rs. 27,575)**

## NOTES

5. Mr. Ravi was insured for consequential loss. A fire occurred on March 31, 1996, and as a result there was diminished turnover (as compared with the corresponding months of the preceding year) of Rs.20,000; Ravi was insured for a period which adequately covered the dislocation and no special factors existed.

The accounts for last accounting period of a year to January 31, 1996, showed a net profit of Rs. 4,000 after debiting standing charges (all insured) Rs.6,000, the turnover being Rs.1,00,000. Ravi had taken fire policy of Rs.4,800 and that the turnover for the year immediately preceding the fire was Rs.64,000. Calculate claim on average basis.

**(Ans: Rs.1,520)**

