Financial Accounting

By

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Preface

I Thank You All mighty for his guidance and blessings. With the help of Class Tutor guidance and Accounts professor, we have started preparing book for accountancy. This book contains Theory part for accountancy with Table of content for easy reference.

I am sharing this book for review with Tutor mam, Accounts Professor and HOD mam for review and comments to improve the contents.

Self and Lokesh feel that this book may be helpful for students, we request you may please share this book to students for their reference.

Please share comments and ideas to improve further

We are planning to continue to prepare further study material for other subjects also with your guidance and blessing

Dedicating this edition to our respectable
HOD
Class Tutor
Accounts Professor

Thanking you

Looking for your guidance

Vijay Anandh A
Lokesh P

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Introduction to Accounting

Accounting is the method of recording all the business transaction which has financial impact/ transaction value referred in money / money's worth. This is a scientific way of recording transactions. Accounting is to record all the transaction has financial value happened between two or more legal entities.

For better understanding, we need to understand or define what is Legal entity.

Legal entity we can define simply entities which has legal rights to and Legal obligations related Business transaction, agreements, contracts, payments, penalty, manufacture, buy or sell or deal with end customer. From the above statement we can understand Legal entity includes an Individual, Group of person, Organization (Partnership firm, HUF, Corporates etc.)

Need for Accounting

Main purpose of any transaction between legal entities is Profit. Main aim of business is (Expect nonprofit oriented organization)to ensure profit, Accounting helps to track business progress at regular intervals say monthly, quarterly and yearly. This will help to understand business direction, root cause of deviation if any to implement corrective measure to improve with effectiveness.

Book keeping

Book keeping is an art and science of classifying, recording and summarizing business transactions in the money or money worth accurately and systematic manner. We should record all business transaction in journal entry/ subsidiary books and ledger.

To start Accounting we should understand Account standards and golden rules

Golden Rules

- ✓ Classify the transaction as money or money worth- Financial impact
- ✓ Understand transaction and identify legal entities involved in transaction
- ✓ Classify legal entities into 3 categories
    - Personal
        - Means transaction relates to any legal entity may be Individual, group of person, Partnership, HUF or corporate etc.
    - Real
        - Business elements which can be realized by seeing / touching like Cash, Building, Material, Vehicle, Land
    - Nominal
        - Business elements which cannot be seen/ touched but we can enjoy the benefit of element and we can share the benefit element to other legal entity Ex. Rent Paid, Interest Paid, Salary Received etc.

- ✓ Apply suitable golden rules to create journal entry keeping above points in mind
- ✓ Transaction has to be entered in the books of legal entity from their point of view
- ✓ Create journal entry applying all the above points

Accounting Golden Rule

Personal Account

Debit the receiver

Credit the giver

Real account

Debit what comes in

Credit what goes out

Nominal Account

Debit All expenses and Loss

Credit All Incomes and Gains

Applying Golden Rules to create journal entry

Ram & co sold goods for 10000

Cash A/c	10000	
To Sales A/c		10000
(Cash Sales for Rs.10000)		

Ram & co sold goods to Ramesh 10000

Ramesh A/c	10000	
To Sales A/c		10000
(Credit sales to Ramesh)		

<u>Journalize the following Business transaction</u>

1. Commenced Business with 100000
2. Deposited cash into SBI 22000
3. Purchased Inventory for 5000
4. Purchased goods from Reliance for 20000
5. Sold goods to Anbu and received cash 50000
6. Paid salary 7000
7. Paid LIPTON 15000 by Cheque
8. Bought furniture by cash 17000

Date	Description	LF	Debit	Credit	
	Cash A/c		100,000.00		Real Account
	To Capital A/c			100,000.00	Nominal Account
	(Commenced Business with Cash)				
	Bank A/c		22,000.00		Real Account
	To Cash A/c			22,000.00	Real Account
	(Cash deposited in Bank)				
	Inventory A/c		5,000.00		Real Account
	Cash A/c			5,000.00	Real Account
	Pruchased inventory by cash				
	Inventory A/c		20,000.00		Real Account
	To Reliance A/c			20,000.00	Personal Account
	(credit purchase)				
	Cash A/c		5,000.00		Real Account
	To Sales A/c			5,000.00	Nominal Account
	Cash sales				
	Salary A/c		7,000.00		Nominal Account
	To Bank A/c			7,000.00	Real Account
	Salary paid				
	Reliance A/c		15,000.00		Personal Account
	To Bank A/c			15,000.00	Real Account
	paid to creditor Reliance				
	Furniture A/c		7,000.00		Real Account
	To Cash A/c			7,000.00	Real Account
	Furniture purchased by cash				

Accounting Standards

Accounting standards of India was defined and still evolving to grow. Initially was defined, set up by Accounting Standards Board (ASB) of India. Institute of Chartered Accounts of India being Indian premier accounting body has put enormous about to improve evolving Indian accounting standards. Accounting Standards Board was constituted on 21st April 1977 by Institute of Chartered Accountant of India (ICAI). ASB is broad based and ensures participation of all interested groups in the standard setting process, which includes

1. Elected members of the council of ICAI
2. Nominee of the Central Government representing Department of Company Affairs
3. Nominee of the Central Government representing the office of Comptroller and Audit General of India
4. Nominee of the Central Government representing the Central Board of Direct Taxes
5. Representative of ICWI
6. Representatives from ICSI
7. Representatives of Industry Association (ASSOCHAM, CIIFICCI)
8. Representative of RBI
9. Representative of SEBI
10. Representative of Comptroller of Accounts
11. Representatives of Central Excise and Customs
12. Representatives of Academic
13. Representatives of Financial Institutions
14. Eminent professionals co-opted by ICAI
15. Chairman of Expert Research Committee and Chairman of Expert Advisory committee of ICAI
16. Representative of any other body considered appropriate by ICAI

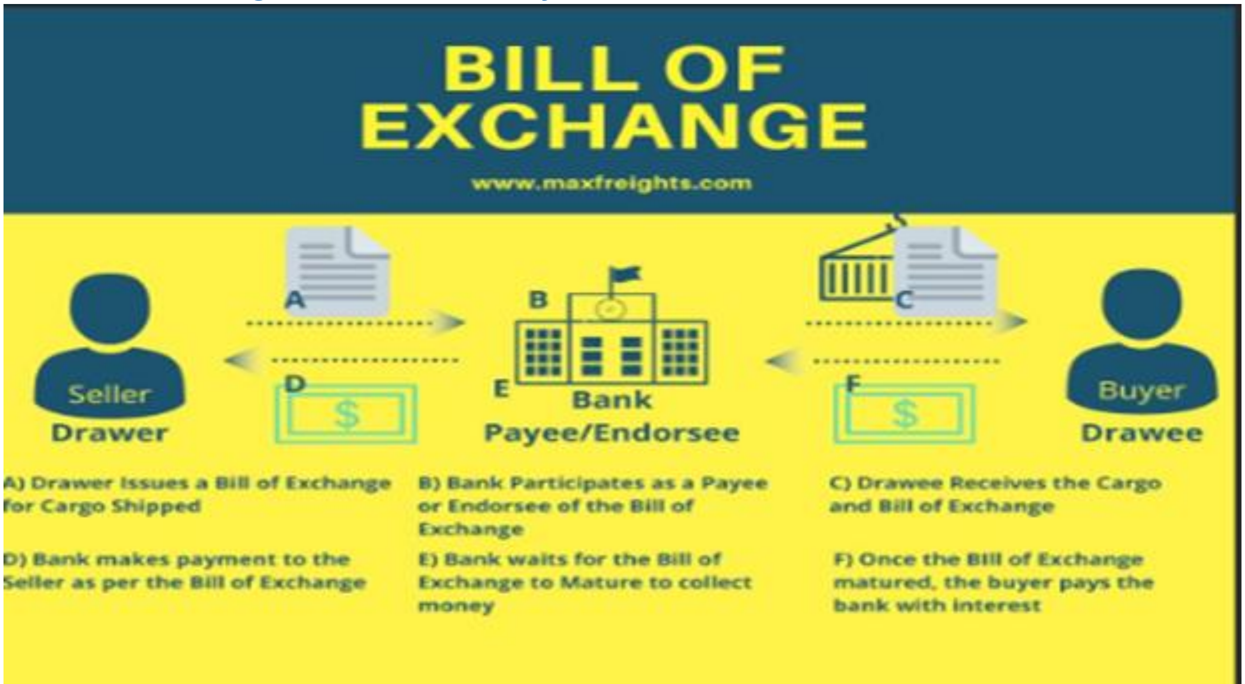
Accounting Standards

Accounting standards prescribed under section 133 under Companies Act 133, as notified by companies Act2015 I (Indian Accounting Standards), please find below the list of accounting standards

- First time adoption of Ind AS 101
- Presentation of financial standards IND AS 1
- Statement of cash flow IND AS 7
- Accounting policies, changes in accounting estimations and errors IND AS 8
- Events after accounting period IND AS 10
- Noncurrent asset held for sale and discontinued operation IND AS 105
- Fair value measurement IND AS 113
- OPERATING SEGMENT IND AS 108
- Related party disclosure IND AS 24
- Separate financial statement IND AS 27
- EPS IND AS 33
- Interim financial reporting IND AS 34
- Investment property IND AS 40
- Revenue from contract with customer IND AS 115
- Inventories IND AS 2
- Income tax IND AS 12
- Plant property and equipment IND AS 16
- Lease IND AS 17
- Employee benefit IND AS 19
- Share based payment IND AS 102
- Accounting for Government Grants and disclosure of Government assistance IND AS 20
- Effects of change in Foreign exchange rate and financial reporting in hyperinflation economics IND AS 21 and IND AS 29
- Borrowing cost IND AS 23
- Impairment of Assets IND AS 26
- Provision contingent liability and contingent asset IND AS 37

- Intangible asset IND AS 38
- Business combinations IND AS 103
- Consolidated financial statement IND AS 110
- Joint Arrangements IND AS 111
- Disclosure of interest in other entities IND AS 112
- Investment in association and JV IND AS 28
- Financial instrument IND AS 109
- Financial instrument presentation and disclosure IND AS 32, IND AS 107 IND AS 113 & IND AS 109
- Insurance contract IND AS 104
- Exploration for evolution of mineral resources IND AS 106
- Regulatory deferred accounts IND AS 114
- Agriculture Ind AS 41

Bills of Exchange and Promissory Notes



Credit is taking place in most of the business between almost all the legal entity. Individual buy his monthly needs by credit from nearby retailer, same individual buy bigger spending using credit card. Individual buys TV / Refrigerator / Washing machine by EMI. Related business firms supposed to sell on credit only. By the same Business units does most of their routine business transactions on credit basis which reduces need for running capital / working capital need. They used to buy / do business transaction on 30 days' credit / 45 days' credit / 90 days' credit etc. Here entities entering into business needs legally approved committed / document.

A bill of exchange is a written acknowledgement of debt, given by the debtor to his creditor, for the sum due and the time of payment as well as the date and place of payment being set down.

A bill of exchange has been defined as an "instrument in writing containing an unconditional order signed by the maker directing a certain person to pay a certain sum of money only to or to the order of a certain person or to the bearer of the instrument." When such an order is accepted by writing on the face of the order itself, it becomes a valid bill of exchange.

Indian Instrumentation Act 1881 section 5 defines Bills of exchange as an “Instrument in writing containing an unconditional order signed by the drawer/ maker directing a certain person to pay a certain sum of money only to or to the order of the certain person or to bearer of the instrument”

Essential elements of Bills of exchange

- ✓ It should be in writing
- ✓ It should contain an order by seller to the purchaser
    - To make payment in future
    - Request by seller to the purchaser to make payment in future does not amount to a bill of exchange
    - The order contained in the bill should be unconditional
    - Maker of the bill or seller is known as drawer and bill should be signed
    - The purchaser upon whom the bill is drawn is known as drawee and he must be a certain person
    - Amount ordered to be paid by drawee in the bill must be certain and it must be referred in the money value only
    - The person to whom payment of the bill is to be made is known as payee
    - Parties to the bill is
        - Drawer --- Who writes bills of exchange
        - Drawee – Who accepts the bill
        - Payee -- Payment to whom is to be made
    - Stamp
        - Stamp is affixed on every BE except bills payable on demand.
    - Amount
        - Amount payable on the bill should be written in Number and words
    - Date
        - Date of bill drawn should be on the face of bill

    - Bill drawn by drawer must be accepted by drawee to make the document legally valid Acceptance of the bill is considered as willingness of the drawee that he agrees with the term and conditions

Types of bills

Inland bills

By the These bills are drawn in India, draw and accepted by Indian entities or made payable in India. Drawer, drawee and payee in India, though the payee in outside India payment should happen in India.

1. Bills Drawn in India
2. Drawer, Drawee and Payee in India
3. If Drawee resides another country, the bill should be made payable in India
4. Payment should happen / Directs to make payment in India
5. Both Drawer and Drawee resident Indian

INR 1,00,000

Stamp

690,4th Avenue
Anna Nagar
Chennai 600090
4th March 2023

Two months after date to Us / our Order, the sum of Indian Rupees One Lac only for

For Lokesh & Co.,
Lokesh, Partner

To
Ramesh & Co
A71, Vadavalli
Coimbatore 641027

Foreign bills

Bills drawn outside India, but made payable in India or Bills drawn India but made payable outside India. Drawee is to accept to make the payment one set.

1. Bills Drawn in India and made payable outside India
2. Bills Drawn outside India but payable in or drawn upon a person residing in India.

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As defined in Indian Instrumentation Act 1881 section 4, Promissory is “An Instrument in writing (not being a bank not or currency note) containing unconditional undertaking signed by the maker to pay a certain sum of money only to or order of certain person or to the bearer of the Instrument”

1. It should be in writing
2. It must contain a promise by the maker of promissory note to make payment in future
3. The promise to pay Unconditional
4. It must be signed by maker of the instrument i.e. debtor and must be legal entity
5. The amount payable should be certain, there should not be any ambiguity and it should be money only not money’s worth
6. It should be properly stamped
7. Both drawer and drawee should be resident Indian
8. Transaction value should be referred in Indian Currency
9. Unconditional Promise to pay
10. Maker of the instrument is Debtor
11. Only two parties involved

Now be seeing definition of Section 4 and 5 of Indian Instrument Act 1881, we feel both are same, but legally difference is there between Promissory Note and Bills of Exchange.

Due date and grace days

Due date is the date mentioned in bills drawn and accepted by the drawee and duly stamped. A grace period is a set length of time after the due date during which payment may be made without penalty. A grace period, typically of **15 days**, is commonly included in mortgage loan and insurance contracts

Promissory Notes

Promissory notes are not very common in business, although they are generally used amongst private individuals in connection with loan transactions.

A promissory note is an instrument in writing containing an unconditional undertaking, signed by the maker, to pay a certain sum of money only to or to the order of a certain person. Under Section 31 (2) of the Reserve Bank of India Act, a promissory note cannot be made payable to bearer.

This also is also covered under negotiable instrument. In fact, the term 'negotiable instrument' applies to bills of exchange, promissory notes and cheques. Consideration is not an essential prerequisite of a promissory note, nor is so the time of payment. The note becomes payable on demand if there is no mention of the time of payment. In any event, three days of grace, as in the case of a bill of exchange, are allowed.

Difference between BILLS OF EXCHANGE and Promissory Note

Bills of Exchange	Promissory Note
Parties involved is 3 or more	Parties involved 2 only
Bills of exchange is unconditional order	Promissory note is an Unconditional promise
Make of the instrument is Creditor	Make of the Instrument is Debtor
Bills of exchange needs to be accepted by Drawee to make the document valid in front of Law	No acceptance is Mandatory
Payer is Drawee	Payer is Drawee
Bills of exchange payable o n demand, do not require any stamp duty	Promissory note is payable on demand and requires ad Value stamp duty
Liability of drawer of bill of exchange is secondary, becomes only drawee fails	Drawer is responsible to make the payment
Foreign Bills of Exchange drawn in 3 sets	Foreign/ India promissory note drawn in single set
If foreign Bills dishonored needs to be notarized and protested	Need not to be notarized and protested if foreign promissory note dishonored

Benefits of Bills of Exchange and Promissory Notes

- This enables / enhances credit transaction, which reduces requirement of working capital or enables enhanced way of utilizing working capital
- This is a conclusive proof of the indebtedness of the purchaser of goods and services
- Both are stands as Legal document, can be enforced in a court for payment if it dishonor

- Both document fix the date when amount is due, which enables creditor to predict when the amount will get realized.
- Both the document can be discounted which enhances liquidity
- Both the documents are negotiable instrument and can be easily transferred from one person to another person

When bills assumed to be dishonored

Usually Bills of assumed to be dishonored, when the payment is not done on or before the date of bills+ grace days, and in other few scenario the Bills will be assumed to be dishonored

I. When the drawee does not accept it within 48 hours from the time of presentation for acceptance.

II. When presentation for acceptance is excused and the bill remains unaccepted.

III. When the drawee is incompetent to contract.

IV. When the drawee is a fictitious person or after reasonable search, cannot be found.

V. Where the acceptance is a qualified one or where one or some of several drawees not being partners make default in acceptance, on being duly required to accept. In this case, the holder may at his own risk treat the bill as accepted.

VI. Dishonor by non-payment : A promissory note, a bill of exchange or cheque is said to be dishonored by non-payment when the maker of the note, acceptor of the bill or drawee of the cheque makes default in payment upon being duly required to pay the same. Also, a negotiable instrument is dishonored by non-payment when presentation for payment is excused and the instrument, when overdue, remains unpaid.

Can bills of exchange renewed?

Yes, can be renewed with the mutual understanding of all the parties involved with the additional charge Interest. Partial renewal also possible. In this case old bills of exchange are cancelled and new Bills of exchange created and accepted with necessary additional charges accepted by both the parties.

Can bill discounted by owner/ Drawer/Holder

Duly signed / accepted bill can be discounted with bank with discounting charges. While discounting bills banker will charge, may kind of interest. This discounting charges has to be completely born by Drawer / holder/ Owner. Duly accepted bill can be discounted by holder/drawer/creditor can discount the bill which is yet to mature with bank the banker will deduct some amount as discounting charges and pay the remaining amount to the drawer. This is nothing but to meet the immediate financial need of the product get the amount from the bank by handing over the B/R document with necessary charges. This resolve immediate financial needs of Drawer/ Owner.

Insolvency of Drawer / Drawee

Either of the party may go on insolvency, in that chase treatment can be

If the drawee insolent

1. Bills needs to be treated as dishonored with necessary accounting entries'
2. Partial payment may be received from the estate of insolvent
3. Balance amount is to be written off

Accounting Treatment in the books of creditor/ Drawer /Holder

While credit transaction happens

Debtor / Customer name Dr Total Amount
To Sales Cr Amount
To CST GST Taxes CR Tax amount

When Bills issued

Bills Receivable a/c DR amount
To Debtor / Customer name cr Amount

When the bill discounted

Bank a/c dr amount
Discount dr discount charges
To bills receivable cr total bills value

When bill presented and honored

Cash a/c dr amount
Bills Receivable cr amount

When bills presented and dishonored

Debtor account dr Total amount
Bills Receivable cr Bill amount
Notary and legal charges Cr expenses

Accounting Treatment in the books of Debtor

While raising credit transaction

Purchase a/c dr
CST GST Taxes dr
To Creditor / seller name cr Total value

While accepting bills

Creditor / Seller dr
To Bills payable cr

While honoring bills

Bills Payable dr
To Cash/Bank cr

When there is a chance of bill is honored perfectly / bill can be delayed for payment/ complete dishonor/ drawee insolvency,

Rebate

There is another chance open bill may be honored before the due date. In this scenario drawee may be offered with discount or rebate by the payer. The discount is called rebate and the same is calculated at agreed rate for the period between due date and the date of earlier payment., the discount offered/ allowed by the holder of the bill is called Retiring Bill

Accounting treatment for retiring bills under rebate

Journal entry in the books of drawer/ Maker / holder / creditor

Cash / Bank A/c	Amount received against BR
BR rebate / Discount	Discount / Rebate allowed
To Bills Receivable	Total BR value

Entry in the Acceptor books

Bills Payable account	Total Bills Payable amount
To Cash Account	Amount paid
To Discount / rebate	Discount / rebate received

Accommodation Bill

Usually bills drawn for value of goods and services offered to drawee to settle the trade debts. But in some scenario bills may be created and accepted to meet the financial commit of friends without any consideration / trade value/ Exchange of goods/ services. Assume A is in financial critical situation needs money of 1,00,000. To meet out his financial need A draw bill on his friend name and his friend accepts the bill, a will discount the bill with bank to raise money, but he makes payment of money to his friend / accepter of bill before the bill due date in such a way that his friend honors bill. This type of bill is called accommodation bill, where in no consideration will be there except mutual trust.

Difference between Trade bill and Accommodation bill

SL	Trade Bill	Accommodation bill
	It arises from indebtedness due to the business transaction by sale of goods and services or by offering loan	It is drawn and accepted only providing fund to one of the party or both the parties
	The full amount discount is borne by drawer on discounting bill	The amount of discount may be borne by drawee, borne by drawer and drawee on agreed ratio
	It is drawn to settle business transaction	It is drawn to meet the financial needs of one or all the parties
	It is accepted for present consideration	No consideration is necessary for accepting bill
	Trade bill acts as an evidence of indebtedness	This is acts as only source of finance
	Drawee can file suit against drawee as he is liable to pay on dishonor	No suit can be filed against drawee

Fill in the blanks

1. When bill is dishonored ______________ account I debited in the books of drawee
2. When bill is dishonored_________________ account debited in the books of drawer
3. When the endorsed bill is dishonored_____ account is debited in the books of drawer
4. Drawer will debit______________account for noting charges paid on bill dishonor
5. Interest on noting charges income in the books of _______
6. Interest on renewal of bills income in the books of _______
7. Bills drawn by_____
8. Promissory note drawn by ______-
9. Accommodation bill drawn by________________

ILLUSTRATION 1. (Discounting a bill) Sandeep received an acceptance for bill of ₹ 50,000 on 1st July, 2020 at 3 months from Sudhir. Sandeep got this acceptance discounted @ 10% p.a. at his bank. On the due date, Sudhir paid the amount due. Pass the Journal Entries in the books of Sandeep and Sudhir. The bank charged 6% CGST and 6% SGST on discounting charges.

SOLUTION

JOURNAL OF SANDEEP

Date	Particulars		L.F.	Dr. (₹)	Cr. (₹)
2020					
July 1	Bills Receivable A/c	Dr.		50,000	
	To Sudhir A/c				50,000
	(Being the acceptance received from Sudhir)				
July 1	Bank A/c	Dr.		48,600	
	Discounting Charges	Dr.		1,250	
	(₹ 50,000 × 10/100 × 3/12)				
	Input CGST A/c	Dr.		75	
	Input SGST A/c	Dr.		75	
	To Bills receivable A/c				50,000
	(Being the bills discounted with the bank @ 10% p.a.)				

In the Books of Sudhir

JOURNAL

Date	Particulars		L.F.	Dr. (₹)	Cr. (₹)
2020					
July 1	Sandeep A/c	Dr.		50,000	
	To Bills Payable				50,000
	(Being the amount of acceptance given to Sandeep)				
Oct 4	Bills Payable	Dr.		50,000	
	To Bank A/c				50,000
	(Being the payment of the bill on due date)				

√ **ILLUSTRATION 2.** On 1st January, 2021, X sells goods to Y for ₹ 8,000 charging CGST 9% and SGST 9% and draws four bills of exchange on him. The first for ₹ 1,500 for one month, the second for ₹ 1,000 for 2 months, the third for ₹ 2,000 for 3 months and the fourth for ₹ 4,780 for 4 months. Y accepts and returns these bills to X.

The second bill is discounted with the bank at 12% p.a. on 4th January, 2021 and on the same date the third bill is endorsed by X to his creditor Z. The fourth bill is sent to the bank for collection on 10th January, 2021.

Pass Journal Entries in the books of X and Y assuming that all bills are met on their due dates.

SOLUTION

X's JOURNAL

			₹	₹
2021 Jan. 1	Y	Dr.	9,440	
	To Sales Account			8,000
	To CGST A/c			720
	To SGST A/c			720
	(Being goods sold to Y on credit)			
" 1	Bills Receivable Account		9,440	
	To Y			9,440
	(Being four bills for ₹ 1,500, ₹ 1,000, ₹ 2,000 and ₹ 4,940 accepted by Y payable 1 month, 2 months, 3 months and 4 months after date respectively)			
Jan. 4	Bank Account	Dr.	976	
	Discount Account	Dr.	20	
	Input CGST Account	Dr.	2	
	Input SGST Account	Dr.	2	
	To Bills Receivable Account			1,000
	(Being second bill discounted at bank at 12% p.a. ; discount charged for 2 months)			
" 4	Z	Dr.	2,000	
	To Bills Receivable Account			2,000
	(Being third bill endorsed over to Z)			
" 10	Bills Sent for Collection Account	Dr.	4,940	
	To Bills Receivable Account			4,940
	(Being fourth bill sent to the Bank for collection)			
Feb. 4	Cash Account		1,500	
	To Bills Receivable Account			1,500
	(Being payment of the first bill received on the due date)			
May 4	Bank Account	Dr.	4,780	
	To Bills Sent for Collection Account			4,780
	(Being fourth bill sent to the bank for collection collected)			

Y's JOURNAL

			₹	₹
2021 Jan. 1	Purchases A/c	Dr.	8,000	
	CGST A/c	Dr.	720	
	SGST A/c	Dr.	720	
	To X			9,440
	(Being goods purchased on credit)			
Jan. 1	X	Dr.	9,440	
	To Bills Payable Account			9,440
	(Being four bills accepted for ₹ 1,500, ₹ 1,000, ₹ 2,000 and ₹ 4,940 payable 1 month, 2 months, 3 months and 4 months after date respectively)			
Feb. 4	Bills Payable Account	Dr.	1,500	
	To Cash Account			1,500
	(Being payment of the first bill on the due date)			
March 4	Bills Payable Account	Dr.	1,000	
	To Cash Account			1,000
	(Being payment of the second bill on the due date)			
April 4	Bills Payable Account	Dr.	2,000	
	To Cash Account			2,000
	(Being third bill met on the due date)			
May 4	Bills Payable Account	Dr.	4,780	
	To Cash Account			4,780
	(Being payment of the fourth bill on the due date)			

✓ **ILLUSTRATION 3.** A sold goods to B on 30th October, 2020 for ₹ 14,000 and received three bills for ₹ 2,000, ₹ 4,000 and ₹ 8,000 at 2, 3 and 4 month's duration respectively. He kept the first bill till maturity, endorsed the second bill in favour of his creditor C and discounted the third bill on 3rd December, 2020 at 6% p.a. The first and second bills were duly met on maturity but the third bill was dishonoured ; the bank paying ₹ 40 as noting charges. On 10th April, 2020 B paid ₹ 4,000 and the noting charges in cash and accepted a new bill at 2 months after date for the balance plus ₹ 80 as interest. The new bill was met on maturity. Give Journal Entries in the books of A and B both ignoring GST.

SOLUTION

A's JOURNAL

Date	Particulars		₹	₹
2020 Oct 30	B	Dr.	14,000	
	To Sales Account			14,000
	(Being goods sold on credit)			
" 30	Bills Receivable Account	Dr.	14,000	
	To B			14,000
	(Being three bills for ₹ 2,000, ₹ 4,000, ₹ 8,000 accepted by B payable 2 months, 3 months and 4 months after date respectively)			
Oct. 30	C	Dr.	4,000	
	To Bills Receivable Account			4,000
	(Being second bil endorsed in favour of C)			
Dec. 3	Bank Account	Dr.	7,880	
	Discount Account	Dr.	120	
	To Bills Receivable Account			8,000
	(Being third bill discounted at 6% p.a. ; discount for 3 months deducted by bank)			
2021 Jan. 2	Bank Account	Dr.	2,000	
	To Bills Receivable account			2,000
	(Being first bill met on the due date)			
March 3	B		8,040	
	To Bank Account	Dr.		8,040
	(Being third bill dishonoured including noting charges ₹ 40)			
April 10	Cash Account	Dr.	4,040	
	To B			4,040
	(Being cash received from B)			
April 10	B	Dr.	80	
	To Interest Account			80
	(Being interest charged for the extended period of credit)			
" 10	Bills Receivable Account	Dr.	4,080	
	To B			4,080
	(Being acceptance received from B for the balance of the amount due plus ₹ 80 as interest payable after 2 months)			
June 13	Bank Account	Dr.	4,080	
	To Bills Receivable Account			4,080
	(Being bill met on the due date)			

B's JOURNAL

			₹	₹
2020 Oct 30	Purchases Account To A (Being goods purchased on credit)	Dr.	14,000	14,000
Oct. 30	A To Bills Payable Account (Being three acceptances for ₹ 2,000, ₹ 4,000 and ₹ 8,000 given payable after 2 months, 3 months and 4 months respectively)	Dr.	14,000	14,000
2021 Jan. 2	Bills Payable Account To Bank Account (Being payment of the bill on the due date)	Dr.	2,000	2,000
Feb. 2	Bills Payable Account To Bank Account (Being second bill met on the due date)	Dr.	4,000	4,000
March 3	Bills Payable Account Trade Expenses Account To A (Being third bill dishonoured including noting charges ₹ 40)	Dr. Dr.	8,000 40	8,040
April 10	A To Cash Account (Being cash paid to A)	Dr.	4,040	4040
April 10	Interest Account To A (Being interest payable to A for the extended period of credit)	Dr.	80	80
April 10	A To Bills Payable Account (Being acceptance given to A for the balance of the amount due plus ₹ 80 as interest payable after 2 months)	Dr.	4,080	4,080
June 13	Bills Payable Account To Bank Account (Being bill met on the due date)	Dr.	4,080	4,080

ILLUSTRATION 4. Journalise the following transactions :

(a) Our own acceptance to Basu & Co. for ₹ 500 dishonoured due to omission of necessary instructions to our bank. Basu & Co., claim ₹ 520 including noting charges which we settle by cheque.

