



# GOVERNMENT ARTS AND SCIENCE COLLEGE

(Affiliated to Manonmaniam Sundaranar University, Tirunelveli.)

KANAYAKUMARI-629401

**STUDY MATERIAL FOR B.COM**

**FINANCIAL ACCOUNTING - II**

**SEMESTER – II**



**Academic Year 2022-2023**

**Prepared by**

**COMMERCE DEPARTMENT**

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**Objectives**

1. To enhance critical and analytical approach to different types of accounting.
2. To provide real life opportunities to manage business accounts.
3. To know the pattern of recording transactions in Hire Purchase and Installment Purchase systems.
4. To understand the accounting treatment to be followed at the time of Insolvency of an individual and while taking a lease of a property.

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**Unit I Consignment**

Consignment – Account Sales – Treatment of Bad Debts – Del- Credere Commission –Over Riding Commission – Difference between Consignment and Sales – Valuation of Unsold Stock – Recurring and Non- recurring expense – Abnormal, Normal Loss – Invoice Price Model.

**Unit II Joint Venture**

Joint Venture – Meaning – Difference between Joint Venture and Partnership, Difference between Consignment and Joint Venture – Methods of Maintaining Accounts – Own Book Model (Joint Bank Account) – Separate Book Model – Memorandum Joint Venture Model.

**Unit III Accounts of Non- Trading Concern**

Accounts of Non- Trading Concern – Meaning – Capital and Revenue Expenditure –Capital and Revenue Receipts – Difference between Capital and Revenue items – Income and Expenditure Account – Receipts and Payments Account – Balance Sheet

**Unit IV Hire purchase**

Hire purchase and Instalment system – Calculation of Cash price and interest – Default and Repossession – complete and partial – Difference between Hire purchase and Instalment system – Instalment system

**Unit V: Royalty Account**

Meaning – Minimum rent – Short working – Type of recoupment - strike and lock out – Insolvency accounts – Insolvency of an individual – Statement of Affairs – Deficiency Account.

**Text & Reference Books**

1. S.P.Jain & K.L.Narang, Advanced Accountancy, Kalyani Publishers, New Delhi.
2. R.L.Gupta and M.Radhaswamy, Advanced Accountancy, Sultan Chand & Sons, New Delhi.
3. M.C.Shukla and T.S.Grewal, Advanced Accountancy, Sultan Chand & Co., New Delhi.
4. Dr.M.A.Arulanandam & K.S.Raman, Advanced Accountancy, Himalaya Publishing House, Mumbai.
5. T.S.Reddy & A. Murthy, Advanced Accountancy, Margham Publications, Chennai.
6. R.S.N.Pillai, Bagavathi & S.Uma, Fundamentals of Advanced Accounting, S.Chand & Company Ltd., New Delhi.

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**UNIT-1**

**CONSIGNMENT**

**CONSIGNMENT**

Consignment accounting is a type of business arrangement in which one person send goods to another person for sale on his behalf and the person who sends goods is called consignor and another person who receives the goods is called consignee, where consignee sells the goods on behalf of consignor on consideration of certain percentage on sale.

**Consignor:** It is the person that sends goods.

**Consignee:** The person who receives the goods is called the consignee.

**Consignment:** Consignment is a business arrangement through which the consignor sends goods to the consignee for sale.

**Consignment Agreement:** It is legally written communication between the consignor and consignee, which defines the terms and conditions of the consignment.

| S.NO | Consignment  | Sales  |
|------|--|--|
| 1    | Ownership of the goods rests with the consignor till the time they are sold by the consignee, no matter the goods are transferred to the consignee | The ownership of the goods transfers with the transfer of goods from the seller to the buyer   |
| 2    | The consignee can return the unsold goods to the consignor.  | Goods sold are the property of the buyer and can be returned only if the seller agrees.        |
| 3    | Consignor bears the loss of goods held with the consignee.   | It is the buyer who will bear the loss if any, after the delivery of goods.                    |
| 4    | The relationship between the consignor and the consignee is that of a principal and agent.   | The relationship between the seller and the buyer is that of a creditor and a debtor.          |
| 5    | Expenses done by the consignee to receive the goods and to keep it safely is borne by the consignor.   | Expenses incurred by the buyer are to be borne by the buyer itself after the delivery of goods |

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**Pro-Forma Invoice:** When the consignor sends goods to the consignee, he also forwards statements showing details of goods such as quantity, price, etc. and that statement is called the Pro-forma invoice.

**Non- Recurring Expenses:** Expenses that are incurred by the consignor to dispatch the goods from his place to place of the consignee are called non-recurring expenses. These expenses are added to the cost of goods.

**Recurring Expenses:** The consignee incurs these expenses after the goods reached his place. These expenses are of maintenance of goods type's expenses.

**Commission:** Commission is the reward/ consideration for the sale of goods on behalf of the consignor. It is as per the consignment agreement.