(b) Patel's promissory note for ₹ 1,000 endorsed in favour of Wadekar was dishonoured. Wadekar paid ₹ 25 as noting charges. We paid Wadekar by cheque and accepted from Patel another bill for the amount due plus interest ₹ 30.

(c) Renewed our acceptance to Kaul & Bros. for ₹ 2,000, by cheque ₹ 800 and a new bill at 3 months at 10% p.a. interest.

(d) Viney Malhotra's acceptance for ₹ 1,500 renewed for 2 months at 12% p.a. interest.

(e) Our acceptance to Himanshu for ₹ 2,500 retired before the date, rebate allowed to us was ₹ 25.

(f) Our acceptance to Ajay Verma for ₹ 1,200 was discharged by Arun Thaman's acceptance to us for a similar amount.

(g) Roy's acceptance for ₹ 1,400 which we sent to the bank for collection was returned by the bank as being dishonoured. Bank paid ₹ 20 as noting charges.

(h) Surjeet renewed a bill for ₹ 1,300 drawn by us by paying us ₹ 500 and accepting a new bill for the balance for 2 months, interest at 12% p.a. being paid in cash forthwith.

SOLUTION

JOURNAL ENTRIES

			₹	₹
(a)	Bills Payable Account Trade Expenses Account To Basu & Co. (Being our acceptance to Basu & Co. dishonoured and noting charges ₹ 20 paid by Basu & Co.)	Dr. Dr.	500 20	520
	Basu & Co. To Bank Account (Being payment made by cheque)	Dr.	520	520
(b)	Patel To Wadekar (Being Patel's promissory note for ₹ 1,000 endorsed in favour of Wadekar dishonoured and noting charges ₹ 25 paid by Wadekar)	Dr.	1,025	1,025

	Wadekar To Bank Account (Being payment made by cheque)	Dr.	1,025	1,025
	Patel To Interest Account (Being interest charged for the extended period of credit)	Dr.	30	30
	Bills Receivable Account To Patel (Being acceptance given by Patel for the amount due ₹ 1,025 plus interest ₹ 30)	Dr.	1,055	1,055
(c)	Bills Payable Account To Kaul & Bros. (Being old acceptance to Kaul & Bros. cancelled)	Dr.	2,000	2,000
	Kaul & Bros. To Bank Account (Being part payment of the old bill made by cheque)	Dr.	800	800
	Interest Account To Kaul & Bros. (Being interest @ 10% on ₹ 1,200—the balance of the old bill—for 3 months)	Dr.	30	30
	Kaul & Bros. To Bills Payable Account (Being new acceptance given for 3 months for the balance of the amount of old bill plus interest ₹ 30)	Dr.	1,230	1,230
(d)	Viney Malhotra To Bills Receivable Account (Being Viney Malhotra's acceptance cancelled)	Dr.	1,500	1,500
	Viney Malhotra To Interest Account (Being interest charged @ 12% p.a. for 2 months on ₹ 1,500)	Dr.	30	30
	Bills Receivable Account To Viney Malhotra (Being new acceptance for 2 months received including interest)	Dr.	1,530	1,530
(e)	Bills Payable Account To Bank Account To Rebate Account (Being our acceptance for ₹ 2,500 retired before due date for ₹ 2,475)	Dr.	2,500	2,475 25
(f)	Bills Payable Account To Bills Receivable Account (Being our acceptance to Ajay Verma discharged by endorsing Arun Thaman's acceptance in favour of Ajay Verma)	Dr.	1,200	1,200
(g)	Roy To Bills Sent for Collection Account To Bank Account (Being bills sent to the bank for collection dishonoured and noting charges paid by bank debited to Roy and credited to Bank)	Dr.	1,420	1,400 20

(h)	Surjeet To Bills Receivable Account (Being Surjeet's acceptance cancelled)	Dr.	1,300	1,300
	Cash Account To Surjeet (Being part payment of the old bill received)	Dr.	500	500
	Cash Account To Interest Account (Being interest on ₹ 800—balance of the old bill—for 2 months @ 12% p.a.)	Dr.	16	16
	Bills Receivable Account To Surjeet (Being new acceptance for 2 months received from Surjeet)	Dr.	800	800

ILLUSTRATION 5. For mutual accommodation of themselves, Samaresh and Animesh draw bills on each other. On 2nd January, 2021, Samaresh draws a bill on Animesh for ₹ 2,000 payable after three months and on 3rd Jan., 2021, Animesh draws a bill on Samaresh for ₹ 1,000 payable after three months. As arranged, both the bills are immediately discounted at 5% per annum and the proceeds are shared equally. On maturity of the first bill Animesh becomes insolvent and is unable to honour the bill. A dividend of 50 paise in the rupee is realised from his estate on 30th June, 2021.

Show the relevant Accounts in the books of Samaresh who closes books on 30th June, 2021.

SOLUTION

In the Books of Samaresh

BILLS RECEIVABLE ACCOUNT

2021		₹	2021		₹
Jan. 2	To Animesh	2,000	Jan. 2	By Bank A/c	1,975
			"	By Discount A/c	25
		2,000			2,000

ANIMESH's ACCOUNT

2021		₹	P.	2021		₹	P.
Jan. 2	To Bank A/c	987	50	Jan. 2	By Bills Receivable A/c	2,000	00
" 2	To Discount A/c	12	50	" 3	By Discount A/c	6	25
" 3	To Bill Payable A/c	1,000	00	" 3	By Bank A/c	493	75
April 5	To Bank A/c	2,000	00	June 30	By Bank A/c	750	00
				" 30	By Bad Debts A/c	750	00
		4,000	00			4,000	00

DISCOUNT ACCOUNT

2021		₹	P.	2021		₹	P.
Jan 2	To Bill Receivable A/c	25	00	Jan. 2	By Animesh	12	50
" 3	To Animesh	6	25	June 30	By Profit & Loss A/c	18	75
		31	25			31	25

BANK ACCOUNT

Date	Particulars	₹	P.	Date	Particulars	₹	P.
2021				2021			
Jan. 2	To Bills Receivable A/c	1,975	00	Jan. 2	By Animesh	987	50
" 3	To Animesh	493	75	April 5	By Animesh	2,000	00
June 30	To Animesh	750	00	" 6	By Bills Payable A/c	1,000	00
" 30	To Balance c/d	768	75				
		3,987	50			3,987	50

BAD DEBTS ACCOUNT

Date	Particulars	₹	P.	Date	Particulars	₹	P.
2021 June 30	To Animesh	750	00	2021 June 30	By Profit & Loss A/c	750	00

BILLS PAYABLE ACCOUNT

Date	Particulars	₹	P	Date	Particulars	₹	P
2021 April 6	To Bank A/c	1,000	00	2021 Jan. 3	By Animesh A/c	1,000	00

ILLUSTRATION 6. Vikas draws a bill for ₹ 6,000 and Vishal accepts the same for mutual accommodation of both of them to the extent of 2/3 and 1/3. Vikas discounts the same for ₹ 5,640 and remits 1/3 of the proceeds to Vishal. Before the due date, Vishal draws another bill for ₹ 8,400 on Vikas in order to provide funds to meet the first bill. The second bill is discounted for ₹ 8,160 with the help of which the first bill is met and ₹ 1,440 are remitted to Vikas. Before the due date of the second bill Vikas became insolvent and Vishal receives a dividend of 50 paise in the rupee in full satisfaction.

Pass the necessary Journal Entries in the books of Vikas and Vishal and prepare Vikas's Account in Vishal's ledger.

SOLUTION

VIKAS's JOURNAL

Particulars		₹	₹
Bills Receivable Account	Dr.	6,000	
To Vishal			6,000
(Being bill accepted by Vishal)			
Bank Account	Dr.	5,640	
Discount Account	Dr.	360	
To Bills Receivable Account			6,000
(Being bill discounted with the bank)			
Vishal	Dr.	2,000	
To Bank Account			1,880
To Discount Account			120
(Being 1/3 of the proceeds of the bill remitted to Vishal and 1/3 of the discount charged)			
Vishal	Dr.	8,400	
To Bills Payable Account			8,400
(Being acceptance given)			
Bank Account	Dr.	1,440	
Discount Account	Dr.	(1) 160	
To Vishal			1,600
(Being the amount received from Vishal on his discounting our acceptance and 2/3 discount debitable to us)			

Bills Payable Account Dr. To Vishal (Being bill dishonoured)		8,400	8,400
Vishal Dr. To Bank Account To Unpaid Account (Being the payment of the amount due by paying 50 paise in a rupee in full satisfaction)		5,600	2,800 2,800

Working Note (1) :

The amount of discount credited to Vishal is calculated as follows :

₹ 4,000	payable to Vishal on account of first bill not remitted to him
₹ 1,440	received from Vishal on discounting the second bill
₹ 5,440	Total Amount due to Vishal is 2/3 of the cash proceeds of the second bill, so Vishal should be credited with 2/3 of the discount of the second bill.

Total amount of discount on second bill (₹ 8,400 – ₹ 8,160) ₹ 240

Therefore, amount of discount credited to Vishal (₹ 240 × 2/3) ₹ 160

VISHAL'S JOURNAL

		₹	₹
Vikas To Bills Payable Account (Being acceptance given)	Dr.	6,000	6,000
Bank Account Discount Account To Vikas (Being 1/3 of the proceeds of the bill received from Vikas and 1/3 of the discount charged by him)	Dr. Dr.	1,880 120	2,000
Bills Receivable Account To Vikas (Being bill accepted by Vikas)	Dr.	8,400	8,400
Bank Account Discount Account To Bills Receivable Account (Being bill discounted)	Dr. Dr.	8,160 240	8,400
Vikas To Bank Account To Discount Account (Being 1/3 of the proceeds of the bill remitted and 1/3 of the discount charged)	Dr.	1,600	1,440 160
Bills Payable Account To Bank Account (Being acceptance met on the due date)	Dr.	6,000	6,000
Vikas To Bank Account (Being Vikas acceptance's dishonoured on his insolvency)	Dr.	8,400	8,400
Bank Account Bad Debts Account To Vikas (Being 50 paise in a rupee received and the balance of the amount due written off as bad debts)	Dr. Dr.	2,800 2,800	5,600

VIKAS'S ACCOUNT

	₹		₹
To Bills Payable Account	6,000	By Bank Account	1,880
To Bank Account	1,440	By Discount Account	120
To Discount Account	160	By Bills Receivable Account	8,400
To Bank Account	8,400	By Bank Account	2,800
		By Bad Debts Account	2,800
	16,000		16,000

ILLUSTRATION 7. A, B and C for mutual accommodation drew the following bills, all for three months :

A drew on B for ₹ 15,000 and on C ₹ 12,000. B drew on A for ₹ 18,000 and on C ₹ 30,000. C drew on A for ₹ 24,000 and on B ₹ 12,000.

All the bills were discounted at 10% p.a. and the proceeds were shared equally. On due date C became bankrupt. Show entries in the books of A assuming that A and B had sent the money due and paid their obligations.

SOLUTION

A's JOURNAL

		₹	₹
Bills Receivable Account	Dr.	27,000	
To B			15,000
To C			12,000
(Being acceptances given by B and C)			
B	Dr.	18,000	
C	Dr.	24,000	
To Bills Payable Account			42,000
(Being acceptances given to B and C)			
B	Dr.	30,000	
To C			30,000
(Being entry for bill drawn by B on C)			
C	Dr.	12,000	
To B			12,000
(Being entry for bill drawn by C on B)			
Bank Account	Dr.	26,325	
Discount Account	Dr.	675	
To Bills Receivable Account			27,000
(Being acceptances from B and C discounted at 10% p.a.)			
Bank Account	Dr.	(1) 9,750	
Discount Account	Dr.	(2) 250	
To B			10,000
(Being amount received from B to make proceeds and discount equal)			
C	Dr.	1,000	
To B			1,000
(Being amount paid by B to C to make distribution equal)			

Bills Payable Account To Bank Account (Being payment of A's own acceptances on the due date)	Dr.	42,000	42,000
C To Bank Account To B (Being C's acceptances dishonoured)	Dr.	42,000	12,000 30,000
B Bad Debts Account To C (Being 1/2 of loss on account of C's insolvency to be borne by B and balance written off as bad debt)	Dr. Dr.	18,500 18,500	37,000
B To Bank Account (Being amount due to B paid to settle his account)	Dr.	1,500	1,500

Working Notes :

(1)

ADJUSTMENT FOR CASH

	Total ₹	*A* ₹	*B* ₹	*C* ₹
Total bills received	1,11,000	27,000	48,000	36,000
Less : Discount @ 10% p.a.	2,775	675	1,200	900
Net proceeds	1,08,225	26,325	46,800	35,100
A ₹ 36,075 | B ₹ 36,075 | C ₹ 36,075 — 1/3 of ₹ 1,08,225				
Adjustment required in Cash to equalise proceeds of each		+ 9,750	− 10,725	+ 975
		36,075	36,075	36,075

(2)

ADJUSTMENT FOR DISCOUNT

	Total Discount ₹	*A's Share* ₹	*B's Share* ₹	*C's Share* ₹
Each should bear 1/3 of total discount	2,775	925	925	925
Less : Discount already borne		− 675	− 1,200	− 900
		+ 250	− 275	+ 25

B's ACCOUNT

	₹		₹
To Bills Payable Account	18,000	By Bills Receivable Account	15,000
" C	30,000	" C	12,000
" C	18,500	" Bank Account	9,750
" Bank Account	1,500	" Discount Account	250
		" C	1,000
		" C	30,000
	68,000		68,000

C's ACCOUNT

	₹		₹
To Bills Payable Account	24,000	By Bills Receivable Account	12,000
" B	12,000	" B	30,000

To B	1,000	By B	18,500
" Bank Account	12,000	" Bad Debts Account	18,500
" B	30,000		
	79,000		79,000

BILLS RECEIVABLE ACCOUNT

	₹		₹
To B	15,000	By Bank Account	26,325
" C	12,000	" Discount Account	675
	27,000		27,000

BILLS PAYABLE ACCOUNT

	₹		₹
To Bank Account	42,000	By B	18,000
		By C	24,000
	42,000		42,000

OBJECTIVE TYPE

1. Fills in the blanks :

(a) When the bill is dishonoured, ... Account is debited in the books of the drawee.

(b) When the bill is dishonoured, ... Account is debited in the books of the drawer.

(c) When the endorsed bill is dishonoured, ... Account is credited in the books of the drawer.

(d) The drawer always debits......... Account for noting charges paid on dishonour of a bill.

(e) When a bill sent for collection is dishonoured, the drawer gives debit to......... Account and credits to......... Account.

(f) At the time of renewal of a bill, Interest Account is ....in the books of the drawer.

(g) When the drawee becomes insolvent, the bill accepted by him is treated as.........

(h) When the bill is met on the due date, ...Account is debited in the books of the drawee.

(i) When the bill discounted with the bank is dishonoured, ...Account is debited and ....Account is credited in the books of the drawer.

(j) The drawee always debits ....Account and credits ....Account for noting charges paid on dishonour of a bill.

(k) A four months bill drawn on 1st January, 2021 will mature for payment on .... 2021.

(l) Bills Receivable Account is a .... Account.

(m) Sandeep pays ₹ 4,000 to Mandeep on maturity of the bill he had accepted. The amount of ₹ 4,000 will be credited to Cash Account and debited to .... Account.

(n) A bill of exchange in drawn by a ....

(o) A promissory note is made by a ....

(p) A promissory note executed by Mr. X is due on 12-8-2021. The maturity date of the promissory note including grace days will be ....

Ans. [(a) **Bills Payable** (b) **Acceptor's** (c) **Creditor's** (d) **Acceptor's** (e) **Acceptor's ; Bills sent for Collection** (f) **Credited** (g) **Dishonoured** (h) **Bills Payable** (i) **Acceptor's ; Bank** (j) **Noting Charges or Trade Expenses, Drawer's** (k) **May 4** (l) **Real** (m) **Bills Payable** (n) **Creditor** (o) **Debtor** (p) **14-8-2021**].

2. State whether the following entries are right or wrong :

(a) Amount of noting charges paid by the drawer is a loss to the drawee.

(b) Interest on renewal of a bill is a gain to the drawer and loss to the drawee.

(c) A bill discounted with the bank or sent to the bank for collection is treated alike in the books of the drawer.

(d) No entry is passed in the books of the drawee when a bill receivable is discounted with the bank.

(e) The drawer debits Drawee's Account and credits Noting Charges Account for noting charges paid by the endorsee of the bill.

(f) Bill of exchange contains an unconditional order.

(g) Promissory note contains an unconditional order.

(h) Certificate of protest is issued by a Notary Public.

Ans. **[(a) Right, (b) Right, (c) Wrong, (d) Right, (e) Wrong, (f) Right, (g) Wrong, (h) Right].**

3. Choose the correct answer

(a) A bill of Exchange is :

- (i) Drawn on a specific banker
- (ii) Drawn by seller and accepted by banker
- (iii) An unconditional undertaking signed by the maker
- (iv) An unconditional order signed by the maker.

(b) A person who draws a bill of exchange is called its–

- (i) Drawer
- (ii) Drawee
- (iii) Promisor
- (iv) Endorsee.

(c) Noting charges are paid by

- (i) Acceptor
- (ii) Payee
- (iii) Drawee
- (iv) None of the above.

(d) On 1-4-2020 X drew a bill of ₹ 1,00,000 after sight for 3 months of Y who accepted the bill on 1-5-2020.

On 4-6-2020, the bill was discounted at 12% p.a. At maturity, the bill returned dishonoured, due to Y's insolvency, noting charges ₹ 500 and 40 paisa in a rupee is recovered from Y's estate. The amount of deficiency in Y's books will be :

- (i) ₹ 60,000
- (ii) ₹ 40,000
- (iii) ₹ 60,300
- (iv) ₹ 40,200.

(e) On 21st February 2021, Akash draws a bill of exchange on Bhupesh for ₹ 10,000 payable 30 days after date. Bhupesh immediately accepts the bill. The due date of the bills will be–

- (i) 24th March, 2021
- (ii) 22nd March, 2021
- (iii) 26th March, 2021
- (iv) 21st March, 2021.

(g) Bills Receivable Book is a part of–

- (i) Journal
- (ii) Ledger
- (iii) Trial Balance
- (iv) Profit and Loss Account.

Ans. **[(a) (iv); (b) (i); (c) (iii); (d) (iii); (e) (iii); (f) (i)]**

1. (i) A Bill of Exchange for ₹ 600 is drawn by M/s Bhogi Lal and Co. on C. Naraindas and accepted by the latter payable at Central Bank of India. Show the Journal entries in the books of account of M/s Bhogi Lal & Co. under each of the following circumstances.

   (a) If they retained the bill till the due date and realised it on maturity.

   (b) If they got it discounted with their bankers for ₹ 580. Bank deducted CGST @ 6% and SGST @ 6%.

   (c) If they endorsed it over to their creditors M/s Cox & Co. in full settlement of their dues of ₹ 650.

   (d) If they sent the bill to the bank for collection.

   (ii) Show what further entries are passed in the books of M/s Bhogi Lal & Co. if the bill is dishonoured on the due date.

2. On 1st January, 2021, Julie supplied goods to Vikram of the value of ₹ 9,000 and settled the account by means of three bills of ₹ 3,000 each, due after two, three and four months respectively.

   A week later, Julie discounted the first bill at the discount of ₹ 60. The other two bills were held till maturity. The first two bills were duly met on maturity. On the maturity of the third bill, however, Vikram arranged to retire the bill paying ₹ 1,000 cash and giving Julie a fresh bill for four months to cover the balance together with 12% interest per annum. Julie discounted for ₹ 2,000.

   Pass the necessary Journal Entries in the books of Juile and Vikram.

3. On 15th June 2021, Saxena Bros. owed Kapoor & Co. ₹ 1,500. The latter drew upon the former two bills, one for Rs. 1,000 payable two months after date and the other for ₹ 500 payable three months after date. Kapoor & Co. discounted the first bill at 6% per annum and endorsed the second bill in favour of Sorabji & Co. The first was duly met on maturity but the second was dishonoured and Sorabji & Co. paid ₹ 4.50 as noting charges. On 1st October Sexena Bros. cleared their account by paying ₹ 506, which also included ₹ 1.50 as interest.

   Write up the Bills Receivable Book and Bills Payable Book and give Journal Entries in the books of Kapoor and Co. and Sexana Bros. Also prepare Saxana Bros.'s Account.

4. On 1st May, 2021, Ahmed sold goods to Bawa for ₹ 6,000 and also purchased goods from Charles for ₹ 5,900. On the same date Ahmed drew a bill on Bawa for ₹ 5,800 for 3 months after date in full settlement of the claim. On 5th May, 2021, Bawa accepted the same and returned to Ahmed. On 8th May, 2021, Ahmed endorsed the bill to Charles in full settlement of the amount.

   On 11th May, 2021, Charles discounted the bill from his banker for ₹ 5,650. On the due date, the bill was dishonoured, the noting charges incurred by the banker amounting to ₹ 50.

   Journalise the above transactions in the books of Ahmed, Bawa and Charles.

5. Draft Journal entries necessary to record the following transactions :

   (a) Dutt's promissory note for ₹ 900 endorsed in favour of Chatterjee was dishonoured. Chartterjee paid ₹ 15 as noting charges. We paid Chatterjee by cheque and accepted from Dutt another bill for the amount due plus interest ₹ 20.

   (b) We retired a bill for ₹ 1,500 drawn by Manjeet before due date for ₹ 1,490.

(c) Krishna accepted a bill for ₹ 2,000 drawn by us which Krishna discharged by paying up ₹ 700 and accepting a new bill for ₹ 1,320 including interest. We discounted the bill for ₹ 1,293. Subsequently the bill was dishonoured.

(d) Goswami retired his acceptance for ₹ 800 by cheque ₹ 300 and a new bill for 2 months, interest at 9% p.a. being paid in cash forthwith.

(e) Renewed our acceptance to Sampat for ₹ 1,000 by cheque ₹ 400 and a new bill at 3 months at 4% p.a. interest.

(f) Our acceptance to Dharam Paul for ₹ 850 was discharged by Verma Bros.'s acceptance to us for a similar amount.

(g) Our own acceptance to Sen & Co., for ₹ 320 dishonoured due to omission of necessary instructions to our bank. Sen & Co., claim ₹ 330 including noting charges which we settle by cheque.

(h) Patel's acceptance for ₹ 2,000 which we sent to the bank for collection was returned by the bank as dishonoured. Bank paid ₹ 10 as noting charges.

6. On 1st April, 2021 Surinder and Veerinder draw on one another at 3 months for ₹ 1,200 for their accommodation. On 3rd April, they discount each other's bill at the rate of 12% p.a. On the due date Surinder honours his acceptance but Veerinder's acceptance is dishonoured and Surinder pays ₹ 10 as noting charges. On 4th August, 2021, Veerinder settles his account by paying ₹ 1,222 which includes ₹ 12 as interest. Pass necessary Journal Entries in the books of Surinder and Veerinder.

7. On 1st July 2021, Ramesh sold goods to Suresh priced at ₹ 6,000 subject to a deduction of 16-2/3% trade discount and drew a bill on Suresh for 3 months. Suresh accepted the bill and returned it to Ramesh. Ramesh and Suresh mutually agreed that this bill should be discharged by cash payment of ₹ 2,000 and a new bill on such a date as would enable the latter to earn a rebate of ₹ 100 @ 10% p.a. The new bill would be accepted for 2 months at 10% p.a. interest. The new bill was met on the due date.

Pass Journal Entries in the books of both the parties.

8. For the mutual accommodation of A and B, A draws a bill on B for ₹ 6,000. B accepts the bill and returns it to A. A discounts the same with his bankers and receives ₹ 5,943. The proceeds are shared between A and B in proportion of 2/3 and 1/3 respectively. On the due date A remits B his proportion of money who meets the bill. Pass necessary Journal Entries in the books of A and B to record the above transactions.

9. P draws the following accommodation bills :

(a) On Q ₹ 20,000. This is discounted for ₹ 19,600 and half of the proceeds is sent to P. Before maturity P remits his share and the bill is honoured.

(b) On R. ₹ 24,000. This is discounted for ₹ 23,400 and one third of the proceeds is sent to R. R fails to pay on maturity and ₹ 60 noting charge is incurred. The bill is met by P. R becomes insolvent and 50 paise dividend in a rupee is realised from his estate.

Show Journal Entries in the Books of P.

Ans. **[Bad Debts ₹ 12,030]**

10. Jaggi owes to Kamath ₹ 2,400. The debt is discharged by Jaggi on 1st February, 2020 by accepting three bills of exchange drawn on him by Kamath—one for ₹ 600 at 2 months, another for ₹ 800 at 3 months and the third for ₹ 1,000 at 4 months. The first bill is endorsed by Kamath in favour of Dass, his creditor. The second bill is discounted at the bank at 12% p.a. All the three bills were dishonoured. The noting charges in each case were ₹ 5. On 5th June, Jaggi agreed to accept another bill for the total amount including interest at the rate 15% p.a. The bill was for 3 months. On 1st September, Jaggi became insolvent, having his bills unpaid. On 1st October, a first and final dividend of 40 paise in a rupee was received from Jaggi's estate. Give Journal Entries in the books of both Jaggi and Kamath.

Ans. **[Bad Debts ₹ 1,504]**

11. On 1st July, 2020 Mr. Verma for mutual accommodation of himself and Mr. Sharma drew on the latter a bill of ₹ 5,000 payable 90 days after sight (without grace). On the same date the bill was discounted with the Punjab National Bank @ $7\frac{1}{2}$% and half of the proceeds were remitted to Mr. Sharma on 2-7-2020.

On 3-7-2020 Mr. Sharma drew a bill on Mr. Verma for ₹ 2,000 payable 90 days after sight (also without grace). He discounted the bill with the Central Bank of India at 10% and remitted half the proceeds to Mr. Verma on the same date.

Mr. Sharma became bankrupt on 10-9-2020 and only 50% was received by Mr. Verma on 25-9-2020 as the first and final dividend from his estate.

Pass the necessary Journal Entries and show the account of Mr. Sharma in the books of Mr. Verma.

Ans. [Bad Debts ₹ 1,750]

12. Lalji draws a bill for ₹ 4,500 on Palji on 2nd January 2021 for 3 months. Lalji gets it discounted with the Bank for ₹ 4,410 ; and on 3rd January remits one-third of the amount to Palji, which Palji receives on 5th January. On the due date, Lalji fails to remit the amount due to Palji ; but he accepts a bill for ₹ 6,300 for 3 months which Palji discounts for ₹ 6,165 and remits ₹ 1,110 to Lalji. Before the maturity of the renewed bill Lalji becomes insolvent and only 50% was realized from his estate on July 10. Pass Journal Entries, with full narration, in the books of Lalji.

Ans. [Bad Debts ₹ 2,100]

13. Short owes Slow ₹ 6,000 for which the former accepts a three months bill drawn by the latter. Slow immediately discounts the bill with his banker Strong Bank at 12% p.a. GST rate was 12% on the due date the bill is dishonoured and Strong Bank pays ₹ 20 as noting charges.

Short pays ₹ 1,180 including interest of ₹ 200 and gives another bill at three months for the balance. Slow endorses the bill to his creditor Slim in full settlement of his debts for ₹ 5,100. Slim discounts the bill from his banker, Strong Bank, who charges ₹ 40 as discount. Before maturity Short becomes bankrupt and a first and final dividend of 20 paise in a rupee is realised from his estate.

Show Journal Entries in the books of Slim and Strong Bank and the Ledger Account of Short in the books of Slow.

Ans. [₹ 4,032 transferred to Bad Debts]

14. On 1st January, 2020, Pandit, for mutual accommodation of himself and Thakur, drew upon the latter a three months bill for ₹ 12,000, which was duly accepted. Pandit discounted the bill at 6% p.a. on 4th January, 2020 and remitted half the proceeds to Thakur.

On 1st February, 2020, Thakur drew and Pandit accepted a bill at three months for ₹ 4,800. On 4th February, 2020, Thakur discounted the bill at 6% p.a. and remitted half the proceeds to Pandit.

At maturity Pandit met his acceptance, but Thakur failed to meet his and Pandit had to take it up. Pandit drew and Thakur accepted a new bill at two months on 4th May, 2020 for the amount due to Pandit plus ₹ 100 as interest. On 1st July, 2020, Thakur became insolvent and a first and final dividend of 50 paise in the rupee was received from his estate on 30th September, 2020.

Pass necessary Journal Entries in the books of Pandit.

Ans. [Bad Debts ₹ 4,250]

15. P draws a bill of ₹ 10,000 and R accepts the same for mutual accommodation equally. P discounts the same for ₹ 9,900 and remits $\frac{1}{2}$ share to R.

Before due date, R draws a bill on P for ₹ 20,000 and discounts the same for ₹ 19,800. He honours the first bill and remits ₹ 4,900 to P.

Before due date of second bill, P becomes bankrupt, and R receives a final dividend of 50 paise per rupee.

Prepare Ledger Accounts in the books of P and R. Journal entries are not required.

Ans. [Bad Debts ₹ 5,000]

Insolvency Accounts

In General, Insolvency denotes an Insolvent is one who is not able to pay his liabilities as when claimed / due for payment. Insolvency can be announced by court any legal entity except corporate, for Corporate term liquidation will be used.

If it is announced on individual, then it is called Insolvency/ Insolvent. In Legal Terms Insolvent can be applied to a person whose liabilities exceed his assets and against whom an order of adjudication has been passed by competent court. The proceedings taken by court against insolvent person are known as insolvency proceedings. Any legal entity except Corporate can be called as Insolvent provided if the referred legal entity is debtor and do not have sufficient assets to repay his liabilities and he must have committed as an act of insolvency, act of debtor which shows that he is not in a position to make full payment of his liabilities.

Act of Insolvency takes place in below circumstance in addition to above points referred

1. When debtor makes transfer all or substantially all of his property to third person for the benefit of creditor
2. When the debtor transfers his property or any part thereof with the intent to defeat or delay his creditor
3. While debtor transfers his property for fraudulent preference. Fraudulent preferences take place when the debtor prefers to preferred creditor ignoring other creditor
4. If the property of debtor sold or attached for a period of 21 days or more
5. If debtor notifies any of his creditor that he has suspended or about to suspend is payments to debts
6. When debtor petitions to court to be adjudged an insolvent
7. When debtor imprisoned for payment of debts
8. If debtor intends to defraud or delay his creditor
    i. Debtor departs from India or remain outside of India
    ii. Debtor depart from his dwelling house or usual place of business otherwise absence

Bankruptcy is a legal proceeding initiated when a person or business is unable to repay outstanding debts or obligations

Bankruptcy is a legal process through which people or other entities who cannot repay debts to creditors may seek relief from some or all of their debts. In most jurisdictions, bankruptcy is imposed by a court order, often initiated by the debtor.

Bankrupt is not the only legal status that an insolvent person may have, and the term bankruptcy is therefore not a synonym for insolvency.

There are two acts deals with Insolvency affairs in India, but both acts mere similar except few points and acts based on English Bankruptcy Act.

1. The Presidency Towns Insolvency Act 1909, which applies to the legal entities residing in the presidency towns of Mumbai, Kolkata and Chennai only
2. The provisional insolvency Act 1920, which applies to legal entity residing other than presidency cities in India

Insolvency Procedure

1. Either Creditor or Debtor by himself has to file a petition before the court Law
2. Legally a person can be called insolvent only If order of adjudication is passed against legal entity by competent court
3. Creditors individually or jointly can file a petition if the amount due is more than 500
4. Debtor commits an act of insolvency within 3 months of petition
5. After filling petition court fixes a date of for hearing and then it either rejects the petition or makes an order of adjudication
6. After adjudication passed, official assign in presidency towns and official receiver other places will be nominated
7. If any property transfer to 3rd party without any consideration before 2 years from the date of Order of adjudication becomes void. But this rule exempts 2 cases only
   a. Any property transfer in connection with marriage or inconsideration of marriage.
   b. When a transfer made in favour of a purchase or encumbrance in good faith and for valuable consideration
8. After adjudication passed the property of the insolvent vest to official assignee / official receiver, who proceeds to realize the assets and distributes sales proceeds of assets in the following manner
   a. First preference to the fully secured creditor will get full amount
   b. Partially secured creditor to the extent of the secured
   c. Realization expenses, remuneration of official assignee or receiver
   d. Preferential creditors
   e. Unsecured creditors and unsecured balance of partly secured creditors

9. Separate statement of affairs will be prepared for Partnership Firm and each partner. Any surplus amount available will be transferred to the statement of affair of Partnership firm. But individual deficiency will not be transferred.
10. Partnership firm secured assets against loan will not be considered for statement of affairs and creditor will not be considered under any category of creditor in statement of affair
11. Please do not ignore / forget to pay preferential creditor, amount which is due government sector

Order of discharge

After the court of adjudication, the insolvent debtor may apply to the court for the order of discharge, after hearing the insolvent debtor and examining the conduct of insolvent as reported by official assigner Receive, court may issue order of discharge which frees insolvent from his previous debts except to government, debt incurred by fraud and liability of maintenances

Interest calculation

Creditors eligible to claim interest up to date order of adjudication. If any balance after making payments to creditors with interest till date of order of adjudication, then from the date of order of adjudication, interest will be paid to creditors @6%pa.

Example

Total creditor 100000

Order of adjudication 1st April 2022

Interest due till order of adjudication 7000

Total assets realized 120000

Date of realization 31st December 2022

Creditors will be paid 107000

Remuneration and realization charges 3000

Balance amount is (120000-107000-3000) 10000

Interest can be paid to creditors @6% p.a for the period after court of adjudication

I.e for 9 months (1st April 2022 - 31st Dec 2022)   9 months

I.e (100000*6%)*9/12   4,500

Statement of Affairs

(As required by the indian Insolvency Act)

In the court of Justice in insolvency

To the insolvent ___you are required to fill up carefully ad accurately , this sheet and the several sheets, A B C D E F G H shows of your affairs on the day of which the order of adjudication was made against you viz date___________

Such sheet when filled up will constitute your schedule and must be verified by Oath or Declaration

Gross Liabilotoes	Liahilities (as stated and estimated by Debtor	Expected to Rank	Assets (As stated and estimated by Debtor	Estimated to Produce
INR	Unsecured creditors as per list A		Property as per List E	
	Fully paid creditor as per list B		Bank Balace	
	Less Estimated value of Securities		Cash	
	Less Amount thereof carried to List C		Cash deposited with solicitor for cost of petition	
	Partly secured creditors as per List C		Stock I Trade	
	Preferred creditors as per List D (creditor for rent, taxes, salaries and wages etc)) payable in full as per contra			
			Machinary	
			Trade Fixtures, Fitting ans Utensis etc	
			Furnitures	
			Life policies	
			Other Properties	
			Book debts as per list F	
			Good	
			Doubt	
			Bad	
			Estimatd to produce	
			Bills of exchange or other smilar securities on hand list G	
			Estimated to produce	
			Surplus from securities in the hands of creditors fully secured	
			Deduct Creditors for preferntil rent, tax,wages and slaries	
			Deficience as explained in list H	

Loan received from wife will be treated as unsecured creditor like other creditors if it is not proved that loan given by wife from the money given by husband to wife.

Difference between Balance sheet and Statement of Affair

Balance Sheet	Statement of Affair
Shows asset in book value	Shows assets in book value and realizable value
Shows intangible assets like goodwill, prepaid expenses	Does not shows intangible assets
Gives information about capital, profit or loss, drawings and interest on capital	Excludes all such items
Will not show the deficiency	Shows the amount of deficiency to be payable to creditor
Prepared on the date of financial year end	Prepared on the date of adjudication order passed
Personal assets and liabilities and Trade assets and liabilities distinguished	Both personal and trade assets are consolidated
Contingent liabilities are shown as note	Contingent liabilities based on rank will be included

Difference between preferential tow insolvency act and provisional insolvency act	
Presidency Town Act	**Provisional Insolvency Act**
Act enacted in 1909	Act enacted in 1920
Act applies to the towns MUMBAI, KOLKATA and Chennai	Persons residing in all the cities other than Presidency city
Preferential amount maximum for clerk 300 and servant 100	Preferential amount for clerk, labor, servant is 20
One month due to Landlord	Rent is not preferential
Domestic goods up to 300 are left with insolvent	Only those assets are left with insolvent which have been exempted under code of civil act

Problems

1. Calculate the preferential and secured creditors from followings list

Sales Tax 25000
Income Tax 15000
Municipal Tax 5000
4month Rent due 20000
Wages of 2 servants for 4 months 800
Wages for Labor for 3months 3000
Manager Salary 5000
Salary for 2 clerk 4 month 2400

Solution

Statement of Preferential Creditor and unsecured creditor						
		Under Presidency Act		Under Provisional Insolvencu Act		
Amount Due	Particulars	Preferential Creditor	Unsecured creditor	Preferential Creditor	Unsecured creditor
25,000.00	Sales Tax	25,000.00		25,000.00	
15,000.00	Income Tax	15,000.00		15,000.00	
5,000.00	Municipal Tax	5,000.00		5,000.00	
20,000.00	Rent due to Landlord	5,000.00	15,000.00		20,000.00
800.00	wages to 2 sevants for 4 months	200.00	600.00	40.00	760.00
3,000.00	5 Labour wages 3 months	500.00	2,500.00	100.00	2,900.00
5,000.00	Manager Salary		5,000.00		5,000.00
2,400.00	2 clerk salary 4 month	600.00	1,800.00	40.00	2,360.00
76,200.00		51,300.00	24,900.00	45,180.00	31,020.00

All the tax due to Government is Prefered liabiloty / creditor

Problem 2

From the list below ascertain the creditors to be shown under list A and B

- Creditor on open account 55000
- Bills payable 10,500
- Creditors 8000
- Bills of Exchange 4000
- Stock estimated to produce 6000
- BR Discounted except to bank 3000) 9000
- Income tax payable 550
- Creditors for salaries and wages 2200

Solution

List A denotes Unsecured creditors

List D denotes rent taxes and wages payable

List A unsecured creditor

1.	Creditors on open account	55000
2.	B/P	10500
3.	Liability on bills discounted	3000
4.	Creditors for Wages, Salaries over Preferential limit	1600
		70,100

List D Rent Tax Wages payable

1.	Creditors for Salaries and wages	600
2.	Income Tax payable	550
		1,150

ILLUSTRATION 1. Mr. Shankar of Mumbai finding himself unable to meet his creditors, has to prepare a Statement of Affairs, for which the following particulars are available on the date of his adjudication as insolvent as on 31-3-2021 :

Leasehold property ₹ 2,00,000, estimated to realise, ₹ 1,90,000.

Plant & Machinery ₹ 80,000, estimated to realise ₹ 60,000.

Stock in Trade ₹ 40,000, estimated to realise ₹ 28,000.

Book debts : Good ₹ 1,20,000, Doubtful ₹ 10,000, estimated to realise 50%, Bad ₹ 28,000, Bills in Hand ₹ 7,500.

Life Policy for ₹ 50,000, whose Surrender Value is ₹ 10,000 held by the insurance company against a loan of ₹ 4,000.

Household Furniture ₹ 7,200, Household Debts ₹ 5,800.

Bills Discounted ₹ 12,000, ₹ 4,000 likely to be dishonoured.

Loan on Mortgage of Leasehold ₹ 1,00,000, Cash in Hand ₹ 200.

Bank Overdraft secured by Personal Guarantee of Shankar's Brother, and Second Mortgage on Leasehold ₹ 1,00,000.

Unsecured Creditors ₹ 3,00,000, Loan from Naresh ₹ 5,000 secured by a second charge on Life Policy. Ground Rent on Household for three months accrued ₹ 750.

He could not pay his office clerks (two persons) salaries for six months ₹ 3,000 and also Rates & Taxes amounting to ₹ 3,000 due to Government.

Prepare Statement of Affairs of Mr. Shankar as on 31-3-2021.

SOLUTION

STATEMENT OF AFFAIRS OF MR. SHANKAR

as on 31-3-2021

Gross Liabilities	*Liabilities (as stated and estimated by Debtor)*		*Expected to Rank*	*Assets (as stated and estimated by Debtor)*	*Book Value*	*Estimated to Produce*
₹		₹	₹		₹	₹
	Unsecured Creditors			Property as per List E		
3,20,700	as per List A	(1)	3,12,700	*viz.,*		
	Creditors Fully			(*a*) Cash	200	200
1,09,000	Secured as per			(*b*) Stock in Trade	40,000	28,000
	List B (2)	1,09,000		(*c*) Plant & Machinery	80,000	60,000
	Estimated Value of			(*d*) Furniture	7,200	7,200
	Securities	2,00,000		Book Debts as per List F		
	Surplus	91,000		Good	1,20,000	1,20,000
	Less : Amount thereof			Doubtful	10,000	5,000
	carried to List C	90,000		Bad	28,000	–

	Balance as per Contra	1,000		Bills of Exchange as per List G	7,500	
				Estimated to Realize		7,500
1,00,000	Creditors Partly Secured as per List C	1,00,000		Surplus from Securities in the hands of Creditors Fully Secured (as per Contra)		
	Less : Estimated Value of Securities	90,000	10,000			1,000
					2,92,900	2,28,900
	Preferential Creditors (Creditors for Salaries, Wages, Rent etc.) payable in full as per List D	3,850		Deduct Preferential Creditors (as per Contra)		3,850
3,850						2,25,050
	Deducted as per Contra	3,850		Deficiency as Explained in List H		97,650
5,33,550			3,22,700			3,22,700

Working Notes :

(1) ***Unsecured Creditors as per List A***

	₹
Household Debtors	5,800
Bills Discounted likely to be dishonoured	4,000
Unsecured Creditors	3,00,000
Two months rent (one month rent is preferential)	500
Clerk's Salary (in excess of ₹ 300 per clerk) (₹ 3,000 – ₹ 600)	2,400
	3,12,700

The gross liabilities of unsecured creditors includes full amount ₹ 12,000 of discounted bills.

(2) ***Fully Secured Creditors as per List B***

	Amount ₹	*Security* ₹
Loan from Insurance Company	4,000	10,000
Naresh	5,000	
Loan on Mortgage of Leasehold	1,00,000	1,90,000
	1,09,000	2,00,000

Note : Since the Surrender Value is ₹ 10,000, both the Insurance Company and Naresh can be fully covered leaving a surplus of ₹ 1,000.

(3) ***Partly Secured Creditors as per List C***

Bank Overdraft of ₹ 1,00,000 will be partly secured because after meeting the first charge on Leasehold, ₹ 90,000 will be left which is insufficient to meet Bank Overdraft fully. The personal Guarantee of Shankar's brother cannot be considered for preparing Shankar's Statement of Affairs.

(4) ***Preferential Creditors as per List D***

	₹
One month's rent	250
Salaries of two clerks (₹ 300 × 2)	600
Rates and Taxes	3,000
Preferential Creditors	3,850

As Shankar is a resident of Mumbai, the Presidency Towns Insolvency Act, 1909 will apply to him, and accordingly Preferential Creditors will be calculated.

ILLUSTRATION 2. Satta Ram filed a petition in bankruptcy on 31st December, 2020. His books showed the following balances :

		₹	₹	₹
Fixtures and Fittings (estimated to produce ₹ 400)			1,030	
Stock-in-trade (estimated to produce ₹ 5,000)			7,210	
Trade Creditors				7,940
Bills Payable				8,700
Sundry Debtors	– Good	3,800		
	– Doubtful (estimated at 50%)	8,000		
	– Bad	8,000		
			19,800	
Bank Overdraft				6,900
Capital				4,500
			28,040	28,040

Liability on bills discounted ₹ 2,500, expected to rank ₹ 600. His life policy (surrender value ₹ 2,000) given as security for a loan of ₹ 1,500 at 10% interest paid up to the preceding 30th June. Mrs. Satta Ram gave up jewellery valued at ₹ 1,200 to the Official Receiver. Official Receiver completed certain pending transactions which resulted in a profit of ₹ 200. There is a creditor of ₹ 100 (included in trade creditors) who is not to rank for dividend. Income-tax due amounted to ₹ 1,540.

Prepare Statement of Affairs and Deficiency Account.

SOLUTION

Unsecured Creditors as per List A

	₹
Trade Creditors	7,940
Less : Creditors not to rank for dividend	100
	7,840
Bills Payable	8,700
Bank Overdraft	6,900
Bills likely to be dishonoured	600
	24,040

Fully Secured Creditors as per List B

	Amount ₹	*Value of Security* ₹
Private loan on the security of life policy	1,500	2,000
Interest @ 10% p.a. on ₹ 1,500 for 6 months (from July 1, 2020 to December 31, 2020) not paid	75	
	1,575	

Preferential Creditors as per List D

	₹
Income-tax due	1,540

STATEMENT OF AFFAIRS OF MR. SATTA RAM

as at 31st December, 2020

Gross Liabilities ₹	*Liabilities*	₹	*Expected to Rank* ₹	*Assets*	*Book Value* ₹	*Expected to Produce* ₹
25,940	Unsecured Creditors as per List A		24,040	Property as per List E :		
				Stock-in-trade	7,210	5,000
1,575	Fully Secured Creditors as per List B	1,575		Fixtures & Fittings	1,030	400
	Less : Estimated Value of Securities	2,000		Mrs. Jewellery		1,200
				Profit from completing pending transactions		200
	Surplus as per contra	425		Book Debts as per List F :		
1,540	Preferential Creditors as per List D	1,540		Good	3,800	3,800
	Deducted as per contra	1,540		Doubtful	8,000	
				Bad	8,000	
				Estimated to produce		4,000
				Surplus from securities in the hands of fully secured creditors		425
					28,040	15,025
				Preferential creditors deducted as per contra		1,540
						13,485
				Deficiency as explained in List H		10,555
29,055			24,040			24,040

Notes (1) The gross liability for unsecured creditors is ₹ 25,940. ₹ 2,500 (and not ₹ 600) in respect of liability for discounted bills should be added for calculation of gross liability.

(2) No distinction has been made between business assets and business liabilities and private assets and private liabilities because the insolvent debtor is an individual.

DEFICIENCY ACCOUNT (LIST H)

	₹	₹		₹	₹
Excess of assets over liabilities *i.e.*, capital on 31-12-2020		4,500	Loss on book debts as per List F :		12,000
Income or profit from other sources :			Other losses :		
Profit from completing pending transactions	200		Loss on realisation of fixtures and fittings	630	
Excess of private assets over private liabilities (1)	85		Loss on realisation of stock	2,210	
Creditors not to rank for dividend	100		Bills likely to be dishonoured	600	
		385			3,440
Deficiency as per Statement of Affairs		10,555			
		15,440			15,440

Working Notes :

(1) ***Excess of private assets over private liabilities has been arrived at as follows :***

	₹	₹
Mrs. Jewellery		1,200
Life Policy		2,000
Total of private assets		3,200
Less : Private Loan on security of life policy	1,500	
Interest on loan @ 10% p.a. for 6 months	75	
Income Tax due	1,540	
		3,115
Excess of private assets over private liabilities		85

ILLUSTRATION 3. Following is the Balance Sheet of Mr. Brown as at 31st March, 2021. He has filed a petition in the court for being declared as insolvent :

Liabilities	₹	*Assets*		₹
Capital	18,000	Goodwill		5,000
Bank Loan (Secured by First Charge on Building)	80,000	Machinery		20,000
Loan from Finance Co., (Secured by Second Charge on Building)	30,000	Building		1,15,000
		Investment in Shares		5,000
		Furniture		7,000
		Stock		9,000
Sundry Creditors	59,000	*Debtors* :	₹	
Sales Tax Payable	8,000	Goods	14,000	
Loan from Wife	5,000	Doubtful	8,000	
		Bad	2,000	24,000
		Cash and Bank		15,000
	2,00,000			2,00,000

Mr. Brown estimated that except the following, all tangible assets are realisable :

(*i*) A machinery ₹ 5,000 included in the Balance Sheet has no value.

(*ii*) Debtors (unrealisable) ₹ 7,600.

(*iii*) Non-moving stock ₹ 3,000.

(*iv*) Useless furniture ₹ 4,000.

(*v*) Investment has no value.

Further Information :

(*i*) Building expected to realise ₹ 1,20,000.

(*ii*) Loan was given by his wife from her personal sources.

(*iii*) A bill discounted for ₹ 10,000 is likely to be dishonoured

(*iv*) One creditor forgoes his claim for ₹ 4,000.

(*v*) Mr. Brown started his business on 1-4-2017. His household expenses upto 31-3-2021 are ₹ 48,000. His private Life Insurance Policy matured for ₹ 30,000 on 31-3-2021.

He made profit of ₹ 40,000 upto 31-3-2019.

He incurred loss of ₹ 50,000 from 1-4-2019 to 31-3-2021.

Also, he suffered speculation loss of ₹ 10,000 in the year ended 31-3-2021.

Based on the above information, prepare Statement of Affairs of Mr. Brown as on 31-3-2021 and Deficiency Account.

SOLUTION

STATEMENT OF AFFAIRS

as on 31st March, 2021

Gross Liabilities	*Liabilities (as stated and estimated by debtor)*		*Expected to Bank*	*Assets (as stated and estimated by debtor*	*Book Value*	*Estimated to Produce*
₹			₹		₹	₹
70,000	Unsecured Credited as per List A		70,000	Property as per List E :		
80,000	Creditor Fully Secured as	₹		Cash at Bank	15,000	15,000
	per List B	80,000		Stock	9,000	6,000
	Less : Estimated Value of			Machinery	20,000	15,000
	Securities	1,20,000		Furniture	7,000	3,000
	Surplus	40,000		Goodwill	5,000	–
	Less : Amount Carried			Investment in Shares	5,000	–
	to List C	30,000		Book Debts as per List F :		
	Balance thereof to Contra	10,000		Good	14,000	14,000
	Creditor Partly Secured			Doubtful	8,000	2,400
30,000	as per List C	30,000		Bad	2,000	–
	Less : Surplus carried				85,000	55,400
	from List B	30,000		Surplus from Securities in the hands of Fully Secured Creditors		
		–	–	(as per Contra)		10,000
	Preferential Creditors					65,400
8,000	Payable in Full as per List D			*Less* : Preferential		
	Sale Tax Payable	8,000		Creditors as per		
	Less : Deducted as per Contra	8,000		Contra		8,000
		–	–			57,400
				Deficiency as Explained in List H		12,600
1,88,000			70,000			70,000

DEFICIENCY ACCOUNT (LIST H)

	₹		₹
Excess of Assets over Liabilities as on 1-4-2017 (Bal. Fig.)	56,000	Net Loss arising from Business since 1-4-2019	50,000
Net Profit Arising from Business upto 31-3-2019	40,000	Bad Debts as per List F	7,600
		Drawings for Household Expenses	48,000

	₹			₹
Profit on Realisation of :		Loss on Realisation of :	₹	
Building	5,000	Furniture	4,000	
Life Policy Matured	30,000	Machinery	5,000	
Creditors Forgone Claims	4,000	Stock	3,000	
Deficiency as per Statement of Affairs	12,600	Goodwill	5,000	
		Investments	5,000	
				22,000
		Loss on Dishonour of Bill		10,000
		Speculation Loss		10,000
	1,47,600			1,47,600

ILLUSTRATION 4. Din Dayal of Delhi commenced business on 1st January, 2016 with a capital of ₹ 65,000. His profits for three years were ₹ 35,400 ; he did not prepare proper accounts for the next two years. His drawings averaged ₹ 4,800 per annum.

On 31st December, 2020 an order of adjudication was made against him when his affairs were as follows :

	₹
Building : Cost ₹ 60,000 estimated to realise	20,000
Plant and Machinery : Cost ₹ 28,000 estimated to realise	10,000
Book Debts : Good ₹ 12,000 ; Doubtful ₹ 4,000 estimated to realise ₹ 1,000 and Bad ₹ 10,000	
Bills Receivable discounted and expected to rank	5,000
Preferential Creditors	1,000
Creditors partly secured (security : life policy estimated to be worth ₹ 8,000)	23,000
Mortgage on Buildings	10,000
Unsecured Creditors	40,000
Household Furniture	3,000
Household Debts	2,000
Furniture : Cost ₹ 2,000 estimated to realise	800
Stock : Cost ₹ 16,000 estimated to realise	11,000
Cash in hand	200

Mrs. Din Dayal gave up jewellery valued at ₹ 2,500 to the Official Receiver. You are required to prepare a Statement of Affairs and a Deficiency Account from the above particulars.

SOLUTION

Profit or loss for the two years, 2019 and 2020, is not given in the problem ; so Trial Balance is prepared to find it out.

TRIAL BALANCE

as on 31-12-2020

		₹		₹	₹
Building	₹	60,000	Capital on 1-1-2016	65,000	
Plant and Machinery		28,000	*Add* : Profit for 3 years	35,400	
Book Debts — Good	12,000			1,00,400	
Doubtful	4,000		*Less* : Drawings for 5 years	24,000	
Bad	10,000				
		26,000			76,400
Furniture		2,000	Preferential Creditors		1,000
Stock		16,000	Creditors Partly Secured		23,000
Cash in hand		200	Mortgage on Buildings		10,000
Loss for the two years, 2019 and 2020 (balancing figure)		18,200	Unsecured Creditors		40,000
		1,50,400			1,50,400

STATEMENT OF AFFAIRS OF DIN DAYAL

as on 31st December, 2020

Gross Liabilities	Liabilities (as stated and estimated by the debtor)		Expected to Rank	Assets (as stated and estimated by the debtor)	Book Value	Expected to Produce
₹		₹			₹	₹
	Unsecured Creditors			Property as per List E :		
47,000	as per List A :	(1)	47,000	Cash in hand	200	200
	Creditors fully			Stock	16,000	11,000
	secured as per	₹		Machinery	28,000	10,000
10,000	List B	10,000		Furniture	2,000	600
	Estimated value			Household Furniture		3,000
	of security	20,000		Jewellery of Wife		2,500
	Surplus as per *contra*	10,000		Book Debts as per		
	Creditors partly secured			List F :		
23,000	as per List C	23,000		Good	12,000	12,000
	Less : Estimated value			Doubtful	4,000	1,000
	of security	8,000		Bad	10,000	—
			15,000		72,200	40,500
	Preferential Creditors			Surplus as per *contra*		10,000
1,000	as per List D	1,000				50,500
	Deducted as per contra	1,000		Preferential Creditors deducted as per *contra*		1,000
						49,500
				Deficiency as explained in List H		12,500
81,000			62,000			62,000

DEFICIENCY ACCOUNT

	₹		₹	₹
Excess of assets over liabilities *i.e.*, Capital on 1-1-2016	65,000	Net loss arising from carrying on business from 1-1-2016 to the date of adjudication		18,200
Net Profit arising from carrying on business from 1-1-2016 to adjudication date after deducting usual trade expenses	35,400	Bad Debts as per List F		13,000
Income or profit from other sources : Excess of private assets over private liabilities (2)	11,500	Expenses incurred since 1-1-2016 other than usual trade expenses *viz.*, Household Expenses		24,000
Deficiency as per Statement of Affairs	12,500	Other Losses :		
		Loss on realisation of	₹	
		Stock	5,000	
		Machinery	18,000	
		Furniture	1,200	
		Building	40,000	
		Loss on Bills Discounted	5,000	
				69,200
	1,24,400			1,24,400

Working Notes :

(1) ***Calculation of Amount of Unsecured Creditors***

	₹
Unsecured Creditors	40,000
Bills likely to be dishonoured	5,000
Household debts	2,000
	47,000

(2) ***Calculation of Excess of Private Assets over Private Liabilities :***

	₹
Life Policy	8,000
Household furniture	3,000
Jewellery of wife	2,500
	13,500
Less : Household debts	2,000
	11,500

ILLUSTRATION 5. The assets of a merchant on 30th June, 2021 as shown by his books were ₹ 45,000 and his liabilities ₹ 31,000. He filed his insolvency petition and estimated his deficiency to be ₹ 22,000. After making the above estimate, he found that the following items were not recorded in his books :

(*a*) Interest @ 10% on his capital from 1st January, 2021.

(*b*) Amount due as wages ₹ 200 ; as salaries ₹ 500 ; as rates and taxes ₹ 300 ; as rent ₹ 500.

(*c*) A contingent liability for ₹ 3,000 on bills discounted by him for ₹ 8,000.

(*d*) A loan of ₹ 5,000 taken from a friend for the marriage of his daughter.

SOLUTION

STATEMENT OF AFFAIRS OF MERCHANT

as at 30th June, 2021

Gross Liabilities	*Liabilities*		*Expected to Rank*	*Assets*	*Book Value*	*Expected to Produce*
₹			₹		₹	₹
44,500	Unsecured Creditors as per List A	(1)	39,500	Property as per List E Book Debts as per List F Bills of Exchange as per List G	45,000	(a) 9,000
—	Creditors Fully Secured as per List B	—		Surplus from securities in the hands of fully secured creditors as per *contra*		—
	Less : Estimated value of securities	—			45,000	9,000
	Surplus to *contra*			*Deduct* : Preferential Creditors as per *contra*		1,000
—	Creditors Partly Secured as per List C	—		Deficiency as explained in List H	8,000	31,500
	Less : Estimated value of securities	—				
1,000	Creditors for Rent, Rates, Taxes, Wages, etc., payable in full as per List D (2)	₹ 1,000				
	Deducted as per *contra*	1,000				
45,500			39,500			39,500

DEFICIENCY ACCOUNT (LIST H)

	₹		₹	₹
Excess of assets over liabilities on 30th June, 2021, *i.e.*, Capital	14,000	Other Losses :		
Deficiency as per Statement of Affairs	31,500	Loss on realisation of assets		36,000
		Loss due to expenses :	₹	
		Wages	200	
		Salaries	500	
		Rates and Taxes	300	
		Rent	500	
				1,500
		Bills discounted likely to be dishonoured		3,000
		Private liability of loan taken from the friend for the marriage of the daughter		5,000
	45,500			45,500

Working Notes :

(1) ***The amount of unsecured creditors has been calculated as follows :***

	₹
Liabilities	31,000
Rent	500
Bills discounted likely to be dishonoured	3,000
Friend's loan	5,000
	39,500

The gross liability of unsecured creditors is ₹ 44,500 ; ₹ 5,000 in respect of bills discounted not likely to be dishonoured have also been added.