**Account Sale:** It is the statement forwarded by the consignee to consignor showing details of goods sold, amounts received, expenses incurred, a commission charged, advance payment and balance due and stock in hand, etc.

### **Commission**

**Simple Commission** – this is usually a fixed percentage on the total sale, calculated as per mutually agreed terms.

**Over-riding Commission** – In case of an extra-ordinary sale of the goods, some specific amount is payable to consignee in the form of an incentive is called over-riding commission. Over-riding commission is also calculated on the total sales.

**Del-credere Commission** – “An agreement by which an agent or factor, in consideration of an additional premium or commission (called a del credere commission), engages, when he sells goods on credit, to insure, warrant, or guarantee to his principal the solvency of the purchaser, the engagement of the factor being to pay the debt himself if it is not punctually discharged by the buyer when it becomes due.”

### **Valuation of unsold Consignment**

Valuation of unsold stock will be done like a closing stock of a Trading concern and should be valued at the cost or the market price whichever is low. This stock will be valued at –

- Proportionate cost price and
- Proportionate direct expenses

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Here, proportionate direct expenses mean — all expenses incurred by the consignor and the expenses of consignee, which are incurred by him till the goods reach the warehouse.

**Loss of Goods**

There may be two types of losses as explained below

**Normal Loss** – Normal loss may occur due to inherent characteristics of goods like evaporation, drying up of goods, etc. It is not separately shown in the consignment account, but included in the cost of goods sold and the closing stock by inflating the rate per unit. To calculate the value of unsold stock, following formula is used.

- Value of closing stock = Total value of goods sent Net quantity received by consignee × Unsold quantity.
- Net quantity received = Goods consigned quantity – Normal loss quantity.

**Abnormal Loss** – An abnormal loss may occur due to any accidental reason. It is credited to the consignment account to calculate actual profitability. Valuation of closing stock is done on the same basis as explained earlier i.e. proportionate cost + proportionate direct expenses.

Abnormal Loss and Insurance

If, there is an insurance policy in respect of the consigned goods; following entries will be passed in the books of a consignor –

| Sr.No. | In the Books of Consignor  | In the Books of Consignee   |
|--------|--|---|
| 1      | <b>Payment of Insurance Premium</b><br>(a) If insurance premium is paid by the consignor, then cash will be credited.<br>(b) If Insurance premium is paid by the consignee, then consignee's A/c will be credited. | Consignment A/cDr<br>To Cash A/c<br>Or<br>To Consignee A/c<br>(Being Insurance premium paid)    |
| 2      | <b>At the time of Abnormal Loss</b>  | Abnormal Loss A/cDr<br>To Consignment A/c<br>(Being Loss Incurred)                              |
| 3      | <b>Acceptance of Claim by Insurance Company</b>  | Insurance Company (Name of the insurer) A/cDr<br>To Abnormal Loss A/c<br>(Being claim admitted) |
| 4      | <b>On receipt of Claim</b>   | Bank A/cDr<br>To Insurance Company A/c<br>(Being amount of claim received)                      |
| 5      | <b>In Case of Loss</b>   | Profit & Loss A/cDr<br>To Abnormal Loss A/c<br>(Being amount of Abnormal Loss transferred)      |

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**Summary of Accounting Entries**

Following Accounting Entries (Except for Loss) will be done in the books of consignor and consignee for transactions related to the consignment –

| <b>Sr. No.</b> | <b>In The Books Of Consignor</b>  | <b>In The Books Of Consignee</b>   |
|----------------|---|--|
|                | <b>When goods are sent to the consignee</b><br>Consignment A/c Dr<br>To Goods Sent on Consignment A/c (Being Goods Sent on Consignment) | No need to do any Entry in this case   |
|                | <b>Expenses Incurred by Consignor</b><br>Consignment A/c Dr<br>To Cash/Bank A/c (Being Expenses incurred on consignment)                | Not Applicable   |
|                | <b>Advance given by consignee</b><br>Cash/Bank A/c Dr<br>To Consignee's A/c (Being advance received from consignee)                     | Consigner A/c Dr<br><br>To Bank/Cash A/c (Being Advance amount paid to Consignor)                      |
|                | <b>Expenses Incurred by Consignee</b><br>Consignment A/c Dr<br>To Consignee's A/c (Being Expenses incurred by consignee)                | Consigner A/c Dr<br>To Bank/Cash A/c (Being Expenses incurred on goods received on consignment)        |
|                | <b>Sale by Consignee</b><br>Consignee's A/c Dr<br>To Consignment A/c (Being Expenses incurred by consignee)                             | Cash (for cash sale) A/c Dr<br>Debtors (for Credit Sale) A/c Dr<br>To Consignor A/c (Being goods sold) |
|                | <b>Commission to Consignee</b><br>Consignment A/c Dr<br>To Consignee's A/c (Being Commission on sale due to consignee)                  | Consigner A/c Dr<br>To Commission A/c (Being Commission earned)  |
|                | <b>Remittance from Consignee</b><br>Cash/Bank A/c Dr<br>To Consignee's A/c (Being due amount received from consignee)                   | Consigner A/c Dr<br>To Bank/Cash A/c (Being Balance due Payment made to consignor)                     |
|                | <b>Entry for Profit on Consignment</b><br>Profit & Loss A/c Dr  | Not Applicable   |