(2) ***The amount of preferential creditors is :***

	₹
Wages	200
Salaries	500
Rates and Taxes	300
	1,000

(3) While filing his petition, the merchant stated his deficiency as ₹ 22,000 and liabilities as ₹ 31,000. This shows that the assets must have realisable value of ₹ 9,000 (₹ 31,000 – ₹ 22,000) because only at this value he can estimate his deficiency of ₹ 22,000.

(4) Interest on capital for 6 months has not been considered as the proprietor cannot get anything on becoming insolvent unless all the creditors are paid in full.

ILLUSTRATION 6. Mr. X files a petition in insolvency as at December 31, 2020, on which date his position was :

Liabilities		*Assets*	₹
Trade Creditors	30,000		
Bills Payable	20,000	Plant and Machinery	
Creditors with lien on stocks	25,000	(realisable value, ₹ 55,000)	80,000
Creditors having a charge on		Sundry Trade Debtors	
Plant & Machinery	20,000	(Bad ₹ 15,500 and Doubtful	
Payable for Salaries & Taxes	800	₹ 6,000 with 50% realisation)	36,500
		Patents (realisable value Nil)	20,000
		Furniture (realisable value ₹ 500)	1,000
		Stock (realisable value ₹ 17,500)	28,500
		Cash	1,500

The insolvent commenced business on 1st Jan., 2016. After depreciation of plant and machinery at ₹ 5,000 p.a. and allowing interest on capital at ₹ 4,000 p.a. and a salary to proprietor at ₹ 1,500 p.a. the trading resulted in profits of ₹ 6,000 in 2016, ₹ 5,000 in 2017, and losses of ₹ 7,000 each in 2018 and 2019 and ₹ 10,400 in 2020. The drawings during the period amounted to ₹ 26,000.

From the foregoing prepare Statement of Affairs and Deficiency Account as on 31st December 2020.

SOLUTION

In the given problem the capital of X is not given. Hence Trial Balance is prepared to know the capital. The difference between credit side total and debit side total of trial balance is assumed as capital. The trial balance is given below :

TRIAL BALANCE OF MR. X

As on Dec. 31st, 2020

Particulars	*Debit Amount* (₹)	*Credit Amount* (₹)
Plant and Machinery	80,000	
Sundry Trade Debtors	36,500	
Patents	20,000	
Furniture	1,000	
Stock	28,500	
Cash	1,500	
Trade Creditors		30,000
Bill Payable		20,000
Creditors with lien on Stocks		25,000
Creditors having a charge on Plant & Machinery		20,000
Payable for Salaries and Taxes		800
Interest on Capital (₹ 4,000 × 5 yrs.)		20,000
Salary to Proprietor (₹ 1,500 × 5 yrs.)		7,500
Profits for 2 years (₹ 6,000 + ₹ 5,000)		11,000
Loss for 3 years (₹ 7,000 + ₹ 7,000 + ₹ 10,400)	24,400	
Drawings	26,000	
Difference in Trial Balance : Capital introduced (Balancing fig.)		83,600
	2,17,900	2,17,900

STATEMENT OF AFFAIRS OF X

As on 31st Dec., 2020

Gross Liabilities	*Liabilities*		*Expected to Rank*	*Assets*	*Book Value*	*Expected to Produce*
₹			₹		₹	₹
	Unsecured Creditors			Assets as per list 'E'		
50,000	as per list 'A'		50,000	Patents	20,000	
	Fully Secured Creditors			Furniture	1,000	500
	as per list	₹		Cash	1,500	1,500
20,000	'B'	20,000		Book Debts as per list 'F'		
	Less : Estimated value of security	55,000		Good	15,000	15,000
	Surplus carried as per *contra*	35,000		Doubtful	6,000	3,000
				Bad	15,500	—
	Partly Secured			B/E as per list G		
	Creditors as per				59,000	20,000

25,000	List 'C'	25,000		Surplus as per *contra*		35,000
	Less : Estimated value of securities	17,500				55,000
			7,500	*Less* : Preferential Creditors as per *contra*		800
						54,200
800	Preferential Creditors as per list 'D'	800		Deficiency as explained in list 'H'		3,300
	Deducted as per *contra*	800				
95,800			57,500			57,500

DEFICIENCY ACCOUNT (LIST H)

	₹		₹	₹
Capital (Excess of assets over liabilities as on 1-1-2016)	83,600	Net Loss for 3 years (₹ 7,000 + ₹ 7,000 + ₹ 10,400)		24,400
Interest on Capital for 5 yrs. (₹ 4,000 × 5)	20,000	Drawings		26,000
Salary to proprietor for 5 yrs. (₹ 1,500 × 5)	7,500	Bad Debts (₹ 15,500 + ₹ 3,000)		18,500
Net Profit for 2 yrs. (₹ 6,000 + ₹ 5,000)	11,000	Loss on realisation of assets :	₹	
Deficiency as per Statement of Affairs	3,300	Patents	20,000	
		Plant & Machinery	25,000	
		Furniture	500	
		Stock	11,000	56,500
	1,25,400			1,25,400

ILLUSTRATION 7. Following are the particulars of the joint and separate estates of the firm and partners A and B :

Liabilities :	Firm ₹	A ₹	B ₹	Assets :	Firm ₹	A ₹	B ₹
Capitals : A	16,000			Debtors	12,000	—	—
B	12,000			Stock	40,000	—	—
Creditors	60,000	4,000	16,000	Furniture	4,000	4,000	4,000
Preferential Creditors	4,000	—	—	Building	28,000	—	—
Mortgage on Building	16,000	—	—	Investments	—	8,000	8,000
B/P	20,000	—	—	Plant	40,000	—	—
Excess of Assets over Liabilities	—	24,000	8,000	Capital A and B	—	16,000	12,000
				Cash	4,000	—	—
	1,28,000	28,000	24,000		1,28,000	28,000	24,000

B/P was secured by second charge on Building and B's personal guarantee and B's investment as collateral security. Estimated realisable values are :

Firm's Assets : Building ₹ 22,000 ; Plant ₹ 8,000 ; Furniture ₹ 2,000 ; Stock ₹ 16,000 ; Debtors : Good ₹ 4,000 ; Doubtful ₹ 4,000 (realisable value ₹ 2,000); Bad ₹ 4,000.

A's Assets : Furniture ₹ 2,000 ; Investments ₹ 6,000.

B's Assets : Furniture ₹ 2,000 ; Investments ₹ 4,000.

From the particulars given above, prepare Statement of Affairs and Deficiency Accounts of the joint estate as also the private estate of the partners.

SOLUTION

The first point to note before preparing firm's Statement of Affairs is :

Is there any surplus in any partner's private estate ? There is no surplus in B's estate because B's private property is not sufficient even to pay B's private liabilities. But there is a surplus of ₹ 4,000 in A's estate calculated as below :

		₹
Realisable value of A's private assets :		
	Furniture	2,000
	Investments	6,000
		8,000
Less :	Private Liabilities (A's Creditors)	4,000
	Surplus in A's Estate	4,000

Surplus of ₹ 4,000 in A's estate can be utilised for paying creditors of the firm ; so it will be shown as a property in the firm's Statement of Affairs.

STATEMENT OF AFFAIRS A AND B

as at ....

Gross Liabilities ₹	*Liabilities*		*Expected to Rank* ₹	*Assets*	*Book Value* ₹	*Expected to Produce* ₹
60,000	Unsecured Creditors as per List A		60,000	Property as per List E		
16,000	Fully Secured Creditors as per List B	₹ 16,000		Cash	4,000	4,000
	Less : Estimated value of securities	22,000		Stock	40,000	16,000
	Carried to List C :	6,000		Plant	40,000	8,000
				Furniture	4,000	2,000
				Surplus from A's Estate		4,000
				Books Debts as per List F :		

20,000	Partly Secured Creditors as per List C	20,000		Good	4,000	4,000
	Less : Estimated value of security	6,000		Doubtful	4,000	
				Bad	4,000	
			14,000	Estimated to produce		2,000
					1,00,000	40,000
4,000	Creditors for Rent, Rates, Taxes, Wages, etc., payable in full as per List D	4,000		Creditors for rent, rates, taxes, wages, etc. deducted as per *contra*		4,000
	Deducted as per *contra*	4,000				36,000
				Deficiency as explained in List H		38,000
1,00,000			74,000			74,000

The amount of B/P is ₹ 20,000. The holder of B/P realises ₹ 6,000 by having a second charge on building and for the balance of the amount, the holder will be considered as unsecured creditor of the firm. The holder of B/P realises ₹ 6,811 as follows :

The partnership firm pays for ₹ 74,000 = ₹ 36,000

Therefore, the firm pays for ₹ 14,000 (*i.e.* ₹ 20,000 – ₹ 6,000) $= \frac{₹\ 36,000}{₹\ 74,000} \times ₹\ 14000 = ₹\ 6,811.$

For the balance of the amount of B/P, *i.e.*, ₹ 14,000 – ₹ 6,811 = ₹ 7,189, the holder of B/P has B's personal guarantee and investments ; so this amount will be realised from B. Since the unsatisfied amount of B/P is ₹ 7,189 and the realisable value of investments is ₹ 4,000, the holder of B/P should be treated as partly secured creditor of B.

DEFICIENCY ACCOUNT OF A AND B (LIST H)

	₹		₹	₹
Excess of assets over liabilities *i.e.*, Capital as on	28,000	Bad debts as per List F		6,000
Income or profit from other sources :		Other Losses :		
Surplus from A's estate	4,000	Loss on realisation of :		
Deficiency as per Statement of Affairs	38,000	Plant	32,000	
		Furniture	2,000	
		Stock	24,000	
		Building	6,000	
				64,000
	70,000			70,000

STATEMENT OF AFFAIRS OF A

₹		₹		₹	₹
4,000	Unsecured Creditors as per List A	4,000	Property as per List E Furniture	4,000	2,000
	Surplus carried to the firm of A and B as explained in List H	4,000	Investments	8,000	6,000
4,000		8,000		12,000	8,000

SURPLUS ACCOUNT OF A

	₹		₹	₹
Excess of Assets over Liabilities *i.e.*, Capital	24,000	Loss on realisation of :		
		Investments	2,000	
		Furniture	2,000	
				4,000

		Loss of Capital in the firm	16,000
		Surplus as per Statement of Affairs	4,000
	24,000		24,000

STATEMENT OF AFFAIRS OF B

₹			₹		₹	₹
16,000	Unsecured Creditors as per List A		16,000	Property as per List E : Furniture	4,000	2,000
7,189	Partly Secured Creditors as per List C	₹ 7,189		Deficiency as explained in List H		17,189
	Less : Estimated value of security	4,000				
			3,189			
23,189			19,189		4,000	19,189

DEFICIENCY ACCOUNT OF B

	₹		₹	₹
Excess of Assets over Liabilities	8,000	Loss on realisation of :		
Deficiency as per Statement of Affairs	17,189	Investments	4,000	
		Furniture	2,000	
				6,000
		Loss on payment due to guarantee		7,189
		Loss of Capital in the firm		12,000
	25,189			25,189

ILLUSTRATION 8. Ploughman and Carter are equal partners. Insolvency petition is filed on 30-6-2021. The Balance Sheet as on 30-6-2021 is as follows (realisable value indicated in brackets) :

	₹		₹
Mortgage Loan (on Freehold)	40,000	Freehold (1,20,000)	1,60,000
Bank Overdraft (secured by second mortgage on Freehold)	1,60,000	Plant and Machinery (72,000)	1,20,000
		Fixtures (4,000)	12,000
Preferential Creditors	6,000	Stock (40,000)	80,000
Unsecured Creditors	2,00,000	Debtors (60,000)	1,00,000
Capital—Ploughman	88,000	Cash	2,000
		Carter—Capital Overdrawn	20,000
	4,94,000		4,94,000

The overdraft is secured, in addition to second mortgage, by Ploughman's personal guarantee against which his investments have been deposited. Ploughman's investments are estimated to realise ₹ 64,000 and after meeting his guarantee his private estate was insolvent. Carter was solvent and ₹ 38,000 was available from his estate for firm's creditors.

Prepare :

(*a*) Statement of Affairs (including rate of dividend for unsecured creditors).

(*b*) Deficiency Account.

(*c*) Capital Accounts in the Ledger (assuming realisations are as per estimates).

SOLUTION

STATEMENT OF AFFAIRS OF PLOUGHMAN AND CARTER

as on 30th June, 2021

Gross Liabilities	Liabilities (as stated and estimated by the debtor)		Expected to Rank	Assets (as stated and estimated by the debtor)	Book Value	Expected to Produce
₹			₹		₹	₹
	Unsecured Creditors			Property as per List E :		
2,00,000	as per List A		2,00,000	Cash	2,000	2,000
	Fully Secured Creditors	₹		Stock	80,000	40,000
40,000	as per List B	40,000		Plant and Machinery	1,20,000	72,000
	Less : Estimated Value			Fixtures	12,000	4,000
	of Securities	1,20,000		Surplus from Carter's		
		80,000		Estate		38,000
	Less : Transfer to					1,56,000
	List C	80,000		Book Debts as per List F	1,00,000	60,000
	Partly Secured				3,14,000	2,16,000
	Creditors as			Preferential Creditors		
1,60,000	per List C	1,60,000		deducted as per *contra*		6,000
	Less : Estimated					2,10,000
	Value of Securities	80,000		Deficiency as explained		
			80,000	in List H		70,000
	Preferential Creditors					
6,000	as per List D	6,000				
	Deducted as per					
	contra	6,000				
4,06,000			2,80,000			2,80,000

Rate of dividend per rupee of unsecured creditors is :

$$\frac{\text{Available assets for unsecured creditors}}{\text{Amount of unsecured creditors}} = \frac{₹\ 2,10,000}{₹\ 2,80,000} = 75 \text{ paise}$$

DEFICIENCY ACCOUNT (LIST H)

	₹		₹	₹
Excess of Assets over Liabilities,		Bad Debts as per List F		40,000
i.e., Capital on 30-6-2021	68,000	Loss on Realisation of Other		
Income from Other Sources :		Assets :		
Surplus from Carter's Estate	38,000	Stock	40,000	
Deficiency as per Statement of Affairs	70,000	Plant & Machinery	48,000	
		Fixtures	8,000	
		Freehold	40,000	
				1,36,000
	1,76,000			1,76,000

CAPITAL ACCOUNTS

	Plough-man	Carter		Plough-man	Carter
	₹	₹		₹	₹
To Balance b/d		20,000	By Balance b/d	88,000	
" Realisation A/c (Loss on Realisation of Assets ₹ 1,76,000 divided equally)	88,000	88,000	" Cash (Surplus from Carter's Estate)		38,000
			" Creditors (Deficiency)		70,000
	88,000	1,08,000		88,000	1,08,000

Questions

OBJECTIVE TYPE

1. **Fill in the blanks :**
   (a) Loss on bills discounted and likely to be dishonoured is included in List...... and shown on the .... side of the Deficiency Account.
   (b) Excess of private assets over private liabilities is shown on the.......side of the Deficiency Account.
   (c) The unsecured creditors having a prior claim over the others are called .... creditors.
   (d) If the realisable value of an asset is more than its book value, the difference will appear on the.........side of the Deficiency Account.
   (e) Statement of Affairs is prepared to record the amount of..........and Deficiency Account is prepared to explain the.........of the deficiency.

Ans. [(a) **A : right hand ; (b) left hand ; (c) preferential ; (d) left hand ; (e) deficiency, causes].**

2. **Indicate the correct answers :**
   (a) Preferential creditors are shown under
   (i) List A (ii) List D (iii) List E.
   (b) Under the Presidency Towns Insolvency Act, rent due to the landlord is preferential for a period of
   (i) one month (ii) two months (iii) three months
   (c) Amount due to Government or local authority is a
   (i) secured claim (ii) unsecured claim (iii) preferential claim.
   (d) Book debts are shown under
   (i) List A (ii) List E (iii) List F.
   (e) Under the Provincial Insolvency Act, rent due to the landlord is preferential for a period of
   (i) one month (ii) three months (iii) Rent is not preferential.

Ans. **[(a) (ii), (b) (i), (c) (iii), (d) (iii), (e) (iii)].**

3. **State the effect of the following in the Statement of Affairs and Deficiency Account with reasons :**
   (i) 24 months before the declaration of insolvency, a private house of ₹ 40,000 was transferred to his wife without consideration and a private bungalow of ₹ 60,000 to his daughter in consideration of her marriage.
   (ii) The insolvent has private assets worth ₹ 80,000 including '*Stridhan*' of ₹ 25,000 of his spouse and private liabilities worth ₹ 35,000.
   (iii) Out of the unsecured creditors of ₹ 80,000 a loan taken from wife of ₹ 28,000 has been included. Wife has paid this sum out of her '*Stridhan*'.
   (iv) Bills Received of ₹ 20,500 were discounted out of which bills worth ₹ 12,000 are not expected to be dishonoured.

4. How will you treat the following items while preparing statement of affairs and deficiency account ?
   (a) The insolvent has transferred a small private house of ₹ 6,00,000 to his daughter in consideration of her marriage.
   (b) ₹ 40,000 loan from wife has been included in unsecured creditors of ₹ 1,60,000. Wife has paid this loan out of her Stridhan.
   (c) 18 months before the declaration of insolvency a private house of ₹ 4,00,000 was transferred to his wife without consideration.
   (d) The insolvent has private assets worth ₹ 1,50,000 including Stridhan of ₹ 25,000 of his spouse and private liabilities worth ₹ 50,000.
   (e) Bills received of ₹ 20,000 were discounted out of which bills worth ₹ 12,000 are not expected to be dishonoured.

SHORT ANSWER TYPE

1. How do you treat loan from wife under Insolvency Act ?
2. What is Deficiency Account ?
3. What is to be given in Property as per List E ?
4. How will you treat bills likely to be dishonoured in case of Insolvency Accounts ?
5. What do you mean by fraudulent preference ?
6. What do you mean by doctrine of reputed ownership ?
7. How will you deal with voluntary transfer in case of Insolvency Accounts ?
8. How do you treat wife's jewellery of ₹ 20,000 surrendered by her to the court in insolvency statements ?
9. What do you mean by preferential creditors ?
10. From the following ascertain the **creditors** to be shown under Lists A and D :

	₹		₹
Creditors on Open Account	55,000	B/R discounted (expected to Rank ₹ 3,000)	9,000
B/P	10,500	Income-tax payable	550
Creditors having lien on Stock	8,000	Creditors for Salaries and Wages	
Bills of exchange	4,000	(Preferential ₹ 600)	2,200
Stock (estimated to produce)	6,000		

Ans. **[List 'A' ₹ 70,100 ; List 'D' ₹ 1,150]**

11. From the following figures of an insolvent, prepare the **Statement of Affairs** as at 31st Dec., 2020. Cash ₹ 320 ; Stock-in-trade ₹ 1,000 ; Debtors-Good ₹ 7,000. Debtors-doubtful ₹ 1,800 ; Debtors-bad ₹ 1,500. Fixtures & Fittings ₹ 564. Investment in Shares ₹ 50 ; Unsecured Creditors (including ₹ 1,000 of his wife, given from stridhan) ₹ 13,000 ; Secured Creditors ₹ 2,500 ; Value of Securities held by secured Creditors ₹ 3,500. Preferential claims for Rent, Rates & Taxes ₹ 190. Stock realises ₹ 666, Fixtures & Fittings ₹ 282, Investments in shares, the book value, and the bad and doubtful debts together ₹ 600.

Ans. **[Deficiency ₹ 3,272]**

12. Prepare **Deficiency Account** from the following details :—

	₹		₹
Excess of assets over liabilities	20,000	Loss from betting	8,000
Net loss from business	6,500	Net Profit from Business	10,000
Income from other sources	4,000	Bad debts	12,000
Household expenses	32,000	Loss on realisation of assets	9,640

Ans. **[Deficiency ₹ 34,140]**

13. From the following particulars prepare **Deficiency Account :**

	₹		₹
Net Loss from 2019 to 2021	18,000	Loss on Bills Discounted	2,000
Gift declared void	1,000	Net Profit in 2017 and 2018	5,000
Excess of Assets over Liabilities (1-1-2017)	20,000	Loss on Sale of Assets	5,000

Bad Debts	10,000	Interest on Capital	1,000
Profit on Sale of Assets	2,000	Loss through Speculation	2,000
Household Expenses	3,000	Surplus from Private Property	4,000

Ans. [**Deficiency ₹ 7,000**]

14. The assets of a Merchant on 30th June, 2021 as shown by his books were ₹ 56,000 and liabilities ₹ 44,000. He filed his insolvency petition in the court and estimated his deficiency to be ₹ 30,000. After making the above estimate, he found that the following items were not included.
Interest at 6% on his capital from 1st January, 2021. A contingent liability for ₹ 2,500 on bills discounted by him for ₹ 10,000.
Amounts due as wages ₹ 300, as Salaries ₹ 700, as rent ₹ 300 and rates and taxes ₹ 200.
Prepare his **Statement of Affairs.**

Ans. [**Deficiency ₹ 34,000**]

15. From the following ascertain the **creditors** to be shown under Lists A and D

	₹		₹
Creditors on open accounts	55,000	Bills Receivable discounted (expected to rank 3,000)	9,000
Creditors having lien on stock	8,000	Income tax payable	550
Bills of Exchange	4,000	Creditors for salaries and wages (preferential ₹ 60)	2,200
Stock & (estimated to produce)	6,000		

Ans. [**List A ₹ 60,140 ; List D ₹ 610**]

16. Ascertain the amount of **creditors** to be shown under Lists B and C.

	₹		₹
Plant (estimated to produce ₹ 25,000)	35,000	Creditors having lein on shares	10,000
First mortgage on Plant	22,000	Trade creditors	30,000
Second mortage on Plant	15,000	Creditors for salaries and wages	1,500
Shares (estimated to produce ₹ 6,000)	8,000	Bills payable	5,000

Ans. [**List B—₹ 22,000 ; List C ₹ 25,000**].

17. The assets of Gopal as on 30-6-2020 as shown by his books were ₹ 70,000 and his liabilities ₹ 60,000. He filed his petition for insolvency and estimated his deficiency to be ₹ 40,000. He found subsequently that the following were not passed through his account books :
(a) Interest @ 6% p.a. on his capital from 1st Jan., 2020.
(b) A contingent liability of ₹ 3,000 on bills discounted by him for ₹ 12,000.
(c) Preferential payments ₹ 1,600. Prepare only **Deficiency Account.**

Ans. [**Deficiency ₹ 44,600**]

18. Garib is insolvent. From the following data prepare **appropriate lists of Creditors :**

	₹		₹
Total Creditors	90,000	Book value of Building	40,000
Creditors (Secured with 1st charge on Buildings)	20,000	Realisable value of Building	35,000
Creditors (Secured with 2nd charge on Buildings)	25,000		

Ans. [**List B ₹ 20,000 ; List C Gross ₹ 25,000 expected value of security ₹ 15,000 ; List A ₹ 45,000**].

19. Prepare **Deficiency Account** from the following information :

	₹		₹
Capital on 1-1-2020 (opening)	800	Loss on sale of assets	500
Bad debts	1,000	Interest on capital	100
Profit on sale of assets	200	Loss through speculation	200
Household expenses	300	Surplus from private property	400
Loss on bills discounted	200	Gift declared void	100
Profit in first two years	500	Loss in next three years	1,800

Ans. [**Deficiency ₹ 1,900**].

20. Mohd. Zaved had on 31st March, 2021 assets of ₹ 66,000 including a machinery valued in the books at ₹ 6,000 (estimated to realise 70% of the book value) and furniture valued ₹ 2,000

(estimated to produce 40%). He also had liabilities ₹ 40,000 of which ₹ 3,000 were fully secured against the machinery and liabilities of ₹ 1,000 were secured against furniture. He filed his petition in insolvency and estimated his deficiency to be ₹ 20,000 before taking into account the following items :

(i) Interest on his capital @ 6% from 30th June, 2021.
(ii) Bills discounted ₹ 1,000 expected to rank ₹ 500.
(iii) Wages ₹ 700; Rent ₹ 800; Salaries ₹ 2,000; Income-tax ₹ 100; Sales-tax ₹ 50; House-tax ₹ 50.
(iv) Mohd. Zaved is a reputed owner of a property worth ₹ 8,000.

Prepare his revised **Statement of Affairs and Deficiency Account.**

Ans. [Deficiency ₹ 24,000; Deficiency A/c Total ₹ 50,000]

LONG ANSWER TYPE

1. Mention the various lists that have to be prepared in support of the Statement of Affairs prepared under the Indian Insolvency Law, giving short particulars as to the contents of each of them.
2. Explain the difference between a Statement of Affairs and a Balance Sheet.
3. What is Deficiency Account ? How is it prepared ?
4. What do you mean by Preferential Creditors ? How are they shown in the Statement of Affairs ?
5. Is there any difference between insolvency of an individual and insolvency of a partnership firm ? If so, explain it.
6. What do you mean by fraudulent preference ? Has it any effect on the Statement of Affairs and the Deficiency Account ?
7. How will you deal with joint and separate estates of partners in insolvency ?
8. Explain the insolvency procedure laid down by the legislation in India.

Practical Problems

INSOLVENCY OF INDIVIDUALS

1. Mr. A is insolvent. He supplies to you the following information as on 31-3-2021 :

	₹		₹
Cash in hand	10,000	Book Debts (Doubtful) Expected to realize 40%	5,50,000
Creditors for Goods	10,00,000	Bills Discounted (₹ 40,000 bad)	1,40,000
Taxes due to Government	35,000	Loan from Nathan secured by second charge on stock	2,00,000
Bank Loan Secured by Lieu on Stock	1,50,000	Bills receivable (₹ 40,000 bad)	1,00,000
Furniture (Expected to Realize ₹ 50,000)	75,000		
Stock (expected to realize 50%)	6,00,000		
Book Debts (Good)	4,50,000		

Mr. A started business four years ago with a capital of ₹ 4,50,000. He drew ₹ 75,000 each year for private purposes, but did not maintain proper books of accounts. Mrs. A gave up her jewellery valued ₹ 1,00,000 to the receiver.

Prepare **Statement of Affairs** of Mr. A as on 31-3-2021 and Deficiency Account as on that date.

Ans. [Deficiency ₹ 2,35,000; Total of Deficiency A/c ₹ 10,35,000]

[**Hints :** Unsecured Creditors Gross ₹ 11,40,000 (expected to rank ₹ 10,40,000). Accumulated Profit (₹ 2,50,000) can be ascertained by preparing Trial Balance.]

2. Mr. Seth of Mumbai finds himself insolvent on 31st December, 2020. His position was as follows :

	₹		₹
Cash in hand	300	Bills Payable	28,000
Bills of Exchange	4,800	Bank Overdraft	12,000
Debtors : Good	8,000	Liability on bills discounted (estimated to rank ₹ 6,000)	10,000
Doubtful (Estimated to realise 80%)	2,400	Creditors secured by life policy	
Bad	1,000		

Furniture (estimated to realise ₹ 5,000)	7,000	(worth ₹ 8,000)	13,000
Machinery (estimated to realise ₹ 41,000)	50,000	Household utensils	300
Stock-in-trade (estimated to realise ₹ 32,000)	40,000	Life policy not charged	6,000
Household Debts	1,000	Mortgages (holding the security worth ₹ 70,000)	50,000
Rent due to Landlord for 2 months	1,200	Creditors holding a second charge on the assets held by fully secured creditors (to the extent of ₹ 14,000)	18,000
Wages due to servant for five months	100		
Clerk's salaries for 4 months in arrears	1,700		
Rates and taxes due	1,000		
Mrs. Loan	11,000	Works Manager's salary due for last 2 months	2,000
Trade Creditors	45,000		

Prepare **Statement of Affairs.** Estimating the cost of winding up at ₹ 1,200, state the rate of dividend which could be expected to be paid to the creditors.

Ans. [Deficiency ₹ 12,980 ; Dividend @ 88 paise per rupee].

3. Ganpat files his petition for insolvency on 31st December, 2020 with the following particulars :

	₹
Sundry Debtors : Good ₹ 5,000, Doubtful ₹ 15,250 (estimated to produce ₹ 10,000) ; Bad ₹ 5,000	
100 shares in Textiles Ltd. (estimated to produce ₹ 7,500)	12,500
Mining shares (estimated to produce ₹ 38,000)	42,500
Loss through speculation	7,500
Creditors on open accounts	45,000
Creditors holding a second charge on mining shares to the extent of ₹ 15,000	17,500
Creditors holding a first charge on mining shares	20,000
Bills Payable	2,500
Bills Receivable discounted (of which ₹ 1,750 is likely to be dishonoured)	3,500
Creditors for rates, taxes, wages etc. (of which ₹ 1,250 is preferential)	1,500
Furniture (estimated to produce ₹ 1,500)	2,000
Cash in hand	60
Stock-in-trade (estimated to realise ₹ 15,000)	19,440
Bills Receivable (estimated to produce ₹ 3,500)	5,000

He started with a capital of ₹ 30,000 on 1st January, 2019 and business resulted in a profit of ₹ 5,000 and ₹ 3,750 for the first two years respectively and loss of ₹ 2,500 for the third year after allowing ₹ 1,500 as interest on capital each year. Withdrawals for the entire period amounted to ₹ 13,000.

Prepare **Statement of Affairs and Deficiency Account.**

Ans. [Deficiency ₹ 7,690 ; Total of Deficiency A/c ₹ 50,940].

4. Shiam Mohan filed a petition in bankruptcy on 30th June. His books showed the following balances :

	₹	₹
Cash in hand	10	
Fixtures and Fittings (estimated to produce ₹ 80)	250	
Stock-in-trade (estimated to produce ₹ 1,200)	1,800	
Sundry Creditors :		
Trade Creditors		2,000
Bills Payable		2,200
Sundry Debtors :		
Good	1,000	
Doubtful (Expected to realise 50%)	2,000	
Bad	2,000	
Bank Overdraft		1,200
Capital		1,660
	7,060	7,060

Liability on bills discounted ₹ 500, expected to rank ₹ 100. His household furniture was valued at ₹ 250. He owned a house valued at ₹ 750, having a mortgage on it of ₹ 600 at 4%. Interest paid up to the preceding 31st December.

Preferential Creditors amounted to ₹ 35 (included in sundry creditors) and ₹ 15 for rates on the house.

Prepare **Statement of Affairs and Deficiency Account.**

Ans. **[Deficiency ₹ 1,837 ; Total of Deficiency A/c ₹ 3,870].**

5. A filed his petition in Bankruptcy on 30th June, 2021. Prepare his Statement of Affairs and Deficiency Account from the following information.

The stock-in-trade cost ₹ 72,000 of which ₹ 6,000 worth is in the hands of a creditor for ₹ 10,000 who is entitled to exercise a lien : Book Debts : Good Rs 97,500. Doubtful ₹ 1,200 worth ₹ 400, Bad ₹ 1,500; Fixtures and Fittings (after depreciation) ₹ 2,300 ; Cash in hand ₹ 100.

Bills Receivable ₹ 11,000 (held by bankers) against overdraft of ₹ 40,000—balance of which is secured by a second mortgage on debtor's freehold property and by the guarantee of his brother. Customers' bills under discount ₹ 15,000 of which ₹ 2,000 is ascertained to be bad and ₹ 1,000 is doubtful. Freehold property ₹ 30,000 subject to a first mortgage of ₹ 20,000. The unsecured creditors amount to ₹ 2,98,000 in addition to the claims for rates, taxes and wages amounting to ₹ 2,400. The Stock-in-trade and the Book Debts (outside the bills) are estimated to be realised at 75% of their face value, and the freehold property which cost ₹ 28,000 is valued at ₹ 22,000. Subject to the modifications stated above, the assets are worth their book values.

You learn that the debtor had a surplus of assets of ₹ 50,000 on 1st January, 2019 since when he has withdrawn ₹ 30,000 per annum in equal monthly instalments. His profits for the year ended 31st December, 2019, were ₹ 21,000 and for 2020 ₹ 4,200 since which time he has not made up his books.

From these details, you are required to prepare as nearly as may be in statutory form (*a*) **Statement of Affairs**, and (*b*) **Deficiency Account.**

Ans. **[Deficiency ₹ 2,10,475 ; Total of Deficiency A/c ₹ 2,85,675 ; Loss for 2021 ₹ 1,55,000].**

6. The capital in the business of X on 31st December, 2019 was ₹ 7,000. During the year ended 31st December, 2020, he sustained a trading loss of ₹ 7,800 and his drawings out of the business were ₹ 7,000. Owing to his unsatisfactory financial position, he was compelled to file his petition, and a receiving order was made against him on 31st December, 2020. His assets consisted of :

(*a*) Book debts ₹ 10,000 of which ₹ 8,000 were considered good and the remaining estimated to produce ₹ 1,000.

(*b*) Stock (cost ₹ 15,000) estimated to produce ₹ 10,000.

(*c*) Machinery (cost ₹ 16,000) estimated to produce ₹ 11,000.

(*d*) Freehold house valued at ₹ 12,000, the deeds of which were lodged with the bank as security for an overdraft on business account of ₹ 8,000.

(*e*) His life policy (surrender value of ₹ 2,000) given as part security for a private loan of ₹ 3,000.

(*f*) His trade creditors amounted to ₹ 40,400 and he owed ₹ 400 to his clerk, being salaries for the two months ended 30th June, 2020.

(*g*) Bills had been discounted amounting to ₹ 3,000 in respect of which it was estimated that X would be liable for ₹ 1,000.

Prepare his **Statement of Affairs and Deficiency Account.** Estimating the cost of winding up at ₹ 800, state the amount of dividend which could be expected to be paid.

Ans. **[Deficiency ₹ 8,800 ; Expected Dividend per rupee 0.775 ; Deficiency A/c Total ₹ 26,800].**

7. On 31st December, 2020 Shri Y files his petition in bankruptcy on which date the Receiving Order was made. You are instructed by the Official Receiver in Bankruptcy to assist the debtor in the preparation of a **Deficiency Account and Statement of Affairs.** Your investigation discloses the following :

Assets	Book Value	Estimated to produce
	₹	₹
Freehold property to a first mortgage thereon having been given to fully secured creditors and a second charge limited to ₹ 10,000 to partly secured creditors.	1,20,000	1,00,000
Stock-in-trade	56,000	39,000
Trade Fixtures and Fittings	8,000	3,000
Book Debts :		
Good	61,000	61,000
Doubtful	27,000	20,000
Bad	17,000	Nil
Bills Receivable	3,000	Nil
Cash in hand	1,000	1,000

Liabilities

His liabilities amounted to ₹ 3,50,000 of which ₹ 74,000 was fully secured, ₹ 38,000 partly secured, liabilities for rent, wages etc. were ₹ 4,500 claimed to be preferential. There was also contingent liability on bills under discount of ₹ 27,400 of which ₹ 2,000 was expected to rank. He has household furniture of the estimated value of ₹ 2,500 and life policies of the surrender value of ₹ 5,000. The two latter items were not in his books of accounts. Out of liabilities for rent, etc. ₹ 2,000 was admitted as preferential.

On 1st January, 2018 Y's capital was ₹ 1,30,000. During the three intervening years, trading results, interest on capitals, and drawings were as follows :

	Trading Results		Drawings	Interest on Capital
	₹		₹	₹
To 31st December, 2018	4,000	Profit	8,000	6,000
To 31st December, 2019	75,000	Loss	10,000	6,500
To 31st December, 2020			15,000	1,500

Out of drawings, Mrs. Y purchased ornaments for ₹ 5,000 which she offers to Mr. Y for paying loans. These are estimated to fetch ₹ 6,000. ₹ 30,000 loss in 2019 (included in ₹ 75,000 above) was due to speculation.

Ans. [Deficiency ₹ 1,14,500 ; Deficiency A/c Total ₹ 2,76,000 ; Loss for 2020 ₹ 97,000].

8. A merchant became insolvent on 1-1-2021 on which date his total assets were ₹ 75,000 and liabilities ₹ 65,000 and he estimated a deficiency of ₹ 20,000 before taking the following items into consideration which were not passed through his account books :

(1) Interest on his capital of ₹ 25,000 @ 6% for one year.

(2) A contingent liability for ₹ 3,000 on bills discounted by him for ₹ 8,000.

(3) Amount due as wages ₹ 300 ; as salaries ₹ 600 ; as rent ₹ 500 ; as rates and taxes ₹ 1,000.

(4) A loan of ₹ 5,000 taken from a friend for the marriage of his daughter, and ₹ 2,000 from his wife.

Prepare a **Statement of Affairs and a Deficiency Account.**

Ans. [Deficiency ₹ 32,400 ; Total of Deficiency A/c ₹ 57,400].

Voyage Accounts

Shipping companies required to calculate their profitability on every voyage. Not like transport industry, who calculate profitability as whole transaction not on each transport.

Voyage account is similar to a **Profit and Loss account;** all expenses are debited to Voyage account and all incomes are credited to Voyage account. Voyage account is prepared to ascertain the profit or Loss of voyage. It covers both inward and outward travelling. To ascertain profitability of each voyage they are to adopt some system of accounting known as voyage. Overall profit or loss ascertained by preparing general profitability account. In accounting treatment Voyage account is nominal account. Though you can see / touch ship this cannot be considered as real account since in voyage account is dealing the voyage from one place to another place not considering the Ship or Vessel.

We need to consider voyage account as nominal account and we need to provide the nominal account treatment. Profit and Loss account has to be calculated for each voyage (outward and inward) of single ship. We need to provide special treatment for the voyage is in progress while the books of accounts are closed for Year-end / accounting period end.

Primage

It is ab additional freight charge, just like surcharge on freight, originally collected by captain of the ship, now a days treated as income of shipping company

Passage money

Fare collected by company from the passenger who are carried on the ship along with merchandize. Usually Passage money collected by Captain.

Freight

The amount charged by the shipping company from the cargo owners for the cargo loaded on the ship is known as freight. In usual commercial term loading charges

Light house charges

Light house charges paid to Port authorities for the various facilities and services offered by them like Radio Signal, Becon light etc.,

Salaries and Wages

Salaries and wages paid to the crew are charged to the voyage account

Stevedoring charges

Loading and unloading of Cargo into and from the ship

Bunker cost

This is the amount spent of fuel, coal , diesel and fresh water used for the purpose of Voyage

Depreciation

To ascertain the true result, voyage account should be debited with Depreciation, tackle, repairs, renewals and replacements

Template of Voyage Account

Name of the Ship
(voyage account holds name of the ship /mission name)

Voyage No ____________ Date of Commencement

From *Departure* location name To Destination location name Date of Arrival ____________________

Voyage Account

Particular	Amount	Particulars	Amount
To Brokerage & Address commission		By Freights	
To Insurance on Freight		Outward	
To Consumable stores		Inward	
To Depreciation on Ship / Hull		By Preimage	
To Port Charges		By Passage Money	
To Stevedoring Expenses		By Voyage in progress	
To Bunker cost		(expenses relating to unfinished voyage on	
To Lighter age		the date of closing of books of accounts)	
To Salaries and Wages		Profit and Loss A/c	
To Lighthouse Charges		Loss on Voyage (balancing number)	
To Repairs and Renewals			
To Overheads			
To Provision for Freight on incomplete voyage (advance freight, preimage received in advance relating to incomplete voyage			

Problem 1

Following are the details furnished by Shipping corporation of India for Voyage no 77, which was commenced from Chennai Port on 1st Feb 2022 and reached Gujarat port on 31st March 2022. Voyage completed at Kolkata port.

2000 tons and 500 tons were loaded into ship from Chennai port for Kolkata and Vizag port respectively.
Chennai to Kolkata 100 per ton as charge
Chennai to vizag 80 per ton as charge
Freight is subject to 10% primage
5% address commission
3% brokerage
Freight was insured at .5%
The hull was insured for voyage @1%
Depreciation @5% pa
Cost of ship 12Lacs

Expenses at different ports are	Chennai	Vizag	Gujarat
Port charges	5000	4000	3000
Coal	18000	4000	
Captain expenses	2000	600	900
Harbour charges	4000	3000	2500

Store purchased 8000 at Chennai, opening was 5000 and closing stock as 2000

Stock of coal estimated as 4500, against stock 4500.
Salaries and wages 12000 per month.
Prepare voyage account

Voyage Account				
for the year ending 31st March 2022				
		Freight		
		Chennai to Kolkata 2000 tons		
		2000*100	200000	
		Chennai to Vizag 500 tons		
		500*80	40,000	
		Vizag to Kolkatt 300 tons		
To poft Charge 5000+1000+3000+3000	12,000.00	300*50	15000	255,000.00
To Coal				
Opening Stock 1500				
Ass Purchase 22500				
Less Closing stock 4500	19,000.00	By Primage 10% on frieght		25,500.00
Captain expenses	3,500.00			
Harbour charges	9,500.00			
Address Commission 5% on 280500	14,025.00			
Brokerage 3% 280500	8,415.00			
Insurance preiun				
.5% on 280500	1,403.00			
Hull 1% 1200000	12,000.00			
Stores	11,000.00			
Depreciation for 2 months	10,000.00			
Salaries	24,000.00			
Net Profit	155,657.00			
	280,500.00			**280,500.00**

ILLUSTRATION 1. Following details are furnished by a Shipping Company in connection with voyage No. 45 which was commenced from port A on 1st February, 2021. The ship arrived at port D on 31st March, 2021 when the voyage was completed.

2,000 tons and 500 tons were loaded at port A for port D and C respectively. Another 300 tons were loaded at C for D. The freight charges were :

A to D ₹ 100 per ton ; A to C ₹ 80 per ton ; C to D ₹ 50 per ton.

The freight is subject to 10% primage, 5% address commission and 3% brokerage. The freight was insured at $\frac{1}{2}$%. The Hull was insured for the voyage @ 1%. Depreciation is provided @ 5% p.a.

Cost of the ship is ₹ 12 lakhs. The expenses at different ports were as under :

	A	*B*	*C*	*D*
	₹	₹	₹	₹
Port charges	5,000	1,000	3,000	3,000
Coal	18,000	—	4,000	
Captains' expenses	1,200	800	600	900
Harbour wages	4,000	—	3,000	2,500

Stores purchased at commencement amounted to ₹ 8,000. Opening Stock of stores was ₹ 5,000 and Closing Stock is estimated at ₹ 2,000. Stock of coal at close is estimated at ₹ 4,500 as against stock of ₹ 1,500 at the beginning.

Salaries and wages of sailors etc. amount to ₹ 12,000 per month. Prepare Voyage Account for the period ending 31st March, 2021.

SOLUTION

VOYAGE ACCOUNT

for the period ending 31st March, 2021

		₹		₹	
To Port Charges (₹ 5,000 + ₹ 1,000 + ₹ 3,000 + ₹ 3,000)		12,000	By Freight		
To Coal :	₹		A to D 2,000 Tons @ ₹ 100 per ton	2,00,000	
Opening Stock	1,500		A to C 500 Tons @ ₹ 80 per ton	40,000	
Add : Purchases	22,000		C to D 300 Tons @ ₹ 50 per ton	15,000	2,55,000
	23,500				
Less : Closing Stock	4,500	19,000			
To Captains Expenses (₹ 1,200 + ₹ 800 + ₹ 600 + ₹ 900)		3,500	By Primage (10% on ₹ 2,55,000)		25,500
To Harbour Wages (₹ 4,000 + ₹ 3,000 + ₹ 2,500)		9,500			
To Address Commission (5% of 2,80,500)		14,025			
To Brokerage (3% of ₹ 2,80,500)		8,415			
To Insurance Premium					
Freight $\frac{1}{2}$% of ₹ 2,80,500		1,403			
Hull 1% of ₹ 12 lakh		12,000			
To Stores (₹ 5,000 + ₹ 8,000 − ₹ 2,000)		11,000			
To Depreciation $\left(₹\ 12,00,000 \times \frac{5}{100} \times \frac{2}{12}\right)$		10,000			

To Salaries & Wages (₹ 12,000 × 2)	24,000		
To Net Profit	1,55,557		
	2,80,500		2,80,50

ILLUSTRATION 2. Packard Steamship Ltd. owns a tramp steamer by name, M.V. Vaikunt, whi was chartered on a voyage on 1st March, 2021, on the following terms :

(i) Mumbai to Basra with general cargo at ₹ 500 per tonne. The charter stipulates for an addre commission to the charterers at 2% of the freight payable on raising the bill of lading together with brokerage of 5% to the charterer's agent, one-third of which is repayable to the ship.

(ii) Basra to Dubai with fertilisers at ₹ 240 per tonne. Address commission of 2% on freight is payab to charterers and a brokerage of 1% is payable to agents on signing the charter.

The vessel is insured with Lloyds on an annual premium of ₹ 6,60,000. The master of the vessel entitled to 1% of the net profits of each voyage after charging such commission.

Further details are :

Repairs and Renewals : at Mumbai ₹ 40,000, and at Basra ₹ 18,000.

Stores Supplies and Provisions : at Mumbai ₹ 1,40,000, at Basra ₹ 1,60,000 and at Dubai ₹ 90,000 o of which ₹ 40,000 was in stock at the conclusion of voyage.

Consumption of Bunkers : Fuel oil 6 tonnes a day, diesel 2 tonnes a day, and fresh water 25 tonnes day while the vessel is in port and fuel oil 15 tonnes a day, diesel 2 tonnes a day and fresh water 25 tonn a day while sailing. Fuel oil, diesel and fresh water cost ₹ 1,200, ₹ 2,500 and ₹ 50 per tonne respectively.

Stevedoring charges : at Mumbai ₹ 20 per tonne; at Basra ₹ 15 per tonne for loading and ₹ 20 per ton for discharging; and at Dubai ₹ 12 per tonne for load/discharge.

Captain's expenses : at Basra ₹ 16,000 and at Dubai ₹ 20,000.

Port charges : at Mumbai ₹ 60,000; at Basra ₹ 70,000 and at Dubai ₹ 54,000.

The vessel loaded the following cargo :

at Mumbai—general cargo—8,000 tonnes, out of which 6,000 tonnes were to be discharged at Bas and the rest at Dubai. The freight from Mumbai to Dubai was fixed at ₹ 600 per tonne net.

at Basra—fertiliser—for discharge at Dubai—6,000 tonnes.

The vessel completed the voyage on 30th April 2021. Number of sailing days as per ship's log came 16.

Prepare a Voyage Account bearing in mind that the company has to provide towards special surv repairs of the vessel ₹ 24 lakhs every year.

SOLUTION

Packard Steamship Ltd.
VOYAGE ACCOUNT OF M.V. VAIKUNT
from 1st March to 30th April, 2021

		₹			
To Port Charges		1,84,000	By Freight :		
Stevedoring Charges :			Mumbai to Basra		
Loading at Mumbai—			6,000 tonnes	₹	
8,000 tonnes @ ₹ 20/tonne	₹ 1,60,000		@ ₹ 500/tonne	30,00,000	
Unloading at Basra—			Mumbai to Dubai		
6,000 tonnes @ ₹ 20	1,20,000		2,000 tonnes @ ₹ 600/tonne		12,00,0
Loading at Basra			Basra to Dubai		
6,000 tonnes @ ₹ 15	90,000		6,000 tonnes @ ₹ 240/tonnes	14,40,000	56,40,0
Unloading at Dubai					
8,000 tonnes @ ₹ 12	96,000		Refund of Brokerage		

To Stores, Supplies and Provisions		3,90,000	By Stock of Stores, Supplies and Provisions	40,000
" Repairs & Renewals :				
At Mumbai	40,000			
At Basra	18,000			
Provision for Special Survey Repairs $\left(\frac{2}{12} \times ₹\ 24,00,000\right)$	4,00,000	4,58,000		
To Consumption of Bunkers :				
For 16 Sailing Days @ ₹ 24,250 (1)	3,88,000			
For 45 days stay at port @ ₹ 13,450 (2)	6,05,250	9,93,250		
" Insurance $\left(\frac{2}{12} \times ₹\ 6,60,000\right)$		1,10,000		
" Address Commission :				
2% on ₹ 30,00,000	60,000			
2% on ₹ 14,40,000	28,800	88,800		
" Brokerage :				
5% on ₹ 30,00,000	1,50,000			
1% on ₹ 14,40,000	14,400	1,64,400		
" Commission to Master $\left(\frac{1}{101} \text{ of } ₹\ 28,39,550\right)$		28,114		
" Net Profit on Voyage		28,11,436		
		57,30,000		57,30,000

Working Notes :

(1) ***Cost of Consumption of Bunkers per day on Sailing Days :***

	₹
Fuel Oil : 15 tonnes @ ₹ 1,200 per tonne	18,000
Diesel : 2 tonnes @ ₹ 2,500 per tonne	5,000
Fresh Water : 25 tonnes @ ₹ 50 per tonne	1,250
	24,250

(2) ***Consumption of Bunkers per day during Stay at Port***

	₹
Fuel oil : 6 tonnes @ ₹ 1,200 per tonne	7,200
Diesel : 2 tonnes @ ₹ 2,500 per tonne	5,000
Fresh Water : 25 tonnes @ ₹ 50 per tonne	1,250
	13,450

Voyage-in-Progress (Incomplete Voyage). At the time of closing the books of accounts at the end of the year, it is possible that voyage may not be complete and it may still be in progress. In such a case, special treatment is required for the following items :

1. Freight received on incomplete journey.
2. Expenses related to incomplete journey.

1. Freight Received on Incomplete Journey. Though the entire freight (including primage) being income, is credited to Voyage Account yet it is unearned income as the journey of the ship is incomplete and is required to be carried forward. Instead of deducting from freight on credit side, a provision for freight

ILLUSTRATION 4. M.V. Indian Glory owned by the Hindustan Shipping Company Ltd. is on the Mumbai—London lines trade. Her daily standing charges (fixed costs) are ₹ 45,000. In the period between 1st July and 31st December, 2020, the ship had finished one round voyage to London and on the date when the books of accounts of the company were closed at the end of the year, the vessel was on her way to London, having sailed out of Mumbai after midnight of 21st December. Loading for London commenced on 1-12-2020.

From the following details prepare a Voyage Account.

Freight earned :

(a) *Complete voyage—Mumbai to London*

(i) 20,000 tonnes textiles at ₹ 280 per tonne.

(ii) 10,000 tonnes copra at ₹ 340 per tonne.

On textiles, a surcharge of 10% was also recovered.

London to Mumbai

32,000 tonnes of urea at ₹ 300 per tonne.

(b) Unfinished voyage :

30,000 tonnes of general cargo at ₹ 240 per tonne plus a surcharge of 15%.

Expenses :

(a) Stevedoring expenses :

(i) at ₹ 20 per tonne at Mumbai for general cargo and ₹ 25 per tonne for textiles and copra.

(ii) at London a uniform rate of £ 1 per tonne.

(b) Fuel consumption

(i) on sailing days :	30 tonnes of fuel oil per day. 5 tonnes of diesel per day.
(ii) on days in port :	10 tonnes of fuel oil per day. 5 tonnes of diesel per day.
(iii) cost per tonne :	Fuel oil ₹ 1,400 per tonne Diesel ₹ 2,500 per tonne
(c) Port dues :	At London—£ 2,000 at Mumbai—₹ 2,40,000 (inclusive of ₹ 60,000 for the incomplete voyage).
(d) Sundry Stores :	₹ 60,000.

(e) During the period, the vessel was in Mumbai port for 70 days and in London port for 40 days.

(f) Conversion rate per £ 1 could be assumed at ₹ 20.

SOLUTION

M.V. Indian Glory
VOYAGE ACCOUNT
from 1st July to 31st December, 2020

		₹			₹
To Standing Charges (184 days @ ₹ 45,000 per day)		82,80,000	By Freight 20,000 tonnes @ ₹ 308 (i.e. ₹ 280 plus 10% of ₹ 280)	₹ 61,60,000	
To Stevedoring Expenses : 30,000 tonnes textile & copra @ ₹ 25 per tonne at Mumbai	₹ 7,50,000		10,000 tonnes copra @ ₹ 340 per tonne	34,00,000	
30,000 tonnes textile & copra @ ₹ 20 per			32,000 tonnes urea @ ₹ 300 per tonne	96,00,000	

Particulars	₹	₹	Particulars	₹	₹
tonne at London	6,00,000		30,000 tonnes of general cargo @ ₹ 276 (i.e. ₹ 240 plus 15% of ₹ 240)	82,80,000	2,74,40,000
32,000 tonnes of urea @ ₹ 20 per tonne at London	6,40,000		By Voyage in Progress (2)		31,66,500
32,000 tonne of urea @ ₹ 20 per tonne at Mumbai	6,40,000				
30,000 tonnes of general cargo @ ₹ 20 per tonne at Mumbai	6,00,000	32,30,000			
To Fuel Consumed (1)		69,48,000			
To Port Dues at Mumbai	2,40,000				
at London (2,000 × ₹ 20)	40,000	2,80,000			
To Sundry Stores		60,000			
To Voyage in Progress (30,000 tonnes @ ₹ 276)		82,80,000			
To Net Profit		35,28,500			
		3,06,06,500			3,06,06,500

Working Notes :

(1) ***Calculation of Fuel Consumed :***

	Tonnes	*Fuel Oil* ₹	*Tonnes*	*Diesel* ₹
Stay at port 110 days	1,100 tonnes (10 tonnes per day) @ ₹ 1,400 per tonne	15,40,000	550 tonnes (5 tonnes per day) @ ₹ 2,500 per tonne	13,75,000
During journey 74 days	30 tonnes per day *i.e.*, 2,220 @ ₹ 1,400 per tonne	31,08,000	370 tonnes (5 tonnes per day) @ ₹ 2,500 per tonne	9,25,000
		46,48,000		23,00,000

Total amount of Fuel Consumed = ₹ 69,48,000.

(2) ***Calculation of Voyage in Progress :***

	Fuel Oil Tonnes	*Diesel Tonnes*	₹
Fuel consumption :			
At port 21 days	210	105	
Sailing days—10	300	50	
	510	155	
Rate per tonne	₹ 1,400	₹ 2,500	
	₹ 7,14,000	₹ 3,87,500	11,01,500
Stevedoring charges (30,000 tonnes @ ₹ 20 per tonne)			6,00,000
Port charges (given)			60,000
Standing charges for 31 days @ ₹ 45,000 per day			13,95,000
Sundry stores (1/6 on time basis)			10,000
			31,66,500

ILLUSTRATION 5. S.S. Jalaksha voyaged from Visakhapattanam for Kolkata on 1st February, 2021. On 31st March, 2021, when the accounts of the company are closed, S. S. Jalaksha was on her way back to Visakhapattanam from Kolkata on Voyage No. 707, having covered half of the return voyage. Following details of expenses and income for the entire voyage to and from Kolkata are furnished :

	₹			₹
Freight charges	8,00,000	Insurance of :	Ship for the voyage	1,00,000
Port charges	30,000		Freight	40,000
Salary of crew	80,000	Depreciation of the ship for the two		
Consumption of : Coal	1,40,000	months of the voyage		80,000
Stores	60,000			

Primage is at 10% on freight charges. Address commission is at 5% on freight charges and primage. Only ₹ 3,00,000 freight was available on return journey to Visakhapattanam. Three-fourths of the total voyage including return journey is complete on 31st March, 2021. Of the total expenses, expenses unconnected with freight shall be carried forward as "in process" for the balance of the journey. As freight is actually earned only on completion of a voyage, you have to carry forward the freight in respect of the return journey as well as all incidental incomes.

Prepare Voyage Account for the period 1st February, 2021 to 31st March, 2021.

SOLUTION

In the Books of S.S. Jalaksha
VOYAGE NO. 707 ACCOUNT
from 1st February, 2021 to 31st March, 2021

	₹		₹	₹
To Port Charges	30,000	By Freight Outward	5,00,000	
To Salary of Crew	80,000	*Add*: Primage 10%	50,000	
To Consumption of Coal	1,40,000			5,50,000
To Consumption of Stores	60,000	By Freight Inward	3,00,000	
To Insurance of Ship	1,00,000	*Add*: Primage 10%	30,000	
Total Expenses Unconnected with Freight for the Entire Voyage	4,10,000			3,30,000
To Depreciation of the Ship	80,000	By Voyage in Progress :		
To Insurance Charges on Freight	40,000	$\frac{1}{2}$ of Total Expenses for the Entire Voyage Unconnected with Freight		
To Address Commission @ 5% on :		$\left(\frac{1}{2}\times ₹\ 4{,}10{,}000\right)$	2,05,000	
Freight Outward @ 5% on ₹ 5,50,000	27,500	$\frac{1}{3}$ of Depreciation		
Freight Inward @ 5% on ₹ 3,30,000	16,500	$\left(i.e.,\ \frac{80{,}000}{1\frac{1}{2}}\times\frac{1}{2}\right)$	(1) 26,667	
To Provision for Incomplete Voyage :				
Freight and Primage on Inward Journey	3,30,000	Address Commission on on Freight Inward	16,500	
To Profit on Voyage	2,39,167	Insurance Charges on Freight		
		$\left(₹\ 40{,}000\times\frac{3{,}00{,}000}{8{,}00{,}000}\right)$	15,000	
				2,63,167
	11,43,167			11,43,167

(1) **Note** : One outward journey and $\frac{1}{2}$ of return journey is complete. Therefore, $\frac{1}{3}$rd $\left(i.e., \frac{\frac{1}{2}}{1\frac{1}{2}}\right)$ of depreciation has been carried forward.

1. **Fill in the blanks :**

(a) Voyage Account is a............account.