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|  |  |                |
|--|--|----------------|
|  | To Consignment A/c (Being Profit earned on consignment)  |                |
|  | <b>Loss on Consignment</b><br>Consignment A/c Dr<br>To Profit & Loss A/c (Being Loss incurred on Consignment transferred to the profit & Loss Account) | Not Applicable |

**Note** – The goods sent on consignment account will be closed by transferring balance into the Purchase account or the Trading account.

**Illustration:** Exe sent on 1<sup>st</sup> July, 2006 to Wye goods casting Rs. 50,000 and spent Rs. 1,000 on packing etc. On 3 July, 2006, Wyes received the goods and sent his acceptance to Exe for Rs. 30,000 payable at 3 months. Wyes spent Rs. 2,000 on freight and cartage, Rs. 500 on godown rent and Rs. 300 on insurance. On 31 December, 2006 he sent his Account Sales (along with the amount due to Exe) Showing that 4/5 of the goods had been sold for Rs. 55,000. Wye is entitled to a commission of 10%. One of the customers turned insolvent and could not pay Rs. 600 due from him. Show the necessary ledgers accounts.

**SOLUTION:**

**Important ledger accounts**

**Consignment to Wyes Account**

| 2006   |                                  | Rs.    | 2006    |                                 | Rs.    |
|--------|----------------------------------|--------|---------|---------------------------------|--------|
| July 1 | To Goods sent on Consignment A/c | 50,000 | Dec. 31 | By Wye-sale Proceeds            | 55,000 |
| July 1 | To Bank expenses                 | 1,000  |         | By Stock on Consignment Account | 10,600 |



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|         |  |        |  |  |        |
|---------|--|--------|--|--|--------|
| Dec.31  | To Wye-<br>expenses &<br>bad debt        | 3,400  |  |  |        |
| Dec. 31 | To Wye-<br>commission                    | 5,500  |  |  |        |
| Dec. 31 | To P&L<br>Account-<br>transfer of profit | 5,700  |  |  |        |
|         |  | 65,600 |  |  | 65,600 |
|         |  |        |  |  |        |

**Goods sent on consignment account**

| 2006   |                   | Rs.    | 2006   |                              | Rs.    |
|--------|-------------------|--------|--------|------------------------------|--------|
| Dec.31 | To Trading<br>A/c | 50,000 | July 1 | By consignment to<br>Wye A/c | 50,000 |
|        |                   |        |        |                              |        |

**Stock on consignment account**

| 2006           |                   | Rs.    | 2006   |                | Rs.    |
|----------------|-------------------|--------|--------|----------------|--------|
| Dec.31<br>2007 | To<br>Consignment | 10,600 | Dec.31 | By Balance c/d | 10,600 |
| Jan.1          | To Balance b/d    | 10,600 |        |                |        |

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| <u>Wye's account</u> |                                     |        |        |                                       |        |
|----------------------|-------------------------------------|--------|--------|---------------------------------------|--------|
| 2006                 |                                     | Rs.    | 2006   |                                       | Rs.    |
| Dec.31               | To<br>Consignment<br><u>Wye A/c</u> | 55,000 | July 3 | By Bills Receivable<br>Account        |        |
|                      |                                     |        |        | By Consignment to<br><u>Wye A/c</u> – | 30,000 |
|                      |                                     |        |        | Expenses & bad<br>dept                |        |
|                      |                                     |        |        | Commission                            | 3,400  |
|                      |                                     |        |        | <u>By Bank</u>                        | 5,500  |
|                      |                                     |        |        | ( <u>balance Received</u> )           | 16,100 |
|                      |                                     | 55,000 |        |                                       | 55,000 |

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**UNIT II**

**Joint venture**

**Introduction and Meaning of joint Venture**

Joint venture is a short term business undertaking jointly by two or more persons who share the profits and losses in an agreed ratio. If there is no agreement concerning the sharing of profits or losses, it is shared equally by all the parties. Co-ventures: the parties who have agreed to undertake the joint venture are called covertures or joint ventures.

**Definition:**

It is described as a temporary partnership without the use of the firm name; such temporary partnership comes to an end on the completion of the venture undertaking. Example is construction of building, underwriting of shares and debentures, consignment of goods etc.