(b) Voyage Account is prepared to ascertain............from each voyage.

Ans. [(a) Nominal; (b) Profit or loss].

2. **State whether the following statements are true or false :**

(a) Passage money is treated as income in Voyage Account.

(b) Profit/Loss is ascertained only for completed voyage while preparing Voyage Account.

(c) Address Commission is calculated as a percentage on freight only.

(d) Voyage Account is a nominal account.

(e) Voyage account is prepared to ascertain profit from all ships owned by shipping company.

Ans. [True : (a), (b), (d). False : (c), (e)].

SHORT/LONG ANSWER TYPE

1. Explain the meaning of the following terms :
(a) Primage ; (b) Address Commission; (c) Passage Money.
2. What is a Voyage Account.
3. What is voyage in progress ? How is it calculated ?
4. Discuss the nature, necessity and method of preparing Voyage Account. What will be the position if voyage is in progress ?
5. How will you calculate profit in case of incomplete voyage ? Explain by taking a practical example.

Or

What will be the position of voyage in progress ?

Practical Problems

1. The S.S. Obyssey undertook a voyage from Athens to Kolkata starting on 1st January, 2021 and reaching on 31st March, 2021. The cargo consisted of 900 tons of food grains and 100 tons of engineering goods. The freight charges were ₹ 150 per ton for foodgrains and ₹ 100 per ton for engineering goods. In addition primage was 10%. Brokerage was payable at 5%. The expenses were :

	Athens	*Kolkata*
	₹	₹
Coal and Diesel	20,000	—
Port Charges	9,000	2,000
Harbour wages	3,000	1,000
Loading charges	2,000	—
Other expenses were :		
Stores	10,000	
Discharging expenses	2,000	
Postage	1,000	
Salaries of crew	10,000	

The ship was insured for ₹ 10,00,000 at 1% for Voyage Policy of Hull. The freight was insured @

$\frac{1}{2}$%. Depreciation is charged on the written down value of the ship at 5% per annum. The value as on 1st January, 2021 was ₹ 8,00,000. Prepare Voyage Account.

Ans. **[Profit ₹ 70,727].**

2. M.V. Indian Empress is regularly employed on cargo trade between India and East Africa. She set on her voyage on 1st July, 2021 and arrived at her destination on 14th August, 2021. You are required to prepare a Voyage Account bearing in mind the following particulars:
   - (i) The vessel was purchased in 2003 for ₹ 100 lakhs and at the time of purchase had 16 years of working life left (Depreciation on ships is charged on straight line basis).
   - (ii) Standing cost per day excluding recovery of depreciation is ₹ 22,000.
   - (iii) The vessel consumes daily 14 tonnes of fuel oil, 2 tonnes of diesel and 15 tonnes of fresh water. The costs of these are ₹ 1,000, ₹ 1,350 and ₹ 20 per tonne respectively.
   - (iv) The vessel loaded the under-mentioned cargo :
     4,000 tonnes on which freight of ₹ 375 per tonne was charged and 3,500 tonnes on which the rate of freight was ₹ 190 per tonne;
     Both the rates are to be enhanced by a surcharge of 20% over the basic rates.
   - (v) Freight brokers were to be paid a brokerage of $2\frac{1}{2}$ %.
   - (vi) Port charges at the loading and discharging ports were ₹ 40,000 and ₹ 85,000 respectively.

Ans. **[Net Profit ₹ 5,75,995].**

3. S.S. Kanishka sailed from Kolkata on 1-2-2021 and arrived at Chennai port on 31-3-2021 via Vishakhapatnam port on Voyage No. 403. Following goods were loaded :
1,000 M.T. and 200 M.T. at Kolkata port for Chennai port and Vishakhapatnam port respectively. Another 500 M.T. were loaded at Vishakhapatnam for Chennai. The freight charges were :
Kolkata port to Chennai port ₹ 600 per M.T. ; Kolkata port to Vishakhapatnam port ₹ 500 per M.T. ; Vishakhapatnam port to Chennai port ₹ 400 per M.T.

The freight is subject to 10% primage, 5% address commission and 2.5% brokerage. The freight was insured at 1/2%. The hull was insured for the Voyage at 1%. Depreciation was provided at 3% p.a. The cost of the ship is ₹ 1 crore. Following were the expenses incurred at different ports :

	Kolkata	*Vishakhapatnam*	*Chennai*
	₹	₹	₹
Port charges	36,000	20,000	20,000
Coal	1,00,000	30,000	—
Captain's contingencies	7,000	2,000	10,000
Harbour wages	10,000	20,000	15,000

Stores purchased for the Voyage amounted to ₹ 50,000. Opening Stock of stores was ₹ 40,000 and closing stock was estimated at ₹ 30,000. Stock of coal at close was estimated at ₹ 30,000 as against stock of ₹ 10,000 at the beginning. The ship will not come back to Kolkata port in the near future as part of the voyage programme. Salaries and wages amounted to ₹ 80,000 p.m.

Prepare Voyage No. 403 Account.

Ans. **[Profit ₹ 2,90,800].**

4. S.S. Jalasakti sailed from Mumbai on 1st February, 2021 and arrived at Kolkata on 31st March, 2021 via Marmagoa, Cochin and Vishakhapatnam. She was loaded with 800 tons of cotton at Mumbai for Vishakhapatnam. At Cochin a further load of 600 tons of coconut oil was booked for Kolkata. Besides, 100 tons of textiles were also loaded at Mumbai for Marmagoa. The freight charges were as follows :

Mumbai to Vishakhapatnam ₹ 80 per ton. Mumbai to Marmagoa ₹ 25 per ton. Cochin to Kolkata ₹ 60 per ton.

Plus Primage 10% and subject to commission at 4% and Brokerage at 2%.

Following were the expenses at different ports :

	Mumbai	*Marmagoa*	*Cochin*	*Vishakhapatnam*	*Kolkata*
	₹	₹	₹	₹	₹
Coal	14,000			2,000	
Port charges	4,000	600	1,000	1,000	3,000

Captain's Expenses	800	500	300	600	700
Harbour Wages	1,200	700	1,100	1,200	2,000
Loading charges	1,600		1,200		

Following were the other expenses :

Stores supplied ₹ 8,400 ; Discharging Expenses ₹ 5,200 ; Despatching of Funds ₹ 400 ; Interest on Advances ₹ 500 ; Postage bills ₹ 600.

The ship was insured for ₹ 5,00,000 at 1.5% premium for the Voyage and the total freight was insured at $\frac{1}{2}$% premium. Depreciation is to be charged on the book value of the ship at ₹ 4,50,000 at 4% p.a. The wages of the sailors are ₹ 8,400 per month.

Prepare Voyage Account.

Ans. **[Net Profit ₹ 25,521].**

5. M.V. Indian Glory is employed on conference trade and is on a regular run between India and the United Kingdom. The Conference freight rate is ₹ 200 per freight tonne to be enhanced by a surcharge of 20% for port congestion and an adjustment of + $7\frac{1}{2}$% for currency factor.

The vessel arrived in Kolkata on 20th February, 2021 and started loading cargo. Loading was over on 1st March (morning) when she set sail for London where she arrived on the night of the 20th of March, 2021. Unloading of the cargo was over and the vessel commenced her next employment on 1st April, 2021 (evening). The total voyage time was calculated at 40 days.

At Kolkata, the ship took in 8,500 freight tonnes. Following direct expenses were incurred :

		₹
(*i*)	Entry fee, tug hire, berth hire at Kolkata	72,000
(*ii*)	Port charges at London	85,000
(*iii*)	Hooghly river dues and lighthouse dues	7,600

(*iv*) Insurance premia on cargo at 0.25% of the basic freight rate.

(*v*) Stevedoring charges are ₹ 18 and ₹ 25 per freight tonne at Kolkata and London respectively.

(*a*) During port stay—4 tonnes of fuel oil and 25 tonnes of fresh water per day.

(*b*) On sailing days—12 tonnes of fuel oil and 10 tonnes of fresh water per day.

Cost of fuel oil—₹ 1,350 per tonne and cost of fresh water—₹ 25 per tonne.

(*vi*) Annual costs of maintenance of ship (you can adopt 360 days as normal working days in a year) :

(*a*) Salaries to officers and crew ₹ 30,00,000 ; (*b*) Insurance premia ₹ 12,15,000 ; (*c*) Repairs and maintenance ₹ 25,00,000 ; (*d*) Interest on loan and capital ₹ 11,25,000 ; (*e*) Working life of vessel bought for ₹75 lakhs is to be taken as six years.

(*vii*) Freight brokerage at $1\frac{1}{2}$% is payable.

Kindly draw a Voyage Account and ascertain the result of the voyage.

Ans. **[Profit on voyage ₹ 1,66,255].**

VOYAGE IN PROGRESS

6. J.J. Jaltranga commenced a voyage on 1st October, 2020 from Mumbai to Chennai. The details of complete voyage, *i.e.* Mumbai to Chennai and back to Mumbai, were as follows :

	₹		₹
Coal Consumption	70,000	Freight	4,00,000
Port Charges	14,000	Stores Consumed	30,000
Depreciation	40,000	Salaries	48,000
Sundry Expenses	4,000	Insurance—Ship	40,000
Wages	8,000	Insurance—Freight	16,000

Primage and address commission are 10% and 5% respectively. Freight relating to the return journey amounted to ₹ 1,20,000 only. The accounts are closed on 31st December The ship was on her half way back to Mumbai on the date of closing the accounts. Prepare Voyage Account upto 31st December, 2020.

Ans. **[Net Profit ₹ 1,54,400; Voyage in Progress ₹ 1,38,400].**

Royalty

Royalty accounting system which deals with special rights owned by legal entity (individual, partnership firm, corporates or government units) on the property. This special rights includes new inventions done by any legal entity. May be registering rights over invention, trademark symbols. This also can be referred as special right owned by legal entity.

This specials owned by the legal entity can be used by themselves or can be leased to some other entity for consideration. This kind of consideration is being treated in accounting system is called Lease/ Royalty Accounting system.

The legal entity who takes benefit on the special rights under Lease or Royalty is called Lessee /tenant patented/ Publisher.

Key Terms

Land Lord

The person who gives out his some special rights over something say mining rights or patent rights or copy rights on lease to another person for consideration

Lessee

The person who takes out special rights from its owner on lease for consideration.

Royalty

Royalty is periodical payment based on output from property / sale executed from the property for the use of certain assets are like mine copy rights or pattern rights to its owner

1. Lessee pays royalty to Landlord for use of mining/ extraction from the mine
2. For use of patent rights, the user pays royalty to owner of invention/ patent
3. Royalty may be paid to the author of the book/ music director/ singer for using or public broadcasting or selling books

Types of Royalty

Mining Royalty

Royalty will be paid by Lessee to the Landlord/Owner of the mine/ Govt based on the utilization / out put from the mine made by the lessee.

Patent Royalty

This type of royalty is similar to mining royalty, Royalty will be paid base on the usage of patent. Charges calculation might have been defined in the agreement.

Copy right royalty

This royalty will be calculated based on the sales made by the lessee of the copy right products Calculation of charges might have been clearly defined in the agreement.

Calculation methods

1. Author of the book based on units sold
2. Owner of mine based on the quantity of extraction done from mine
3. New inventions based on out put
4. Owner of oil well based on quantity of Oil extracted

Likewise cost will be calculated based on the benefit withdrawn enjoyed with rate per unity

Nature	Rent	Royalty
Nature of Asset	Rent is paid for the usage tangible assets	Consideration payable for use tangible and intangible assets
Basis of payment	It is payable on daily/ weekly/ monthly/ yearly ie based on span	It is based on production/ extraction / yield or sales
Fixed / Variable	Fixed	Variable
Minimum guarantee	There is no concept of minimum rent, based on duration rent will be calculated	In the agreement separate clause will be defined for minimum guaranteed amount though we are not using special rights/ making any revenue
Parties	Tenant and Owner / Landlord	Lessee / Patentee/ publisher and lessor / patent holder/ author

Accounting treatments in the books of lessee

When there is no royalty in a year

a) If minimum rent not defined in Agreement
   Short working account dr
     To Landlord account
b) Minimum rent defined in agreement
   Minimum rent a/c
     To Landlord a/c

   Short working a/c

To minimum rent a/c

Landlord a/c
To Bank a/c

P/L or Production a/c dr
To Royalty a/c

When the Royalty less then minimum rent and short working recoverable in subsequent period
Minimum rent not defined in agreement
Royalty a/c
Short working a/c
Landlord

If minimum / dead rent defined in agreement/ account opened
Minimum rent a/c
Landlord a/c

Royalty a/c
Short working a/c
To minimum rent a/c

Landlord a/c
To Bank a/c

P/L or Production a/c
Royalty account a/c

When royalty equal to minimum rent no special treatment is required

When royalty exceeds minimum rent and short workings are recouped/ recovered/ regained.

Royalty a/c
Landlord a/c

Landlord a/c
To short working a/c
To bank a/c

P/L or Production a/c

To Royalty a/c

ILLUSTRATION 1. (*When royalty is to be recouped within fixed period*). Bengal Coal Limited leased a colliery on 1st January, 2017 at a minimum rent of ₹ 15,000 merging into a royalty of ₹ 1 per ton with a stipulation to recoup shortworkings over the *first three years of the lease*. The output for the first four years of the lease was 8,000 ; 13,000 ; 21,000 and 18,000 tons respectively. Draft the necessary journal entries in the books of the company giving effect to the above.

SOLUTION

ANALYTICAL TABLE

Year	*Output (Tons)*	*Royalties @ ₹ 1 per ton*	*Short-workings*	*Surplus*	*Recoup-ment*	*Shortworkings not recoupable*	*Paid to Landlord*
		₹	₹	₹	₹	₹	₹
2017	8,000	8,000	7,000(15,000 − 8,000)	—	—	—	15,000
2018	13,000	13,000	2,000(15,000 − 13,000)	—	—	—	15,000
2019	21,000	21,000	—	6,000(21,000 − 15,000)	6,000	3,000(9,000 − 6,000)	15,000
2020	18,000	18,000	—	3,000(18,000 − 15,000)			18,000

JOURNAL ENTRIES IN THE BOOKS OF BENGAL COAL LTD.

				₹	₹
2017 Dec. 31	Royalties Account	Dr.		8,000	
	Shortworkings Account	Dr.		7,000	
	To Landlord				15,000
	(Being royalties @ ₹ 1 per ton on 8,000 tons and shortworkings ₹ 7,000 due to make up the minimum amount of ₹ 15,000)				
" 31	Landlord	Dr.		15,000	
	To Bank Account				15,000
	(Being the payment of minimum rent)				
Dec. 31	Production Account	Dr.		8,000	
	To Royalties Account				8,000
	(Being transfer of actual royalties to Production Account)				

2018 Dec. 31	Royalties Account Dr. Shortworkings Account Dr. To Landlord (Being royalties @ ₹ 1 per ton on 13,000 tons subject to a minimum rent of ₹ 15,000)		13,000 2,000	15,000
Dec. 31	Landlord Dr. To Bank Account (Being the payment of minimum rent)		15,000	15,000
" 31	Production Account Dr. To Royalties Account (Being transfer of royalties)		13,000	13,000
2019 Dec. 31	Royalties Account Dr. To Landlord (Being royalties @ ₹ 1 per ton on 21,000 tons)		21,000	21,000
" 31	Landlord Dr. To Shortworkings Account To Bank Account (Being minimum rent of ₹ 15,000 paid to the landlord and ₹ 6,000 shortworkings recouped)		21,000 6,000	27,000
" 31	Production Account Dr. To Royalties Account (Being transfer of royalties for the year)		21,000	21,000
" 31	Profit and Loss Account Dr. To Shortworkings Account (Being transfer of irrecoverable shortworkings)		3,000	3,000
2020 Dec. 31	Royalties Account Dr. To Landlord (Being royalties due @ ₹ 1 per ton on 18,000 tons)		18,000	18,000
Dec. 31	Landlord Dr. To Bank Account (Being payment of royalties)		18,000	18,000
" 31	Production Account Dr. To Royalties Account (Being transfer of royalties to Profit and Loss A/c)		18,000	18,000

ILLUSTRATION 2. *(When there is special condition for recoupment of shortworkings).* Mohan took a mine on lease for 20 years. Rate of royalty is ₹ 1 per ton. Minimum rent is ₹ 8,000 per year. Next year shortworkings of that year will not be recouped in which yield will be less than 4,000 tons and the year in which royalty will be more than minimum rent, only 50% of excess will be used for recoupment of shortworkings.

Prepare the Necessary Accounts in the books of lessee when the yield for first four years respectively is 3,500 tons, 7,000 tons, 7,500 tons and 9,000 tons.

SOLUTION

ANALYTICAL TABLE

Year	*Output (tons)*	*Royalties @ ₹ 1 for ton*	*Minimum Rent*	*Shortworkings*	*Surplus*	*Shortworkings recouped*	*Shortworkings not recouped*	*Paid to Landlord*
		₹	₹	₹	₹	₹	₹	₹
I	3,500	3,500	8,000	4,500	—	—	(1) 4,500	8,000
II	7,000	7,000	8,000	1,000	—	—	—	8,000
III	7,500	7,500	8,000	500	—	—	1,000	8,000
IV	9,000	9,000	8,000		1,000	500	—	8,500

(1) Shortworking of year I cannot be recouped next year because output of this year is less than 4,000 tons. Hence, this shortworking has become non-recoupable in year I.

In the Books of Lessee (Mohan)

ROYALTIES ACCOUNT

Year		₹	Year		₹
I	To Landlord A/c	3,500	I	By Profit & Loss A/c	3,500
II	To Landlord A/c	7,000	II	By Profit & Loss A/c	7,000
III	To Landlord A/c	7,500	III	By Profit & Loss A/c	7,500
IV	To Landlord A/c	9,000	IV	By Profit & Loss A/c	9,000

SHORTWORKINGS ACCOUNT

Year		₹	Year		₹
I	To Landlord A/c	4,500	I	By Profit & Loss A/c	4,500
II	To Landlord A/c	1,000	II	By Balance c/d	1,000
III	To Balance b/d	1,000	III	By Profit & Loss A/c	1,000
	To Landlord A/c	500		By Balance c/d	500
		1,500			1,500
IV	To Balance b/d	500	IV	By Landlord A/c	500

LANDLORD ACCOUNT

Year		₹	Year		₹
I	To Bank A/c	8,000	I	By Royalties A/c	3,500
				By Shortworkings A/c	4,500
		8,000			8,000
II	To Bank A/c	8,000	II	By Royalties A/c	7,000
				By Shortworkings A/c	1,000
		8,000			8,000
III	To Bank A/c	8,000	III	By Royalties A/c	7,500
				By Shortworkings A/c	500
		8,000			8,000
IV	To Shortworkings A/c	500	IV	By Royalties A/c	9,000
	To Bank A/c	8,500			
		9,000			9,000

PROFIT & LOSS ACCOUNT

Year		₹	Year		₹
I	To Royalties A/c	3,500			
	To Shortworkings A/c	4,500			
II	To Royalties A/c	7,000			
III	To Royalties A/c	7,500			
	To Shortworkings A/c	1,000			
IV	To Royalties A/c	9,000			

ILLUSTRATION 3. *(When amount of shortworkings or surplus or royalty is given).* The Bharat Mining Company holds a lease of a coal mine for a period of 20 years, commencing from 1st April, 2015. The lease provided for the payment on 15th April, 2016 and (annually thereafter) a royalty of ₹ 2 per ton on coal

produced in the previous year subject to a minimum rent of ₹ 8,000 per year. Shortworkings can be recouped out of royalty in excess of the minimum rent for the next two years only. In the year of strike the minimum rent was to be regarded as having been reduced proportionately having regard to the length of stoppage. The first year in respect of which minimum rent was payable expired on 31st March, 2016. The excess paid for the first year was ₹ 3,750, of the second year ₹ 3,000. In the third year the surplus was ₹ 3,200 and of the fourth year ₹ 4,000. In the fifth year actual royalties amounted to ₹ 14,000 and in the sixth year ₹ 7,500 only. During the sixth year there was a stoppage due to strike lasting three months.

Write up the Necessary Accounts in the books of Bharat Mining Company.

SOLUTION

ANALYTICAL TABLE

Year	Royalty	Minimum Rent	Short-workings	Surplus	Recoup-able	Unrecoup-able	Paid to landlord
	₹	₹	₹	₹	₹	₹	₹
2016	4,250	8,000	3,750	—	—	—	8,000
2017	5,000	8,000	3,000	—	—	—	8,000
2018	11,200	8,000	—	3,200	3,200	550	8,000
2019	12,000	8,000	—	4,000	3,000	—	9,000
2020	14,000	8,000	—	6,000	—	—	14,000
2021	7,500	6,000	—	1,500	—	—	7,500

ROYALTIES ACCOUNT

Date	Particulars	₹	Date	Particulars	₹
2016 Mar. 31	To Landlord	4,250	2016 Mar. 31	By Production A/c	4,250
2017 Mar. 31	" Landlord	5,000	2017 Mar. 31	" Production A/c	5,000
2018 Mar. 31	" Landlord	11,200	2018 Mar. 31	" Production A/c	11,200
2019 Mar. 31	" Landlord	12,000	2019 Mar. 31	" Production A/c	12,000
2020 Mar. 31	" Landlord	14,000	2020 Mar. 31	" Production A/c	14,000
2021 Mar. 31	" Landlord	7,500	2021 Mar. 31	" Production A/c	7,500

SHORTWORKINGS ACCOUNT

Date	Particulars	₹	Date	Particulars	₹
2016 Mar. 31	To Landlord	3,750	2016 Mar. 31	By Balance c/d	3,750
2016 Apr. 1	" Balance b/d	3,750			
2017 Mar. 31	" Landlord	3,000	2017 Mar. 31	" Balance c/d	6,750
		6,750			6,750
2017 April 1	" Balance b/d	6,750	2018 Mar. 31	" Landlord	3,200
			Mar. 31	" Profit and Loss A/c	550
			Mar. 31	" Balance c/d	3,000
		6,750			6,750
2018 Apr. 1	" Balance b/d	3,000	2019 Mar. 31	" Landlord	3,000

LANDLORD

Date	Particulars	₹	Date	Particulars	₹
2016 Mar. 31	To Balance c/d	8,000	2016 Mar. 31	By Royalty Account	4,250
			" 31	" Shortworkings A/c	3,750
		8,000			8,000
Apr. 15	" Bank Account	8,000	Apr. 1	" Balance b/d	8,000
2017 Mar. 31	" Balance c/d	8,000	2017 Mar. 31	" Royalties Account	5,000
				" Shortworkings A/c	3,000
		16,000			16,000
Apr. 15	To Bank Account	8,000	Apr. 1	By Balance b/d	8,000
2018 Mar. 31	" Shortworkings A/c	3,200	2018 Mar. 31	" Royalties Account	11,200
" 31	" Balance c/d	8,000			
		19,200			19,200
Apr. 15	" Bank Account	8,000	Apr. 1	" Balance b/d	8,000
2019 Mar. 31	" Shortworkings A/c	3,000	2019 Mar. 31	" Royalties Account	12,000
" 31	" Balance c/d	9,000			
		20,000			20,000
Apr. 15	" Bank Account	9,000	Apr. 1	" Balance b/d	9,000
2020 Mar. 31	" Balance c/d	14,000	2020 Mar. 31	" Royalties Account	14,000
		23,000			23,000
Apr. 15	" Bank Account	14,000	Apr. 1	" Balance b/d	14,000
2021 Mar. 31	" Balance c/d	7,500	2021 Mar. 31	" Royalties Account	7,500
		21,500			21,500
Apr. 15	" Bank Account	7,500	Apr. 1	" Balance b/d	7,500

Dr. **SHORTWORKINGS ACCOUNT** Cr.

		₹			₹
2018	To Landlord	2,000	2018	By Balance c/d	2,000
2019	To Balance b/d	2,000	2019	By Landlord	2,000
2020	To Landlord	3,000	2020	By Balance c/d	3,000
2021	To Balance b/d	3,000	2021	By Landlord	2,000
				By Profit & Loss A/c	1,000
		3,000			3,000

ROYALTY ACCOUNT

Date	Particulars	₹	Date	Particulars	₹
31-12-2015	To Singhania's A/c	13,800	31-12-2015	By Production A/c	13,800
31-12-2016	To Singhania's A/c	11,220	31-12-2016	By Production A/c	11,220
31-12-2017	To Singhania's A/c	9,240	31-12-2017	By Production A/c	9,240
31-12-2018	To Singhania's A/c	11,400	31-12-2018	By Production A/c	11,400
31-12-2019	To Singhania's A/c	12,360	31-12-2019	By Production A/c	12,360
31-12-2020	To Singhania's A/c	13,560	31-12-2020	By Production A/c	13,560

SHORT WORKINGS ACCOUNT

Date	Particulars	₹	Date	Particulars	₹
1-1-2015	To Balance b/d	4,900	31-12-2015	By Singhania's A/c	1,800
			"	By Profit & Loss A/c	400
			"	By Balance c/d	2,700
		4,900			4,900
1-1-2016	To Balance b/d	2,700	31-12-2016	By Profit & Loss A/c	2,700
31-12-2016	To Singhania's A/c	780	"	By Balance c/d	780
		3,480			3,480
1-1-2017	To Balance b/d	780	31-12-2017	By Singhania's A/c	240
			"	By Balance c/d	540
		780			780
1-1-2018	To Balance b/d	540	31-12-2018	By Balance c/d	1,140
31-12-2018	To Singhania's A/c	600			
		1,140			1,140
1-1-2019	To Balance b/d	1,140	31-12-2019	By Singhania's A/c	360
			"	By Profit & Loss A/c	180
			"	By Balance c/d	600
		1,140			1,140
1-1-2020	To Balance b/d	600	31-12-2020	By Singhania's A/c	600

SINGHANIA'S ACCOUNT

Date	Particulars	₹	Date	Particulars	₹
31-12-2015	To Shortworkings A/c	1,800	31-12-2015	By Royalty A/c	13,800
"	To Bank A/c	12,000			
		13,800			13,800
31-12-2016	To Bank A/c	12,000	31-12-2016	By Royalty A/c	11,220
			31-12-2016	By Shortworkings A/c	780
		12,000			12,000
31-12-2017	To Shortworkings A/c	240	31-12-2017	By Royalty A/c	9,240
"	To Bank A/c	9,000			
		9,240			9,240
31-12-2018	To Bank A/c	12,000	31-12-2016	By Royalty A/c	11,400
			31-12-2016	By Shortworkings A/c	600
		12,000			12,000
31-12-2019	To Shortworkings A/c	360	31-12-2019	By Royalty A/c	12,360
	To Bank A/c	12,000			
		12,360			12,360
31-12-2020	To Shortworkings A/c	600	31-12-2020	By Royalty A/c	13,560
	To Bank A/c	12,960			
		13,560			13,560

PROVISION AGAINST SHORTWORKINGS ACCOUNT

		₹			₹
2018	To Balance c/d	8,000	2018	By Profit & Loss A/c	8,000
2019	To Balance c/d	15,000	2019	By Balance b/d	8,000
				By Profit & Loss A/c	7,000
		15,000			15,000
2020	To Profit & Loss A/c	8,000	2020	By Balance b/d	15,000
	To Shortworkings A/c	7,000			
		15,000			15,000

Note. Cost of the development of land ₹ 2 crores is not to be considered as its is a capital expenditure. It has nothing to do with royalty accounts. Cost of ₹ 2 crores will be recovered from production by way of depreciation by following depletion method of depreciation as given below :

$$\text{Depreciation per tonne} = \frac{\text{Cost of the Development of the Land}}{\text{Quantity of Estimated Coal Deposit}} = \frac{₹\ 2\text{ crores}}{20\text{ lakhs tonnes}} = ₹\ 10$$

Every year Production Account will be charged depreciation @ ₹ 10 per tonne of output produced.

ILLUSTRATION 7. ***(When minimum rent is reduced (i) on proportionate basis in case of strike and (ii) certain percentage of the period of lockout)*** New Steel Ltd. obtained a lease from Old Coal Ltd., for a coal mine on 1st January, 2015 on the following terms and conditions :

(1) Royalty at ₹ 1 per tonne raised.

(2) Minimum rent ₹ 24,000 per annum.

(3) Recoupment of shortworking of each year during three years following subject to a maximum of ₹ 5,000 p.a.

(4) In the event of strike the minimum rent would be taken *pro rata* on the basis of actual working days but in the event of lockout, the lessee would enjoy a concession in respect of minimum rent for 50% of the period of lockout.

Besides the above, New Steel Ltd. have been granted a cash subsidy equal to 25% of the unrecoupable shortworkings by the Central Government up to the first five years of the lease.

Working up to first six years is as follows :

Year	2015	2016	2017	2018	2019	2020
			₹			
Actual Royalty (₹)	14,000	20,400	32,200	27,200	21,600	19,400
					(Strike 2 months)	(Lockout for 4 months)

Show the ledger accounts in the books of New Steel Ltd.