**Difference between Joint Venture and Consignment**

The main differences between joint venture and consignment are as under:

| <b>Point of difference</b> | <b>Joint venture</b>   | <b>Consignment</b>  |
|----------------------------|--|---|
| 1. Nature                  | It is a temporary partnership business without a firm name   | It is an extension of business by principal through agent   |
| 2. Parties                 | The parties involving in joint venture are known as covertures                                       | Consignor and consignee are involving parties in the consignment.   |
| 3. Relation                | The relation between covertures is just like the partners in partnership firm.                       | The relation between the consignor and consignee is 'principal and agent'.                                    |
| 4. Sharing Profit          | The profits and losses of joint venture are shared among the co-ventures in their agreed proportion. | The profits and losses are not shared between the consignor and consignee. Consignee gets only the commission |
| 5. Rights                  | The co-ventures in a joint venture have equal rights   | In consignment, the consignor enjoys principal's right whereas consignee enjoys the right of agent.           |

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|                                   |   |  |
|-----------------------------------|---|--|
| 6. Exchange of Information        | The co-ventures exchange the required information among them regularly.   | The consignee prepares an account sale which contains a details of business activities carried on and is being sent to the consignor |
| 7. Ownership                      | All the co-ventures are the owners of the joint venture.  | The consignor is the owner of the business.  |
| 8. Method of Maintaining Accounts | There are different methods of maintaining accounts in joint venture. As per agreement the co-ventures maintain their account | In consignment, there is only one method of maintaining account.   |
| 9. Basis of Account               | Cash basis of accounting is applicable in joint venture.  | Actual basis is adopted in consignment   |
| 10. Continuity                    | As soon as the particular venture is completed, the joint venture is terminated.  | The continuity of business exists according to the willingness of both consignor and consignee.                                      |

**Distinction between joint venture and partnership**

| <b>DIFFERENCE</b>       | <b>Joint Venture</b>  | <b>Partnership</b>   |
|-------------------------|---|--|
| Meaning                 | Joint Venture is a business formed by two or more than two persons for a limited period and a specific purpose. | A business arrangement where two or more persons agree to carry on business and have mutual share in the profits and losses is known as Partnership. |
| Governing Act           | There is no such specific act.  | The partnership is governed by the Indian Partnership Act, 1932.   |
| Business carried on by  | Co-venture's  | Partners   |
| Status of Minor         | A minor cannot become a co-venture.   | A minor can become a partner to the benefits of the firms.   |
| Basis of Accounting     | Liquidation   | Going Concern  |
| Trade Name              | No  | Yes  |
| Ascertainment of Profit | At the end of the venture or on interim basis as the case may be.   | Annually   |

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**Methods of maintaining Joint Venture Accounts:**

There are different methods of recording joint venture transactions. They can be broadly classified into two following methods:

- I. When separate set of books are maintained
- II. When separate set of books are not maintained.

**I. When separate set of books are maintained.**

Under this system three following accounts are prepared:

1. Joint Bank Account.
2. Joint Venture Account
3. Co-venture's Accounts

**1. Joint Bank Account:** The co-venture's opens separate bank Account for joint venture transaction by making initial contributions. It is opened jointly.

**Format of Joint Bank A/c**

| Dr  |          |  | Cr       |
|---|----------|--|----------|
| Particulars   | Amount ₹ | Particulars  | Amount ₹ |
| To Co-venturers A/c (share of capital by cash)                                | XXX      | By Joint venture A/c (for purchases from joint bank a/c)                         | XXX      |
| To Joint venture A/c (for cash sales)   | XXX      | By Joint venture A/c ( for expenses paid out of joint bank a/c)                  | XXX      |
| To Joint venture A/c (For sale of asset)                                      | XXX      | By Co-venturers A/c (B/F) (for payment made to co-venturers on final settlement) | XXX      |
| To Joint venture A/c ( contract price received in cash)                       | XXX      |  |          |
| To co- venturers A/c ( amount received from co-venturers on final settlement) | XXX      |  |          |
|   | XXX      |  | XXX      |

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**2. Joint Venture Account:** this account is prepared for the purpose of ascertaining venture profit. This account is debited for all venture expenses and it's credited for all sales collections. Venture profit or loss is transferred to co-venturers' accounts.

**Format of Joint Venture A/c**

| Dr  |             | Cr  |             |
|---|-------------|---|-------------|
| Particulars   | Amount<br>₹ | Particulars   | Amount<br>₹ |
| To Co-venturers A/c (contribution in the form of Goods)                     | XXX         | By Joint bank a/c (for cash Sales)  | XXX         |
| To Joint Bank A/c (for cash purchases from joint bank a/c)                  | XXX         | By Debtor's A/c (for credit sales)  | XXX         |
| To Creditor's A/c (For credit purchases)                                    | XXX         | By Co-venturer's a/c (for collection received by co-venturers)            | XXX         |
| To Joint Bank A/c (for expenses paid out of joint bank a/c)                 | XXX         | By Co-venturer's a/c (for unsold stock (asset) taken over by co-venturer) | Xxx         |
| To Co-venturer's A/c (for commission, interest etc. payable to co-ventures) | XXX         | By Joint Bank a/c (for sale of asset)                                     | xxx         |
| To Co-venturer's A/c (for liabilities taken over by co-venturer)            | XXX         | By Joint Bank a/c   | XXX         |
| To Equity shares a/c (for loss due to under valuation shares)               | xxx         | By Equity shares a/c (for profit due to over valuation of shares)         | Xxx         |
| To Debtors A/c (for cash discount allowed to debtors)                       | xxx         | By Equity shares A/c (for contract price received in cash and shares)     | xxx         |
| To Debtors A/c (for bad debts from customers)                               | xxx         | By creditor's A/c (for cash discount allowed by creditors)                | xxx         |
| To Co-venturer a/c (for profit on joint venture)                            | xxx         | By Co-venturer's A/c (for loss on joint venture)                          | xxx         |
|   | xxxx        |   | xxxx        |

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**3. Co-venture's account:** Personal accounts of venture's are maintained to keep record of their contributions of cash, goods or meeting venture expenditure directly and direct payment received by them on venture transaction. This account is closed simultaneously with the closure of joint bank account.

**Format of Co-venturers account**

| Dr  |             | Cr   |             |
|---|-------------|--|-------------|
| Particulars   | Amount<br>₹ | Particulars  | Amount<br>₹ |
| To Joint Venture A/c<br>(for collection received by co-venturers)               | XXX         | By Joint bank a/c<br>(share of capital by cash)                                | XXX         |
| To Joint Venture A/c<br>(for unsold stock (asset ) taken over by a co-venturer) | XXX         | By Joint Venture A/c<br>( for contribution in the form of goods)               | XXX         |
| To Joint Venture A/c<br>(loss on Joint venture)                                 | XXX         | By Joint Venture A/c<br>(for expenses paid by co-venturers)                    | XXX         |
| To Joint Bank A/c<br>(for payment made to co-venturers on final settlement)     | XXX         | By Joint Venture A/c<br>(for commission, interest etc. payable to co-ventures) | XXX         |
|   |             | By Joint Venture A/c<br>( for liabilities taken over by co-venturer)           | XXX         |
|   |             | By Joint Venture A/c<br>( for profit on joint venture)                         | XXX         |
|   |             | By Joint Bank A/c( amount received from co-venturers on final settlement)      | XXX         |
|   | XXXX        |  | XXXX        |



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**Journal entries:**

Following are the journal entries made when separate set of books are maintained:

| Particulars  | L<br>F | Dr Amount ₹          | Cr Amount ₹          |
|--|--------|----------------------|----------------------|
| 1. when contribution made by co-venturers  |        | Joint bank A/c Dr    | To co-venturer's A/c |
| 2. when the expenses paid through Joint bank A/c   |        | Joint venture A/c Dr | To Joint bank A/c    |
| 3. when the expenses paid or materials supplied by the co-venturers from the private account |        | Joint venture A/c Dr | To co-venturer's A/c |
| 4. Sales proceeds or collections   |        | Joint bank A/c Dr    | To Joint venture A/c |
| 5. Collections received by co-venturers  |        | Co-venturer's A/c Dr | To Joint venture A/c |
| 6. Assets taken over by co-venturers   |        | Co-venturer's A/c Dr | To Joint venture A/c |
| 7. Liabilities taken over by co-venturers  |        | Joint venture A/c Dr | To co-venturer's A/c |
| 8. Profit on Joint venture   |        | Joint venture A/c Dr | To co-venturer's A/c |
| 9. Loss on joint venture   |        | Co-venturer's A/c Dr | To Joint venture A/c |
| 10. Final settlement by co-venturers   |        | Co-venturer's A/c Dr | To Joint Bank A/c    |



### **UNIT III**

#### **ACCOUNTS OF – NON TRADING CONCERN**

Maintenance of proper books of accounts is necessary to safeguard the money of its members and general public from any kind of misuse or misappropriations. It is important to know the total receipts, total payments, and also to know financial status of an institution. Hence, the account opened and maintained for and by the organizations discussed above is known as Non-trading account.

Normally, registration of members, minute book, cash receipt journal, cash payment journal, etc. are main record which is maintained by these organizations/ institutions in their non-trading accounts. At the end of an accounting period, these institutions prepare its final accounts, which include the following –

- Receipt and Payment Account
- Income and Expenditure Account
- Balance-Sheet

#### **Capital Expenditure**

Capital expenditure is the expenditure incurred to acquire fixed assets, capital leases, office equipment, computer equipment, software development, purchase of tangible and intangible assets, and such kind of any value addition in business with the purpose to enhance the income. However, to decide nature of the capital expenditure, we need to pay attention on –

- The expenditure, which benefit cannot be consumed or utilized in the same accounting period, should be treated as **capital expenditure**.
- Expenditure incurred to acquire Fixed Assets for the company.
- Expenditure incurred to acquire fixed assets, erection and installation charges, transportation of assets charges, and travelling expenses directly relates to the purchase fixed assets, are covered under capital expenditure.
- Capital addition to any fixed assets, which increases the life or efficiency of those assets for example, an addition to building.