SOLUTION

ROYALTY ACCOUNT

		₹			₹
2015 Dec. 31	To Old Coal Ltd.	14,000	2015 Dec. 31	By Production A/c	14,000
2016 Dec. 31	To Old Coal Ltd.	20,400	2016 Dec. 31	By Production A/c	20,400
2017 Dec. 31	To Old Coal Ltd.	32,200	2017 Dec. 31	By Production A/c	32,200
2018 Dec. 31	To Old Coal Ltd.	27,200	2018 Dec. 31	By Production A/c	27,200
2019 Dec. 31	To Old Coal Ltd.	21,600	2019 Dec. 31	By Production A/c	21,600
2020 Dec. 31	To Old Coal Ltd.	19,400	2020 Dec. 31	By Production A/c	19,400

SHORTWORKINGS ACCOUNT

		₹			₹
2015			2015		
Dec. 31	To Old Coal Ltd.	10,000	Dec. 31	By Balance c/d	10,000
2016			2016		
Jan. 1	To Balance b/d	10,000	Dec. 31	By Balance c/d	13,600
Dec. 31	To Old Coal Ltd.	3,600			
		13,600			13,600
2017			2017		
Jan. 1	To Balance b/d	13,600	Dec. 31	By Old Coal Ltd.	5,000
			Dec. 31	By Balance c/d	8,600
		13,600			13,600
2018			2018		
Jan. 1	To Balance b/d	8,600	Dec. 31	By Old Coal Ltd.	3,200
			Dec. 31	By Cash (Subsidy)	450
			Dec. 31	(25% of ₹ 1,800)	
			Dec. 31	By Profit & Loss A/c	1,350
			Dec. 31	By Balance c/d	3,600
		8,600			8,600
2019			2019		
Jan. 1	To Balance b/d	3,600	Dec. 31	By Old Coal Ltd.	1,600
			Dec. 31	By Cash (Subsidy), (25% of ₹ 2,000)	500
			Dec. 31	By Profit & Loss A/c	1,500
		3,600			3,600
2020			2020		
Dec. 31	To Old Coal Ltd.	600	Dec. 31	By Balance c/d	600
2021					
Jan. 1	To Balance b/d	600			

OLD COAL LTD.

		₹			₹
2015			2015		
Dec. 31	To Bank A/c	24,000	Dec. 31	By Royalty A/c	14,000
			Dec. 31	By Shortworkings A/c	10,000
		24,000			24,000
2016			2016		
Dec. 31	To Bank A/c	24,000	Dec. 31	By Royalty A/c	20,400
				By Shortworkings A/c	3,600
		24,000			24,000
2017			2017		
Dec. 31	To Shortworkings A/c	5,000	Dec. 31	By Royalty A/c	32,200
Dec. 31	To Bank A/c	27,200			
		32,200			32,200
2018			2018		
Dec. 31	To Shortworkings A/c	3,200	Dec. 31	By Royalty A/c	27,200
Dec. 31	To Bank A/c	24,000			
		27,200			27,200
2019			2019		
Dec. 31	To Shortworkings A/c	1,600	Dec. 31	By Royalty A/c	21,600
Dec. 31	To Bank A/c	20,000			
		21,600			21,600
2020			2020		
Dec. 31	To Bank A/c	20,000	Dec. 31	By Royalty A/c	19,400
			Dec. 31	By Shortworkings A/c	600
		20,000			20,000

Insurance

In simple term Insurance means a contract between insurer and insurance entity to indemnify unexpected / unforeseen loss incurred by the insurer

Insurance means a contract of indemnity where one party called insurer undertakes to indemnify the loss suffered by the other party called insured on the happening of some unforeseen events in consideration of fixed sum of money called premium.

There are different insurance

1. Health insurance
2. Agricultural insurance
3. Fire / Theft / loss due to natural calamities insurance
4. Property insurance
5. Life insurance
6. Product insurance

Out of these several insurances we are going to see the accounting treatments for

CLAIM FOR LOSS OF PROFIT

CLAIM FOR LOSS OF STOCK

Stock insurance

Stock maintenance in any type of Business is critical like life blood of the company or continue business of Sales/ manufacturing without any disturbance of want of stock. To maintain 0inimum stock , companies will try store the stock near of industry or business premises with legitimate care

While keeping stock/ inventory there is risk of loss due to fire or theft. To indemnify the loss all the Business units will insure their stocks against loss of fire loss of theft by paying standard premium against their stock value. If fire breaks out that will not only destroy inventory, it will create loss on many products/ property like loss of building / loss of electrical items / appliances. Hence business will prefer to insure their property also against loss

Ascertainment of claim when abnormal goods are available

Abnormal items/stock/inventory which is not normal stock/ inventory might be rated as slow moving item. The profit arising out of this kind stock will not be show in gross profit. This will be shown non-trading profit. This can be identified easily, since this cannot sold in normal rate and rare selling product may not be their regular business product or stock.

While calculating last year trading profit we should eliminate revenue/profit or loss arriving out of abnormal products. To arrive rate of gross profit on sale, we may use the following formula by excluding abnormal products

$$\text{Gross profit rate} = \frac{\text{Gross profit on sale of normal products/goods}}{\text{Sale of normal goods}} \times 100$$

Preparation of Memorandum of Trading account

While preparing memorandum of trading we should consider below points

1. Eliminate abnormal product sales revenue
2. Eliminate abnormal product cost
3. Gross profit must be calculated on sale value of normal goods /inventory using above formula

Calculation of actual amount of Loss

	Stock of normal goods on the date of fire	xxxxx
	Stock of abnormal goods on the date of fire	xxxxxx +
Less	Stock or goods salvaged	xxx
Add	Expense for extinguishment of fire	xxx
Result	Actual loss of fire	xxx

Calculation of amount of claim

Calculation of claim amount will not differ because of abnormal stocks are in storage. If the amount of policy less than total stock , the average clause will be applied.

Loss in profit

Fire insurance covers the loss incurred by Business of fire accident. But due to fire resuming business may take additional 20 days or 30 days. During that if business was normal they should have made profit, which Business mot able to make due to fire accident. To indemnify the loss of profit due to fire, they will execute separate policy to cover their loss by paying premium

Now we can get it to calculations.

√ **ILLUSTRATION 1.** (***Where average clause is not applicable***) On 29th August, 2021, the godown of a trader caught fire and a large part of the stock of goods was destroyed. However, goods costing ₹ 1,08,000 could be salvaged incurring fire fighting expenses amounting to ₹ 4,700.

Trader provides you the following additional information :

	₹
Cost of stock on 1st April, 2020	7,10,500
Cost of stock on 31st March, 2021	7,90,100
Purchases during the year ended 31st March, 2021	56,79,600
Purchases from 1st April, 2021 to the date of fire	33,10,700
Cost of goods distributed as samples for advertising from 1st April, 2021 to the date of fire	41,000
Cost of goods withdrawn by trader for personal use from 1st April, 2021 to the date of fire	2,000
Sales for the year ended 31st March, 2021	80,00,000
Sales from 1st April, 2021 to the date of fire	45,36,000

The insurance company also admitted fire fighting expenses. Trader had taken the fire insurance policy for ₹ 9,00,000 with an average clause.

Calculate the **amount of the claim** that will be admitted by the insurance company.

(CA—IPCE, Nov. 2012 Modified)

SOLUTION

MEMORANDUM TRADING ACCOUNT

for the period 1st April, 2021 to 29th August 2021

			₹		₹
To Opening Stock		₹	7,90,100	By Sales	45,36,000
To Purchases		33,10,700		By Closing Stock (Bal. Fig.)	8,82,600
Less : Advertisement	41,000				
Drawings	2,000	43,000	32,67,700		
To Gross Profit [30% of Sales (1)]			13,60,800		
			54,18,600		54,18,600

STATEMENT OF INSURANCE CLAIM

	₹
Value of Stock Destroyed by Fire	8,82,600
Less : Salvaged Stock	(1,08,000)
Add : Fire Fighting Expenses	4,700
Insurance Claim	7,79,300

Note : Since policy amount is more than claim amount, **average clause will not apply.** Therefore, claim amount of ₹ 7,79,300 will be admitted by the Insurance Company.

Working Notes :

(1) *Calculation of Gross Profit Ratio for 2020-21*

TRADING ACCOUNT

for the year ended 31st March, 2021

	₹		₹
To Opening Stock	7,10,500	By Sales	80,00,000
To Purchases	56,79,600	By Closing Stock	7,90,100
To Gross Profit (Bal. Fig.)	24,00,000		
	87,90,100		87,90,100

Rate of Gross Profit in 2020-21 $= \frac{\text{Gross Profit}}{\text{Sales}} \times 100 = \frac{24,00,000}{80,00,000} \times 100 = 30\%$

ILLUSTRATION 2. ***(Where average clause is to be applied).*** Fire occurred in the premises of Gharib Dass on 1st April, 2021 and a considerable part of the stock was destroyed. The stock salvaged was ₹ 56,000. A fire insurance policy for ₹ 3,42,000 was taken to cover loss of stock by fire. You are required to ascertain the insurance claim which the company should claim from the insurance company for the loss of stock by the fire from the following particulars :

	₹		₹
Purchases for the year 2020	18,76,000	Stock on 1st January, 2020	2,88,000
Sales for the year 2020	23,20,000	Stock on 31st December, 2020	4,84,000
Purchases from 1st January, 2021 to 1st April, 2021	3,64,000	Wages paid during the year 2020	2,00,000
Sales from 1st January, 2021 to 1st April, 2021	4,80,000	Wages paid during 1st January, 2021 to 1st April, 2021	36,000

Fire also broke out on 21st December, 2020 and destroyed stock of the estimated cost of ₹ 1,00,000.

There was a practice in the concern to value stock at cost less 10%, but all of a sudden this practice was changed and stock on 31st December, 2020 was valued at cost plus 10%.

SOLUTION

TRADING ACCOUNT OF GHARIB DASS

for the year ending 31st December, 2020

	₹		₹
To Stock on 1-1-2020 $\left(₹\ 2{,}88{,}000 \times \frac{100}{90}\right)$	3,20,000	By Sales	23,20,000
To Purchases	18,76,000	By Closing Stock $\left(₹\ 4{,}84{,}000 \times \frac{100}{110}\right)$	4,40,000
To Wages	2,00,000	By Stock destroyed by fire	1,00,000
To Gross Profit	4,64,000		
	28,60,000		28,60,000

$$\text{Percentage of Gross Profit to sales} = \frac{\text{Gross Profit}}{\text{Sales}} \times 100 = \frac{₹\ 4{,}64{,}000}{₹\ 23{,}20{,}000} \times 100 = 20\%.$$

Stock destroyed on 21st December, 2020 has been shown on the credit side of the Trading Account for the year 2020 to ascertain correct percentage of gross profit.

MEMORANDUM TRADING ACCOUNT OF GHARIB DASS

upto 1st April, 2021

	₹		₹
To Stock on 1-1-2021	4,40,000	By Sales	4,80,000
To Purchases	3,64,000	By Closing Stock (Balancing figure)	4,56,000
To Wages	36,000		
To Gross Profit (20% of ₹ 4,80,000)	96,000		
	9,36,000		9,36,000

		₹
	Value of stock on 1st April, 2021	4,56,000
Less :	Stock salvaged	56,000
	Stock destroyed by fire	4,00,000

$= \frac{\text{[illegible]}}{110} \times$ ₹ 7,70,000 = ₹ 1,82,000.

ILLUSTRATION 4. ***(Where figures are missing for preparation of Memorandum Trading A/c)***

A fire occurred in the premises of M/s Durga & Co. on 15 May, 2021. The entire stock as well as books and records were destroyed. From the Balance Sheet of the previous accounting year ended on 31-3-2021, you find the following items :

	₹		₹
Cash at Bank	60,000	Creditors	1,80,000
Cash in hand	300	Stock in trade	50,000
Debtors	2,00,000		

Following further information is available to you :

(1) To meet daily wages, a cheque of ₹ 12,000 is drawn from the bank on the first working day of each month and a maximum of ₹ 300 is kept in the till on any day;

(2) There was no cash purchase or cash sales;

(3) All collections are deposited into bank each day;

(4) Sundry expenses, other than wages, paid by cheque amount to ₹ 6,000 per month, drawn on the second day of each month;

(5) Debtors confirm their dues of ₹ 2,50,000 ;

(6) The only creditor of the business which supplies goods to it, confirms that the business owes ₹ 2,00,000 after it had paid ₹ 2,40,000 by cheque during the period from 1-4-2021 to 15-5-2021;

(7) Balance at bank on 15-5-2021 was ₹ 42,000 ;

(8) The business usually makes a gross profit of 25% on sales which it is expected to maintain in 2021-22 also.

Prepare a statement showing the insurance claim recoverable. *(I.C.W.A. Final)*

SOLUTION

MEMORANDUM TRADING ACCOUNT

for the period from 1-4-2021 to 15-5-2021 (the date of fire)

		₹		₹
To Stock (on 1-4-2021)		50,000	By Sales (3)	3,08,000
To Purchases	(4)	2,60,000	By Closing Stock (Balancing Figure)	1,03,000
To Wages	(1)	24,000		
To Gross Profit (25% on ₹ 3,08,000 Sales)		77,000		
		4,11,000		4,11,000

STATEMENT SHOWING THE INSURANCE CLAIM RECOVERABLE

	₹
Estimated value of stock on the date of fire	1,03,000
Less : Salvage of stock	Nil
Insurance Claim Recoverable for Loss of Stock	1,03,000

Working Notes

(1) ***Calculation of Wages***

CASH ACCOUNT

	₹		₹
To Balance b/d	300	By Wages (Balancing Figure)	24,000
To Bank (Amount withdrawn from bank for April and May @ 12,000 per month)	24,000	By Balance c/d (Maximum balance kept on any day)	300
	24,300		24,300

(2) ***Calculation of Amount Received from Debtors***

BANK ACCOUNT

	₹		₹
To Balance b/d	60,000	By Creditors	2,40,000
To Debtors (Amount received from Debtors) (Balancing Figure)	2,58,000	By Cash	24,000
		By Sundry Expenses (for April & May)	
		By Balance c/d	42,000
	3,18,000		3,18,000

(3) ***Calculation of Sales***

DEBTORS ACCOUNT

	₹			₹
To Balance b/d	2,00,000	By Bank	(2)	2,58,000
To Sales (Balancing Figure)	3,08,000	By Balance c/d		2,50,000
	5,08,000			5,08,000

(4) ***Computation of Purchases***

CREDITORS ACCOUNT

	₹		₹
To Bank	2,40,000	By Balance b/d	1,80,000
To Balance c/d	2,00,000	By Purchases (Balancing Figure)	2,60,000
	4,40,000		4,40,000

ILLUSTRATION 5. ***(Where two fires occur besides calculating average Gross Profit Ratio & Salvage operation expenses)*** A fire occurred in the premises of M/s Low Luck Traders twice during the accounting year 2020-21, that is on 31st July, 2020 and again on 30th November, 2020. From the following particulars, calculate the claim to be lodged in respect of the goods lost by fire on the aforementioned dates :

(1) The stock as at 31st March, 2020 was valued at ₹ 9,90,000.

(2) The purchases from 1st April, 2020 to 31st July, 2020 amounted to ₹ 35,60,000 and included furniture purchased for ₹ 10,000.

(3) Sales for the period from 1st April, 2020 to 31st July, 2020 amounted to ₹ 50,00,000.

(4) The purchases from 1st August, 2020 to 30th November, 2020 amounted to ₹ 49,50,000 of which goods costing ₹ 1,05,000 were received on 10th December, 2020.

(5) The sales for the period from 1st August, 2020 to 30th November, 2020 amounted to ₹ 60,60,000 out of which sales on "sales or return" basis amounted to ₹ 1,00,000. No intimation was received from the customers in respect of 60% of the goods sold on approval basis.

(6) Information regarding sales and gross profit of the last three years was as follows:

Year	*Sales* ₹	*Gross Profit* ₹
2017-18	1,00,00,000	12,00,000
2018-19	1,20,00,000	9,60,000
2019-20	1,35,00,000	13,40,000

(7) In the beginning of the year 2020-21, the selling price was raised by 20%.

(8) The closing stock of 2019-20 was undervalued by ₹ 10,000.

(9) The value of the goods salvaged on 31st July, 2020 was ₹ 3,00,000.

(10) The value of the goods salvaged on 30th November, 2020 was also ₹ 3,00,000.

(11) The expenses of the salvage operations were ₹ 20,000 on 31st July, 2020 and ₹ 10,000 on 30th November, 2020.

(12) The firm had taken out a fire insurance policy of ₹ 6,00,000 on 1st April, 2020. At the time of receiving the insurance claim on 31st July, 2020, no additional premium was paid for restoration of the insurance policy to its original amount. The policy was subject to the average clause.

SOLUTION

Calculation of Rate of Gross Profit for 2020-21

$$\text{Gross Profit Ratio} = \frac{\text{Gross Profit}}{\text{Sales}} \times 100$$

$$\text{2017-18} = \frac{₹\ 12{,}00{,}000}{₹\ 1{,}00{,}00{,}000} \times 100 = 12\%$$

$$\text{2018-19} = \frac{₹\ 9{,}60{,}000}{₹\ 1{,}20{,}00{,}000} \times 100 = 8\%$$

$$\text{2019-20} = \frac{₹\ 13{,}50{,}000}{₹\ 1{,}35{,}00{,}000} \times 100 = 10\%$$

(Gross Profit = ₹ 13,40,000 as given + ₹ 10,000 for undervaluation of Closing Stock)

$$\text{Average Gross Profit Ratio} = \frac{12\% + 8\% + 10\%}{3} = 10\%$$

	Past	*2020-21*
Sales	100	120 (100 + 20% Increase)
Gross Profit	10	30 (120 – 90)
Cost	90 (100 – 10)	90 (Cost remaining same as in the past)

$$\text{Therefore, Rate of Gross Profit for 2020-21} = \frac{\text{Gross Profit}}{\text{Sales}} \times 100 = \frac{30}{120} \times 100 = 25\%$$

MEMORANDUM TRADING ACCOUNT

for the period commencing 1-4-2020 to 31-7-2020 the date of first fire

	₹	₹		₹
To Opening Stock (1-4-2020) (₹ 9,90,000 + ₹ 10,000)		10,00,000	By Sales	50,00,000
To Purchases	35,60,000		By Stock on the date of fire (Balancing figure)	8,00,000
Less : Furniture Purchased	10,000	35,50,000		
To Gross Profit (25% of Sales)		12,50,000		
		58,00,000		58,00,000

		₹
	Stock on the date of fire on 31-7-2020	8,00,000
Less :	Goods salvaged	3,00,000
		5,00,000
Add :	Expenses of salvage operations	20,000
	Loss by fire	5,20,000

Value of Claim on 31-7-2020 $= \frac{\text{Value of Policy}}{\text{Stock on the date of fire}} \times \text{Loss by fire}$

$= \frac{₹\ 6,00,000}{₹ 8,00,000} \times ₹\ 5,20,000 = ₹\ 3,90,000.$

MEMORANDUM TRADING ACCOUNT

for the period from 1-8-2020 to 30-11-2020 the second date of fire

	₹	₹		₹	₹
To Opening Stock (*i.e.* Value of goods salvaged on 1-8-2020)		3,00,000	By Sales	60,60,000	
			Less : Sales on Approval	60,000	60,00,000
To Purchases	49,50,000		By Stock lying with customers (Cost of goods on approval basis)		
Less : Goods not yet received	1,05,000	48,45,000	*i.e.* ₹ 60,000 × $\frac{75}{100}$)		45,000
To Gross Profit (25% of Sales)		15,00,000	By Stock on the date of fire (Balancing figure)		6,00,000
		66,45,000			66,45,000

		₹
	Stock on the date of fire	6,00,000
Less :	Value of goods salvaged	3,00,000
		3,00,000
Add :	Expenses of salvage operations	10,000
	Loss by second fire in the same financial year	3,10,000

Value of claim on 30-11-2020 $= \frac{\text{Value of Policy remaining after meeting first claim during the year 2020-21}}{\text{Stock on the date of fire}} \times \text{Loss by fire}$

$= \frac{₹\ 6,00,000 - ₹\ 3,90,000}{₹\ 6,00,000} \times ₹\ 3,10,000 = ₹\ 1,08,500.$

ILLUSTRATION 6. *(Where poor selling goods are in stock).* On 25th June, 2021 a fire broke out in the premises of Unlucky Co. All the stocks were destroyed except some which were partly damaged and sold subsequently for ₹ 7,900.

From the following particulars ascertain the claim to be submitted to the Insurance Company assuming that the policy was for ₹ 20,000.

	₹		₹
Stock as on 1st January, 2021	24,400	Purchases during the year 2020	1,53,500
Purchases upto the date of the fire	73,000	Sales during the year 2020	1,96,500
Sales upto the date of the fire	97,000	Stock as on 1st January, 2020	18,500

The stock as on 1st January, 2020 included a special item valued ₹ 5,600 which was sold at a profit of 20% on sales. A part of this item was sold in 2020 while the balance was sold on 3rd May, 2021 for ₹ 2,500. Except for this item, the gross profit on all other items was at a uniform rate throughout the period.

SOLUTION

TRADING ACCOUNT OF UNLUCKY CO.
for the year ending 31st December, 2020

	Normal Items ₹	*Abnormal Items* ₹		*Normal Items* ₹	*Abnormal Items* ₹
To Opening Stock	12,900	5,600	By Sales	1,92,000	(1)4,500
To Purchases	1,53,500	—	By Closing Stock	22,400	(2)2,000
To Gross Profit	48,000	900			
	2,14,400	6,500		2,14,400	6,500

(1) ***Sales value of special item is calculated as follows :***

		₹
	Cost of special item	5,600
Add :	25% profit on cost which is equivalent to 20% on sales	1,400
		7,000
	Total sales value of the special item	7,000
Less :	Sale of special item in 2021	2,500
	Sale of special item in 2020	4,500

(2) ***Cost of the sale of special item in 2021 :***

	₹
Sale value	2,500
Less : 20% Profit included therein $\left(₹\ 2{,}500 \times \frac{20}{100}\right)$	500
Cost	2,000

$$\text{Gross Profit on Normal Sales} = \frac{\text{Gross Profit on Normal Sales}}{\text{Normal Sales}} \times 100$$

$$= \frac{₹\ 48{,}000}{₹\ 1{,}92{,}000} \times 100 = 25\%$$

MEMORANDUM TRADING ACCOUNT OF UNLUCKY CO.
upto 25th June, 2021

	Normal Items ₹	*Abnormal Items* ₹		*Normal Items* ₹	*Abnormal Items* ₹
To Stock on 1-1-2021	22,400	2,000	By Sales	94,500	2,500
To Purchases	73,000	—	By Stock on 25-6-2021	24,525	
To Gross Profit (25% on Normal Sales and balancing figure in case of abnormal items)	23,625	500			
	1,19,025	2,500		1,19,025	2,500

	₹
Value of stock on the date of fire	24,525
Less : Sale of partly damaged stock	7,900
Value of stock destroyed by fire	16,625

Claim to be lodged = Value of stock destroyed × $\frac{\text{Insurance Policy}}{\text{Value of stock on the date of fire}}$

$$= ₹\ 16,625 \times \frac{₹\ 20,000}{₹\ 24,525} = ₹\ 13,558$$

ILLUSTRATION 7. *(Where poor selling goods are in stock).* On 1st July, 2021 a fire took place in the Godown of Ram Kumar which destroyed all stocks. Calculate the amount of insurance claim for stock from the following details :

	₹		₹
Sales in 2019	2,00,000	Stock as on 1-1-2021	2,70,000
Gross Profit in 2019	60,000	Purchases from 1-1-2021 to 30-6-2021	4,00,000
Sales in 2020	3,00,000	Sales from 1-1-2021 to 30-6-2021	7,20,000
Gross Profit in 2020	60,000		

Following are also to be taken into consideration :

1. Stock as on 31st December, 2020 had been undervalued by 10 per cent.
2. A stock taking conducted in March, 2021 had revealed that stocks costing ₹ 80,000 were lying in a damaged condition. 50 per cent of these stocks had been sold in May, 2021 at 50 per cent of cost and the balance stocks were expected to be sold at 40 per cent of cost.

SOLUTION

Calculation of Rate of Gross Profit in 2020

	₹
Gross Profit as given	60,000
Add : Profit to be increased due to increase in value of closing stock $\left(₹\ 2,70,000 \times \frac{10}{90}\right)$	30,000
	90,000
Sales in 2020	3,00,000

Therefore, percentage of gross profit to sale $\left(\frac{₹\ 90,000}{₹\ 3,00,000} \times 100\right) = 30\%$

MEMORANDUM TRADING ACCOUNT

upto 1st July, 2021

	Normal Items ₹	*Abnormal Items* ₹	*Total* ₹		*Normal Items* ₹	*Abnormal Items* ₹	*Total* ₹
To Opening Stock $\left(₹\ 2,70,000 \times \frac{100}{90}\right)$	2,20,000	80,000	3,00,000	By Sales	7,00,000	20,000	7,20,000
				" Gross Loss		(1) 44,000	44,000
To Purchases	4,00,000	—	4,00,000	" Closing Stock (Balancing figure)	1,30,000	16,000	1,46,000
To Gross Profit @ 30% on normal sales	2,10,000		2,10,000				
	8,30,000	80,000	9,10,000		8,30,000	80,000	9,10,000

Working Note

Amount of claim for loss of stock is total of normal stock and abnormal stock, i.e., ₹ 1,46,000.

	₹
(1) *Calculation of Gross Loss on Abnormal Items* :	
Cost of abnormal items sold	80,000
Cost of $\frac{1}{2}$ of the abnormal items	40,000

	20,000
Less : Value of sales @ 50%	20,000
Gross loss on 50% abnormal items	
Add : 60% loss on balance of 50% goods $\left(₹\ 40{,}000 \times \frac{60}{100}\right)$	24,000
Total gross loss on abnormal items	44,000

ILLUSTRATION 8. ***(Where poor selling goods are in stock)*** On 15th December, 2020 the premises of NAGAR LTD. were destroyed by fire, but sufficient records were saved from which the following particulars were ascertained :

	₹
Stock at cost on 1st April, 2019	2,20,500
Stock at cost on 31st March, 2020	2,38,800
Purchases *less* returns, year ended 31st March, 2020	11,94,000
Sales *less* returns, year ended 31st March, 2020	14,61,000
Purchases *less* returns, 1st April, 2020 to 15th December, 2020	10,15,000
Sales *less* returns, 1st April, 2020 to 15th December, 2020	11,62,000

In valuing stock for Balance Sheet as at 31st March, 2020 ₹ 6,900 had been written off for certain stock which was a poor selling line, having cost of ₹ 20,700. A portion of these goods were sold in June, 2020 at a loss of ₹ 750 on the original cost of ₹ 10,350. The remainder of this stock was now estimated to be worth the original cost. Subject to the above exception gross profit had remained at a uniform rate throughout. The stock salvaged was ₹ 17,500. The stock was insured for ₹ 2,50,000.

Required : Calculate the amount of claim to be lodged with the insurance company for loss of sotck.

(ICMA – Inter June, 2015 Modified)

SOLUTION

TRADING ACCOUNT

for the year ended 31.3.2020

	Normal item (₹)	*Abnormal item* (₹)	*Total* (₹)		*Normal item* (₹)	*Abnormal item* (₹)	*Total* (₹)
To Opening Stock A/c	2,20,500	—	2,20,500	By Sales *less* Returns A/c	14,61,000	—	14,61,000
To Purchases *less* Returns	11,73,300	20,700	11,94,400	By Closing Stock (2,38,800 + 6,900)	2,25,000	20,700	2,45,700
To Gross Profit	2,92,200	–	2,92,200				
	16,86,000	20,700	17,06,700		16,86,000	20,700	17,06,700

$$\text{Rate of Gross Profit} = \frac{(2{,}92{,}000 \times 100)}{14{,}61{,}000} = 20\%$$

MEMORANDUM TRADING ACCOUNT

For the period of 1st April, 2020 to 15th December, 2020

	Normal item (₹)	*Abnormal item* (₹)	*Total* (₹)		*Normal item* (₹)	*Abnormal item* (₹)	*Total* (₹)
To Opening Stock A/c	2,25,000	20,700	2,45,700	By Sales	11,52,400	9,600	11,62,000
To Purchases	10,15,000	—	10,15,000	By Loss	—	750	750
To Gross Profit (20% of ₹ 11,52,400)	2,30,480	—	2,30,480	By Closing Stock (B/f)	3,18,080	10,350	3,28,430
	14,70,480	20,700	14,91,180		14,70,480	20,700	14,91,180

Account of Loss of Stock :

Value of Stock on date of fire	3,28,430
Less : Stock Salvaged	17,500
Loss of Stock by fire	3,10,930

Since the value of the stock is more than the Insurance policy. Average Clause should be applied.