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### **Revenue Expenditure**

Revenue expenditure is the expenditure incurred on the fixed assets for the 'maintenance' instead of increasing the earning capacity of the assets. Examples of some of the important revenue expenditures are as follows –

- Wages/Salary
- Freight inward & outward
- Administrative Expenditure
- Selling and distribution Expenditure
- Assets purchased for resale purpose
- Repairs and renewal expenditure which are necessary to keep Fixed Assets in good running and efficient conditions

### **Revenue Expenditure Treated as Capital Expenditure**

Following are the list of important revenue expenditures, but under certain circumstances, they are treated as a capital expenditure –

- **Raw Material and Consumables** – If those are used in making any fixed assets.
- **Cartage and Freight** – If those are incurred to bring Fixed Assets.
- **Repairs & Renewals** – If incurred to enhance life of the assets or efficiency of the assets.
- **Preliminary Expenditures** – Expenditure incurred during the formation of a business should be treated as capital expenditure.
- **Interest on Capital** – If paid for the construction work before the commencement of production or business.
- **Development Expenditure** – In some businesses, long period of development and heavy amount of investment are required before starting the production especially in a Tea or Rubber plantation. Usually, this expenditure should be treated as the capital expenditure.
- **Wages** – If paid to build up assets or for the erection and installation of Plant and Machinery.

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### **Receipt and Payment Account**

It is a real account. Basic rule of double entries is followed to prepare this account. It is prepared from a cash book at the end of the accounting period. Every transaction regarding the cash transactions is recorded in the Cash Book in a chronological order. We may say that the Receipt and Payment account is a summary of cash payment and cash receipts during the current year.

For example, if rent and salary paid on monthly basis all over the accounting period, and donation or subscription received during the current year recorded in a cash book date wise, but at the end of the accounting period, the Receipt and Payment account will contain total amount of rent paid, salary paid, subscription received and donation received. All cash receipt will be recorded on the debit side and all cash payment will be recorded on the credit side.

### **Income and Expenditure Account**

Income and expenditure account is a nominal account and as an equivalent to Profit and Loss account.

The essential features of an income and expenditure account are as follows –

- Expenses and losses are recorded in the debit side of it and all incomes and gains are recorded on the credit side.
- Capital income and expenditure are excluded and revenue income and expenses are included in it.
- It is based on a mercantile system of accounting, therefore, the income and expenses related to preceding years or subsequent years are excluded while preparing the income and expenditure account.
- The credit balance of an income and expenditure account shows surplus. Further, excess of income over the expenditure and the debit balance of it show deficit i.e. excess of the expenditure over income.
- Only nominal accounts are considered in preparation of this account.

### **Balance Sheet**

The date, on which a balance sheet is prepared, particulars of all the assets and liabilities are recorded in the same manner as we do in any other profit making firms. Its capital fund is made up of surplus income over expenditure and other incomes capitalized in the given period of time. Sometimes, two balance sheets need to be prepared viz...

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- At the beginning of the accounting year to know the opening capital fund and
- At the end of the financial year to know the financial position of the organization.

**Conversion of Receipt and Payment Account into Income and Expenditure Account**

Following are the steps required to convert receipt and payment account into income & expenditure account –

- Opening balance and closing balance of a receipt and payment account representing opening cash in hand, opening cash at bank, closing cash in hand, and closing cash at bank need to be ignored.
- Items of capital receipts and capital payment will be excluded while preparing an income and expenditure account.
- Revenue items of an income and expenditure will be considered only at the time of preparation of an income & expenditure account from the receipt and payment account.
- All adjustment regarding the outstanding expenses, prepaid expenses, provision for bad debts, provision for depreciation, income received in advance, and income receivable will be done.
- An income and expenditure relating to preceding year or subsequent year will be ignored, and the items only related to the current year will be considered.

**Method to Calculation**

With the help of ledger accounts, we may calculate the value of income or expenses.

The following two examples describe the method of calculation –

**Example (1)** – to calculate the amount of expenses of the current year, we need to prepare a ledger account of a particular expense and then the balancing figure of it will represent the amount of expense for the current year.