Application of Average Clause :

$$\text{Amount of Claim} = \text{Loss of Stock by Fire} \times \frac{\text{Insured Amount}}{\text{Value of Stock on Date of Fire}}$$

$$= 3{,}10{,}930 \times \frac{2{,}50{,}000}{3{,}28{,}430} = ₹\ \mathbf{2{,}36{,}679}$$

ILLUSTRATION 9. *(Where claim for stock of damaged goods is to be calculated).* The premises of Salav Enterprise, a proprietary concern, were damaged by fire on 12th February, 2021. As a result, some trading stock was totally destroyed, and in addition, stock costing ₹ 96,000 was partly damaged. The insurance company agreed to reduce the value of the damaged stock to ₹ 52,800. On 31st December, 2020, the stock-in-trade of the concern was valued at ₹ 4,12,000. Subsequently the following purchases were made:

	₹		₹
8th January, 2021	1,09,920	14th February, 2021	42,400
21st January, 2021	72,000	20th February, 2021	2,24,000
27th January, 2021	5,360	8th March, 2021	1,37,600

Additional information for the three months ended 31st March, 2021 is given below :

(a) 50% of the damaged goods were sold before 31st March, 2021 at a profit of 15%.
(b) With the exception of the damaged goods, the firm has earned a gross profit of 30% of the cost of goods sold.
(c) The sales during the three months ended 31st March, 2021 were ₹ 5,64,360.
(d) The undamaged stock at 31st March, 2021 was valued at ₹ 2,03,280.
(e) The firm has an insurance cover for loss and damage to stock by fire.

Prepare a statement of insurance claim.

SOLUTION

		₹
Total sales during 3 months		6,65,360
Less: Sales of partly damaged goods $\left(\frac{1}{2} \times ₹\ 52{,}800 \times \frac{115}{100}\right)$		30,360
Sales of undamaged stock		6,24,000

Computation of Cost of Damaged Stock

	₹	₹
Stock as at 31-12-2020		4,12,000
Add: Purchases during 1-1-2021 to 31-3-2021		5,91,280
		10,03,280
Less : Cost of partly damaged stock		96,000
		9,07,280
Less : Cost of undamaged stock sold :		
Sales of undamaged stock	6,24,000	
Less: Gross profit included therein $\left(₹\ 6{,}24{,}000 \times \frac{30}{130}\right)$	1,44,000	4,80,000
Expected balance of undamaged stock		4,27,280
Less: Actual cost of undamaged stock valued on 31-3-2021		2,03,280
Stock completely destroyed		2,24,000

Statement of Insurance Claim

	₹
Cost of stock completely destroyed	2,24,000
Add : Agreed value of partly damaged stock	52,800
Total claim for Stock Damaged	2,76,800

ILLUSTRATION 10. ***(Where slow item of goods is there besides calculating average G.P. Ratio)*** The premises of P were destroyed by fire on 30-6-2021. Following figures, however, were collected from various sources. Prepare a statement of claim in respect of the loss of stock for submission to the Fire Insurance Company. The firm closes its books on 31st December every year.

Details	*2018*	*2019*	*2020*	*30-6-2021*
	₹	₹	₹	₹
Opening Stock	20,000	22,000	11,800	34,020
Purchases less returns	1,60,000	1,45,000	1,70,000	35,000
Sales less returns	2,00,000	1,98,500	1,87,500	26,000
Freight (Inwards)	5,000	3,000	5,000	1,000
Freight (Outwards)	6,000	7,000	3,000	250

In 2018, while valuing closing stock, a slow moving item costing ₹ 5,000 was valued at ₹ 4,000. This was sold for ₹ 4,500 in 2019. In 2019, an item costing ₹ 6,000 was wrongly valued at ₹ 7,000. This was sold for ₹ 5,500 in 2020. In 2020, a slow moving item, costing ₹ 12,000 was valued at ₹ 10,000 ; 50% of which was sold before 30-6-2021 for ₹ 6,000. The value of salvage was ₹ 8,000.

SOLUTION

TRADING ACCOUNT OF P

	2018	2019	2020		2018	2019	2020
	₹	₹	₹		₹	₹	₹
To Opening Stock	20,000	22,000	11,800	By Sales	2,00,000	1,98,500	1,87,500
Less : Abnormal Item		4,000	7,000	*Less* : Sales of Abnormal Item		4,500	5,500
		18,000	4,800			1,94,000	1,82,000
To Purchases	1,60,000	1,45,000	1,70,000	By Closing Stock (at Cost)	23,000	10,800	36,020
To Freight (Inwards)	5,000	3,000	5,000				
To Gross Profit	38,000	38,800	38,220				
	2,23,000	2,04,800	2,18,020		2,23,000	2,04,800	2,18,020

Note. The item of freight (outwards) has not been considered in the Trading Account because this item is debited to the Profit and Loss Account :

Percentage of Gross Profit on Sales

$$2018 = \frac{₹\ 38,000}{₹\ 2,00,000} \times 100 = 19\% \qquad 2019 = \frac{₹\ 38,800}{1,94,000} \times 100 = 20\%$$

$$2020 = \frac{₹\ 38,220}{₹\ 1,82,000} \times 100 = 21\%$$

From the above it is evident that ratio of gross profit to sales is increasing by 1% every year, so ratio of gross profit for 2021 can be taken as 22% (*i.e.* 1% more than of 2020). Alternatively, weighted average of gross profits of 2018, 2019 and 2020 can be calculated by assigning weights, 1, 2 and 3 respectively as follows :

Year	*% of Gross Profit*	*Assumed Weights*	*Product of G.P. & Weights*
2018	19	1	19
2019	20	2	40
2020	21	3	63
		6	122

$$\text{Average \% of Gross Profit on Sales} = \frac{122}{6} = 20.33\%$$

MEMORANDUM TRADING ACCOUNT OF P
for the 6 months ending June 30, 2021

	₹		₹
To Opening Stock (at Cost)	36,020	By Sales	26,000
Less : Cost of Slow Moving Item	12,000	*Less* : Sale of Slow Moving Item	6,000
	24,020		20,000
To Purchases	35,000	By Closing Stock (Balancing figure)	44,420
To Freight (Inwards)	1,000		
To Gross Profit (22% on ₹ 20,000)	4,400		
	64,420		64,420

Amount of Claim

	₹
Value of Stock as per Memorandum Trading A/c	44,420
Add : 50% of the cost of slow moving item not yet sold $\left(\frac{50}{100} \times ₹\ 12,000\right)$	6,000
	50,420
Less : Stock salvaged	8,000
Claim to be lodged	42,420

ILLUSTRATION 11. ***(Where value of stock and rate of G.P. is to be calculated).*** On 2nd June, 2021, the stock of Shri Daga was destroyed by fire but sufficient records were saved from which the following particulars were ascertained :

	₹		₹
Stock at cost—1st April, 2020	90,000	Sales—year ended 31st March, 2021	6,00,000
Stock at cost—31st March, 2021		Purchases—1-4-21 to 2-6-21	1,50,000
(at 10% lower than cost)	1,08,000	Sales—1-4-21 to 2-6-21	3,20,000
Purchases—year ended 31st March, 2021	4,30,000		

Sales up to 2nd June, 2021 included ₹ 50,000 for which goods had not been despatched.

Purchases up to 2nd June, 2021 included machinery purchased for ₹ 10,000 and did not included ₹ 20,000 for which purchase invoices had not been received from suppliers though goods have been received at the godown.

The value of stock salvaged from the accident was worth ₹ 15,000 and this was handed over to the insured. Ascertain the amount of claim for loss of stock.

SOLUTION

Working Notes :

(1) ***Ascertainment of the Rate of Gross Profit for the Previous Year :***

	₹	₹
Stock as on 1-4-2020		90,000
Add : Purchases		4,30,000
		5,20,000
Less : Stock as on 31-3-2021	1,08,000	
Adjustment for under valuation $\left(₹\ 1,08,000 \times \frac{10}{90}\right)$	12,000	
		1,20,000
		4,00,000
Gross Profit (Bal. Fig.)		2,00,000
Sales		6,00,000

Rate of Gross Profit on Sales = $\frac{₹\ 2,00,000}{₹\ 6,00,000} \times 100 = 33\frac{1}{3}\%$

(2) ***Ascertainment of Stock on 2nd June, 2021***

	₹	₹
Opening Stock at Cost		1,20,000
Purchases	1,50,000	
Less : Machinery purchased	10,000	
	1,40,000	
Add : Adjustment of Goods received (Invoices not received)	20,000	
		1,60,000
		2,80,000
Less : *Cost of Goods Sold* :		
Sales	3,20,000	
Less : Goods not yet delivered	50,000	
	2,70,000	
Less : Gross Profit $33\frac{1}{3}\%$ on Sales	90,000	
		1,80,000
Value of Stock on 2nd June, 2021		1,00,000

STATEMENT OF INSURANCE CLAIM

	₹
Value of Stock on 2nd June, 2021	1,00,000
Less : Salvage Value	15,000
Insurance Claim	85,000

✓ **ILLUSTRATION 12.** (*Claim for Loss of Profit*). On 1st November, 2020 a severe fire broke out in the premises of Ill Luck Co. Ltd. The indemnity period lasted for 4 months during which the sales of the company were reduced to ₹ 2,00,000 only. The company closes its account on 30th June every year. Profit and Loss Account for the year ended 30th June, 2020 is given below :

PROFIT AND LOSS ACCOUNT

for the year ended 30th June, 2020

	₹		₹
Opening Stock	5,00,000	By Sales	47,50,000
Purchases	30,00,000	" Closing Stock	2,50,000
Variable Expenses	7,87,500		
Standing Charges	3,62,500		
Net Profit	3,50,000		
	50,00,000		50,00,000

The company took a loss of profit policy for a sum of ₹ 6,00,000. The sales of the company for the 12 months ending the date of fire were ₹ 50,00,000 and for the 4 months from 1st November, 2016 to 28th February, 2020 were ₹ 15,00,000.

It was noted that the sales for the first four months of the year under indemnity were 20% higher than previous year. Compute the claim for loss of profit.

SOLUTION

Calculation of Amount of Short Sales :

	₹
Sales from 1-11-2019 to 28-2-2020	15,00,000
Add : 20% increase expected in the current year	3,00,000
	18,00,000
Less : Sales from 1-11-2020 to 28-2-2021	2,00,000
Short Sales	16,00,000

Calculation of Gross Profit :

$$\frac{\text{Net Profit + Standing Charges}}{\text{Sales}} \times 100$$

$$\frac{₹\ 3{,}50{,}000 + ₹\ 3{,}62{,}500}{₹\ 47{,}50{,}000} \times 100 = \frac{₹\ 7{,}12{,}500}{₹\ 47{,}50{,}000} \times 100 = 15\%$$

Gross Profit on sales for the 12 months ending the date of fire :

15% on ₹ 50,00,000 = ₹ 7,50,000

Loss of Profit :

$$15\% \text{ on short sales } \left(i.e., \frac{15}{100} \times ₹\ 16{,}00{,}000 \right) = ₹\ 2{,}40{,}000$$

Claim of Loss :

$$\text{Loss of Profit} \times \frac{\text{Amount of Policy}}{\text{Gross Profit on preceding 12 month's adjusted sales}}$$

$$= ₹\ 2{,}40{,}000 \times \frac{₹\ 6{,}00{,}000}{15\% \text{ of } ₹\ 50{,}00{,}000 \times \frac{120}{100}} = ₹\ 1{,}60{,}000.$$

ILLUSTRATION 13. (*Claim for Loss of Profit*). From the following information, you are required to work out claim under the Loss of Profits insurance policy.

1. Cover—Gross Profit—₹ 1,00,000.
2. Indemnity period—Six months.
3. Damage—due to a fire accident on 28th December—accounting year ends on 31st December.
4. Net Profit plus all standing charges in the prior accounting year—₹ 1,50,000.
5. Standing charges uninsured—₹ 25,000.
6. Turnover of the last accounting year was ₹ 5,00,000, the rate of gross profit being 25%.
7. The annual turnover, namely, the turnover for 12 months immediately preceding the fire—₹ 5,20,000.
8. As a consequence of fire, there was a reduction in certain insured standing charge at the rate of ₹ 25,000 per annum.
9. The standard turnover ₹ 2,60,000.
10. Increased cost of working during the period of indemnity was ₹ 20,000.
11. Turnover during the period of indemnity was ₹ 1,00,000 and out of this turnover of ₹ 80,000 was maintained due to increased cost of working.

SOLUTION

Calculation of Short Sales :

	₹
Standard turnover	2,60,000
Turnover during the indemnity period	1,00,000
Short Sales	1,60,000

Calculation of Rate of Gross Profit

$$\frac{\text{Net profit plus all standing charges} - \text{Uninsured standing charges}}{\text{Sales of the last accounting year}} \times 100$$

$$= \frac{₹\ 1,50,000 - ₹\ 25,000}{₹\ 5,00,000} \times 100 = 25\%$$

Amount of Claim

		₹	₹
Loss of profit on short sales of ₹ 1,60,000 @ 25%			40,000
Add : Increased cost of working :			
Actual amount of increased cost		20,000	
Gross profit @ 25% on turnover for 12 months immediately preceding the date of fire $\left(₹\ 5,20,000 \times \frac{25}{100}\right)$		1,30,000	
Gross profit as above plus uninsured standing charges (1,30,000 + 25,000)		1,55,000	
Claim for increased cost of working $\left(₹\ 20,000 \times \frac{1,30,000}{1,55,000}\right)$			16,774
[Gross profit @ 25% on additional sales of ₹ 80,000 due to increased cost $\left(\frac{25}{100} \times ₹\ 80,000\right) = ₹\ 20,000$ is more than ₹ 16,774, so claim admissible is ₹ 16,774]		56,774	56,774
Less : Saving in standing charges for $\frac{1}{2}$ year $\left(₹\ 25,000 \times \frac{1}{2}\right)$			12,500
			44,274

Application of Average Clause

$$\frac{\text{Sum Insured}}{\text{Gross Profit on preceding 12 month's sales}} \times \text{Amount of Claim}$$

$$= \frac{₹\ 1,00,000}{25\% \text{ of } ₹\ 5,20,000} \times ₹\ 44,274 = \frac{₹\ 1,00,000}{₹\ 1,30,000} \times ₹\ 44,274 = ₹\ 34,057.$$

Therefore, claim for loss of profit to be lodged is ₹ 34,057.

ILLUSTRATION 14. *(Claim for Loss of Profit)*. A fire occurred on 1st July, 2020, in the premises of Arolite Ltd. and business was practically disorganised upto 30th November, 2020. From the books of account, the following information was extracted :

	₹		₹
Actual turnover from 1st July, 2020 to 30th November, 2020	60,000	Insured standing charges for the last financial year	60,000
Turnover from 1st July, 2019 to 30th November, 2019	2,00,000	Turnover for the last financial year	5,00,000
Net Profit for the last financial year	90,000	Turnover for the year ending 30th June, 2020	5,50,000
Total standing charges for the year	72,000		

The company incurred additional expenses amounting to ₹ 9,000 which reduced the loss in turnover. There was also a saving during the indemnity period of ₹ 2,486.

The company holds a 'loss of profit' policy for ₹ 1,65,000 having an indemnity period for 6 months. There had been a considerable increase in trade and it had been agreed that an adjustment of 20% be made in respect of upward trend in turnover.

Compute claim under "loss of profit insurance" assuming that all sales during the indemnity period are because of additional cost.

SOLUTION

Calculation of Short Sales

	₹
Standard turnover : Sales from 1-7-2019 to 30-11-2019	2,00,000
Add : 20% increase in sales due to upward trend in turnover	40,000
	2,40,000
Less : Sales during the indemnity period, 1st July, 2020 to 30th November, 2020	60,000
Short Sales	1,80,000

Calculation of Rate of Gross Profit

$$\frac{\text{Net profit + Insured standing charges}}{\text{Turnover for the last financial year}} \times 100 = \frac{₹\ 90,000 + ₹\ 60,000}{₹\ 5,00,000} \times 100 = 30\%$$

Calculation of Amount of Claim

	₹	₹
Loss of profit on short sales of ₹ 1,80,000 @ 30%		54,000
Add : Additional expenses—Lowest of the following amounts		
(*i*) Actual amount of additional expenses	9,000	
(*ii*) Gross profit on additional sales of ₹ 60,000 during the indemnity period @ 30%	18,000	
(*iii*) Gross profit @ 30% on turnover for 12 months immediately preceding the date of fire ₹ 6,60,000 *i.e.*, 30% of (₹ 5,50,000 + 20% increase of ₹ 5,50,000)	1,98,000	
Gross profit as above plus uninsured expenses (₹ 1,98,000 + ₹ 12,000)	2,10,000	

$$\text{Additional expenses} \times \frac{\text{Gross profit}}{\text{Gross profit + Uninsured expenses}}$$

$$₹\ 9,000 \times \frac{₹\ 1,98,000}{₹\ 1,98,000 + ₹\ 12,000} = ₹\ 8,486$$

	₹
Therefore, claim for additional expenses is the third figure of ₹ 8,486 because it is the lowest	8,486
	62,486
Less : Saving in expenses	2,486
Amount of claim	60,000

Application of Average Clause

$$\text{Net Claim} = \text{Amount of claim} \times \frac{\text{Sum insured}}{\text{Gross profit on preceding 12 months sales (adjusted)}}$$

$$₹\ 60,000 \times \frac{₹\ 1,65,000}{₹\ 1,98,000} = ₹\ 50,000$$

ILLUSTRATION 15. A fire occurred in the premises of M/s Kirti & Co. on 15th December, 2020. The working remained disturbed upto 15th March, 2021 as a result of which sales got adversely affected. The firm had taken out an insurance policy with an average clause against consequential losses for ₹ 2,50,000.

Following details are available from the quarterly sales tax return filed/GST return filed :

Sales	*2017-18* (₹)	*2018-19* (₹)	*2019-20* (₹)	*2020-21* (₹)
From 1st April to 30th June	3,80,000	3,15,000	4,11,900	3,24,000
From 1st July to 30th September	1,86,000	3,92,000	3,86,000	4,42,000
From 1st October to 31st December	3,86,000	4,00,000	4,62,000	3,50,000
From 1st January to 31st March	2,88,000	3,19,000	3,80,000	2,96,000
Total	12,40,000	14,26,000	16,39,900	14,12,000

A period of 3 months (*i.e.* from 16-12-2020 to 15-3-2021) has been agreed upon as indemnity period.

Sales from 16-12-2019 to 31-12-2019	68,000
Sales from 16-12-2020 to 31-12-2-20	Nil
Sales from 16-3-2020 to 31-3-2020	1,20,000
Sales from 16-3-2021 to 31-3-2021	40,000

Net profit was ₹ 2,50,000 and standing charges (all insured) amounted to ₹ 77,980 for the year ending 31st March, 2020.

You are required to calculate the loss of profit claim amount. ***(CA-IPCC Nov., 2022 Modified)***

SOLUTION

Gross Profit Ratio

	₹
Net Profit for the year 2019-20	2,50,000
Add : Insured Standing Charges	77,980
Ratio of Gross Profit = $\frac{3,27,980}{16,39,900}$ = 20%	3,27,980

Calculation of Short Sales

Indemnity period : 16-12-2020 to 15-3-2021

Standard sales to be calculated on basis of corresponding period of year 2019-20.

	₹
Sales for period 16-12-2019 to 31-12-2019	68,000
Sales for period 1-1-2020 to 15-3-2020 (Note 1)	2,60,000
Sales for period 16-12-2019 to 15-3-2020	3,28,000
Add : Upward Trend in Sales (15%) (Note 2)	49,200
Standard Sales (adjusted)	3,77,200
Actual Sales of Disorganised period	
Calculation of Sales from 16-12-2020 to 15-3-2021	
Sales for period 16-12-2020 to 31-12-2020	Nil
Sales for 1-1-2021 to 15-3-2021 (₹ 2,96,000 – ₹ 40,000)	2,56,000
Actual Sales	2,56,000
Short Sales (₹ 3,77,200 – ₹ 2,56,000)	1,21,200

Loss of Gross Profit

Short Sales × Gross Profit Ratio = 1,21,200 × 20%	24,240

Application of Average Clause

$$\text{Net Claim} = \text{Gross Claim} \times \frac{\text{Policy Value}}{\text{Gross Profit on Annual Turnover}}$$

$$= 24,240 \times \frac{2,50,000}{3,26,240 \text{ (W.N. 3)}}$$

Amount of Loss of Profit Claim = ₹ 18,575

Working Notes :

1. **Sales for period 1-1-2020 to 15-3-2020**

	₹
Sales for 1 Jan. to 31 March (2019-20) (given)	3,80,000
Less : Sales for 16-3-2020 to 31-3-2020 (given)	(1,20,000)
Sales for Period 1-1-2020 to 15-3-2020	2,60,000

2. **Calculation of Upward Trend in Sales**

	₹
Total Sales in year 2017-18	12,40,000
Increase in Sales in year 2018-19 as compared to 2017-18	1,86,000

% increase = $\frac{1,86,000\ (14,26,000 - 12,40,000)}{12,40,000}$ = 15%

Increase in sales in year 2019-20 as compared to year 2018-19

$$\% \text{ increase} = \frac{2,13,900\ (16,39,900 - 14,26,000)}{14,26,000} = 15\%$$

Thus annual percentage increase trend is of 15%.

3. **Gross Profit on Annual Turnover**

	₹
Sales from 16-12-2019 to 30-12-217 (adjusted) (68,000 × 1.15)	78,200
1-1-2020 to 31-3-2020 (adjusted (3,80,000 × 1.15)	4,37,000
1-4-2020 to 30-6-2020	3,24,000
1-7-2020 to 30-9-2020	4,42,000
1-10-2020 to 15-12-2020 (3,50,000 – Nil)	3,50,000
Sales for 12 months just before date of fire*	16,31,200
Gross Profit on Adjusted Annual Sales @ 20%	3,26,240

Note : Alternatively, the annual adjusted turnover may be computed as ₹ 17,98,000 (₹ 15,64,000 × 1.15) considering the annual % increase trend for the entire period of last 12 months preceding to the date of fire. In that case, the gross profit on adjusted annual sales @ 20% will be computed as ₹ 3,59,720 and net claim will be computed accordingly.

ILLUSTRATION 16. (*Claim for Loss of Profit/Stock*). The cost structure of All-in-one Ltd. is as under:

Materials 30% ; Labour 20% ; Variable Overheads 20% ; Fixed Overheads 15% ; Net Profit 15%; Sales for 2020 amounted to ₹ 30,00,000.

Future sales are expected to increase by 60% in 2021 and on that basis loss of profit policy was taken on 1-1-2021. All expenses were incurred.

In 2021, opening stock was ₹ 4,00,000. There was fire on 1st September and dislocation continued up to 30th November. During which period sales amounted to ₹ 3,00,000. Sales for the corresponding period in the previous year were ₹ 8,00,000. Though 60% increase was budgeted, actual sales were only 25% higher. Sales in 2021 upto 31st August amounted to ₹ 7,50,000. Purchases during the period were ₹ 5,00,000. There was no opening stock or closing stock of finished goods, cost structure remained same as before. Calculate the insurance claim for (*a*) loss of profit and (*b*) loss of stock.

SOLUTION

(*a*) ***Calculation of Insurance Claim for Loss of Profit***

Net Profit Percentage	15% of Sales
Fixed Overheads	15% of Sales

Therefore, Rate of Gross Profit = 15% + 15% = 30%

	₹
Sales during dislocation period of previous year, *i.e.*, Sales from 1-9-2020 to 30-11-2020	8,00,000
Add : 25% upward trend	2,00,000
	10,00,000
Less : Actual sales during dislocation period of 1-9-2021 to 30-11-2021	3,00,000
Short Sales	7,00,000
Loss of Profit @ 30% on ₹ 7,00,000 Short Sales	2,10,000
Therefore, Claim for Loss of Profit	2,10,000

Average clause need not be applied because loss of profit is fully insured. Loss of profit policy was taken on the basis of 60% expected increase in sales whereas actual sales were higher by 25%.

(*b*) *Calculation of Insurance Claim for Loss of Stock*

	₹
Opening Stock of Materials on 1-1-2021	4,00,000
Add : Purchases during 1-1-2021 to 30-8-2021	5,00,000
	9,00,000
Less : Material consumed @ 30% of sales made during 1-1-2021 to 30-8-2021 (30% of 7,50,000 Sales)	2,25,000
Loss of Stock by Fire	6,75,000
Therefore, Insurance Claim for Loss of Stock	6,75,000

ILLUSTRATION 17. *(Calculation of Amount of Policy)* CCL wants to take up a Loss of profit policy. Turnover during the current year is expected to increase by 20%. The company will avail overdraft facilities from its bank @ 15% interest to boost up the sales. The average daily overdraft balance will be around ₹ 3 lakh. All other fixed expenses will remain same. Following further details are also available from the previous year's account :

Total Variable Expenses ₹ 24,00,000 ; Fixed Expenses : Salaries ₹ 3,30,000 ; Rent, Rates and Taxes ₹ 30,000 ; Travelling Expenses ₹ 50,000 ; Postage, Telegram, Telephone ₹ 60,000 ; Directors' Fees ₹ 10,000 ; Audit Fees ₹ 20,000 ; Miscellaneous Income ₹ 70,000 ; Net Profit ₹ 4,20,000

Determine the amount of policy to be taken for the current year.

SOLUTION

CALCULATION OF GROSS PROFIT OF THE PREVIOUS YEAR

		₹
Net Profit		4,20,000
Less : Miscellaneous Income		70,000
Operating Profit		3,50,000
Add : Fixed Expenses :	₹	
Salaries	3,30,000	
Rent, Rates & Taxes	30,000	
Travelling Expenses	50,000	
Postage, Telegram & Telephone	60,000	
Directors' Fees	10,000	
Audit Fees	20,000	
		5,00,000
Gross Profit		8,50,000

DETERMINATION OF THE AMOUNT OF THE POLICY

	₹
Gross Profit on the basis of last year's sales	8,50,000
Add : Increase in Gross Profit because of 20% Expected Increase in Sales	1,70,000
Expected Gross Profit in the current year	10,20,000
Add : Increased standing charges to be covered : 15% of ₹ 3,00,000 overdraft facilities	45,000
Policy to be taken for the Current year	10,65,000

INVESTMMENT ACCOUNTING

In real life any individual prefer to invest portion of their earnings to grow themselves and meet their future needs. Likewise business enterprise will do portion their capital into varied method of investment. This investment will play vital role on their running capital by showing gains. Now enterprises will have to measure the growth of investment and they need to realign their investments.   For example

If we invest in stock market, every one will prefer to invest or diversify their portfolio, which help to minimize their risk from particular sector. During the course of their invest they will analyze the performance of investment/ sector and they realign their investment into right sector and avoid or reduce the investment in slow growth sector. Likewise corporate/ enterprises will do manage their investment by setting up a separate department/ officer.

In fact Mutual fund operates in the same way and they are managing their investments/ capital in the best way to get returns.   While doing by this way we need to have tracking mechanism/ systematic management of investments.

Here we n eed understand how the revenue is coming out of investments

1. Rent on property
2. Appreciation of property value / appreciation share value/ mutual fund value
3. Revenue by Royalty
4. Dividend from Shares/ interest from other form of investments
5. Maturity value of Government bond, debenture and other securities
6. Loan to other legal entity will fetch interest and maturity/ refund of loan amount

Likewise, we may see revenue and appreciation of investment’s.

Investments may be long term and short term investments. As per IAS 13 investments are classified as

a. Current Investment-Carrying amount of current investment
b. Long term investments

Current Investments can be defined as “Investments in nature are readily realizable and intended to be held for less than year from the date of such investments. As per income tax act Short term capital gains refers investment realized within 12months as short term and invest realized after 12 months as long term capital gains. Short term capital gains will attract capital gain and Long term capital gains will be kept away from taxable income.

Other than short term investments rest all will be called as long term invest though it has liquidity.

Cost of Investments

Cost of investment includes charges related invest acquisition expenses like brokerage, duties and fess. In case of investment acquired are partial acquired by issuing shares/ issuing other securities as consideration.

Acquisition value of any investment may not be equivalent to nominal value. Ex. If we buy shares of LMW (LAXMIMACH) today cost is 9,996 but its face value is 10, can be called as nominal value. But in books of investment one share value called as 9,996 instead of Rs.10

Likewise, lot of investment value will differ from their face value / nominal value.

Dividend, rent, interest and other receivables from investment are usually considered as income ROI. However in some condition such inflows recovery of cost and does not form part of realization of cost. Ex. Bonus shares issued will not be considered as income from shares, but reduces the cost of investment. When we receive interest before acquisition such revenue will reduce the cost of investment, they will not be considered as income from investment. Assume if we buy cum dividend, the dividend we receive will be considered to reduce the cost of investment. This is being referred reacquisition revenue.

Rights Share

In case of right shares offered are subsequently subscribed for cost of such right share is then added to carrying amount original value. If we sell the right share value to other legal entity the consideration will be treated as profit/ revenue from the holding assets and same will posted in P/L account of the year.

As per IAS 40, Investment property is investment in Building, land which are in envisaged to be used significantly for Business operation/ use

Disbursal of investment- difference between holding value and realized value after adjusting expenses relating to realization will be posted into P/L account for the year.

Investment Account.

The account of investment kept in the same way like other investments. The separate investment account should be opened for each kind of security and the head of account particular regarding the nature of security, date when interest or dividend is due, date of redemption etc should be stated. When the number of investment carried in large a separate investment ledger is employed for recording all the investment.

- It helps keeping record of each security separately
- It helps to ascertain value of security
- It helpful to collection of interest and dividend as and when they become due
- It is helpful to ascertain accrued income at the end of financial year
- Facilitate to determine profit or loss of investment while selling

Thank you all....

Thanks for guidance and helping to circulating this book with our students