From the following particulars, please find out the amount of rent need to be shown in income & expenditure account –

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| <b>Particulars</b>   | <b>Amount<br/>(in Rs.)</b> |
|--|----------------------------|
| Outstanding Rent at the beginning of the year (as on 01-04-2013) | 6,000                      |
| Amount as shown in the receipt and payment account               | 26,000                     |
| Outstanding Rent at the end of the year (31-03-14)               | 4,000                      |

**Solution –**

**Rent Account**

| <b>Date</b> | <b>Particulars</b>   | <b>Amount</b> | <b>Date</b>  | <b>Particulars</b>   | <b>Amount</b> |
|-------------|--|---------------|--------------|--|---------------|
|             |  |               | 01-04-13     | By Balance b/d   | 6,000         |
|             | To Cash Paid<br>(As per receipt<br>and payment<br>account) | 26,000        | 31-03-14     | By Income and<br>expenditure a/c<br><b>(Balancing<br/>Figure)*</b> | 24,000        |
| 31-03-14    | To Balance C/d   | 4,000         |              |  |               |
|             | <b>Total</b>   | <b>30,000</b> | <b>Total</b> |  | <b>30,000</b> |

It is very clear from the above example that the balancing figure represents rent for the current year i.e. to be transferred and shown in the debit side of the income & expenditure account. Following the same method, we can calculate the amount of any other expenses.

**Subscription**

Subscription is the major source of an income for the non-trading concerns. Subscriptions are received from the members of a club or institution. A receipt and payment account records all the actual subscription received during the current year and an income & expenditure account shows

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the subscriptions, which relates to the current accounting period. Therefore, some adjustments require to calculate the subscription of the current year.

**Example (1)** – to calculate the amount of Subscription for the current year, the ledger account of a subscription account needs to be drawn and the balancing figure of this will represent the amount of subscription of the current year.

With the following particulars, please find out the amount of subscription to be shown in an income & expenditure account –

| Particulars  | Amount<br>(in Rs.) |
|--|--------------------|
| Outstanding subscription at the beginning of the year (as on 01-04-2013) | 6,000              |
| Amount as shown in the receipt and payment account                       | 26,000             |
| Outstanding subscription at the end of the year (31-03-14)               | 4,000              |
| Subscription received in advance for the next year                       | 2,000              |

**Solution –**

**Subscription Account**

| Date     | Particulars   | Amount | Date     | Particulars | Amount |
|----------|---|--------|----------|-------------|--------|
| 01-04-13 | To balance b/d  | 6,000  | 31-03-14 | By Cash     | 28,000 |
| 31-03-14 | To Advance Subscription (to be shown as Liabilities in Balance Sheet) | 2,000  |          |             |        |

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|          |  |               |              |                   |               |
|----------|--|---------------|--------------|-------------------|---------------|
| 31-03-14 | To Income &<br>Expenditure<br>Account (Balancing<br>Figure)* | 24,000        | 31-03-14     | By balance<br>c/d | 4,000         |
|          | <b>Total</b>   | <b>32,000</b> | <b>Total</b> |                   | <b>32,000</b> |

It is very clear from the above example that the balancing figure represents subscription for the current year, which needs to be transferred to the income & expenditure account as an income.

### Special Funds

Some special funds are created by the respective institutions for specific purpose. For example, a prize fund may be created to give the best player of the year award. Any income relating to those funds should be added to the funds and deficit, if any may be charged from the income & expenditure account.

**Example (2)** – to calculate the amount of an income related to the current year, we need to prepare a ledger account of the particular income. Further, the balancing figure of this account will represent the amount of an income for the current year.

From the following particulars, please find out the amount of Subscription that needs to be shown in the Income & Expenditure account –

| Particulars  | Amount<br>(in Rs.) |
|--|--------------------|
| Outstanding Subscription at the beginning of the year (as on 01-04-2013) | 6,000              |
| Amount as shown in the receipt and the payment account                   | 26,000             |
| Outstanding subscription at the end of the year (31-03-14)               | 4,000              |

**Solution –**

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**Subscription Account**

| <b>Date</b> | <b>Particulars</b>   | <b>Amount</b> | <b>Date</b>  | <b>Particulars</b>                                    | <b>Amount</b> |
|-------------|--|---------------|--------------|---|---------------|
| 01-04-13    | To balance b/d   | 6,000         |              |   |               |
|             | By Income and<br>expenditure a/c<br>(Balancing<br>Figure)* | 24,000        | 31-03-14     | By Cash (As per<br>receipt and<br>payment<br>account) | 26,000        |
|             |  |               | 31-03-14     | By balance c/d  | 4,000         |
|             | <b>Total</b>   | <b>30,000</b> | <b>Total</b> |   | <b>30,000</b> |

It is very clear from the above example that balancing figure represents Subscription for the current year i.e. to be transferred and shown in the credit side of the income & expenditure account.



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**UNIT IV**

**HIRE PURCHASE**

Under Hire Purchase System, hire purchaser pays the cost of purchaser asset in number of installments. The ownership of the goods is transferred by the Hire Vendor only after payment of outstanding balance.

**Installment System:**

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

**Calculation of Cash Price:**

In some cases, die cash price is not given. Since the assets purchased cannot be capitalized at more than the cash price, it will be necessary to find out what it is. The way to proceed is to take up die final installment first and to deduct interest from it. Interest for one year can be found out by multiplying the sum due at the end of the year by the formula  $\text{Rate of Interest} / 100 + \text{Rate of Interest}$ .

**Default and Repossession**

**Default**

- Insolvency of the debtor, including bankruptcy and receivership
- A business debtor ceasing to operate
- A business debtor's loss of license or franchise rights
- Permitting another security interest or lien to encumber the collateral The last substantive title of Article 9, the 9-600's, governs default. Article 9 does not define default but does detail the remedies available to a secured party upon a debtor's default and sets forth the procedure for executing those remedies.
- Failing to maintain casualty insurance to protect tangible collateral
- Death of a debtor or dissolution of a corporate debtor
- Death of a guarantor
- Defaulting on other debts
- Once any contractual default occurs, the secured party may move to enforce its rights and remedies as described in the security agreement or as provided under Article 9.

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## DIFFERENCE BETWEEN HIRE PURCHASE AND INSTALLMENT SYSTEM

| BASIS                     | INSTALLMENT PURCHASE  | HIRE PURCHASE   |
|---------------------------|---|---|
| <b>Time of Ownership</b>  | Ownership is said to have transferred at the very inception of the agreement. | Ownership is said to transfer only on payment of last installment.              |
| <b>Right to terminate</b> | No right to terminate the installment purchase agreement.                     | Hirer has the right to terminate the agreement and return the goods.            |
| <b>Charges</b>            | Monthly payment here is termed as installment                                 | Monthly payment here is termed as Hire Charges.                                 |
| <b>Risk, repair etc.</b>  | The risks are borne by the buyer from day one.                                | All the risks are borne by the financing company till the last payment by hirer |
| <b>Right to sell</b>      | It is with the buyer because he becomes the owner on day one itself.          | Such rights lies with the financing company because they are the owners.        |
| <b>Default</b>            | Financier is liable to receive the remaining dues as it is not forfeited.     | Financier has right to forfeit the money paid till date.                        |

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**Specimen of hire purchase account**

percentage of loading and the amount of expenses incurred on hire purchase business. The proforma of Hire Purchase Trading Account is given in Figure 6.2.

**Figure 6.2 : Proforma of Hire Purchase Trading Account**

| Dr.   | Hire Purchase Trading Account | Cr.   |
|---|-------------------------------|---|
| To H.P. Stock<br>(opening)                          | ...                           | By Cash Received                                    |
| To H.P. Debtors<br>(opening)                        | ...                           | By Goods Repossessed<br>(market value)              |
| To Goods Sold on H.P.<br>(at H.P. price)            | ...                           | By H.P. Stock<br>(closing)                          |
| To Stock Reserve<br>(loading on closing H.P. stock) | ...                           | By H.P. Debtors<br>(closing)                        |
| To Expenses   | ...                           | By Stock Reserve<br>(loading on opening H.P. stock) |
| To Net Profit.<br>(transferred to P & L A/c)        | ...                           | By Goods Sold on H.P.<br>(loading)                  |
|   | ...                           | ...   |

The proforma of Hire Purchase Trading Account as given in Figure 6.2 is the usual form in which the Hire Purchase Trading Account is prepared. But, it is better to divide it into two parts as shown in Figure 6.3, the first part to contain only those items which are recorded at H.P. price and the second part showing the adjustment of loading and the expenses, losses, etc. relating to hire purchase business for ascertaining the profit or loss.

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**Figure 6.3 : Another Proforma of Hire Purchase Trading Account**

| <b>Dr.</b>  | <b>Hire Purchase Trading Account</b> | <b>Cr.</b>   |
|---|--------------------------------------|--|
| To H.P. Stock<br>(opening)  |                                      | By Cash Received ...   |
| To <b>H.P.</b> Debtors<br>(opening)   | ...                                  | By Goods Repossessed<br>(instalments unpaid) ...               |
| To Goods Sold on H.P.<br>(at H.P. price)  | ...                                  | By H.P. Stock<br>(closing) ...                                 |
|   |                                      | By H.P. Debtors<br>(closing) ...                               |
|   | ...                                  | ...  |
| To Stock Reserve<br>(loading on closing <b>H.P.</b> stock)                                    | ...                                  | By Stock Reserve<br>(loading on opening <b>H.P.</b> stock) ... |
| To Loss on Goods Repossessed<br>(dif. between market value or cost<br>and unpaid instalments) | ...                                  | By Goods sold on H.P.<br>(loading) ...                         |
| To Expenses<br>(on hire purchase business)  |                                      |  |
| To Profit<br>(transferred to P & L A/c)   |                                      |  |
|   | ...                                  | ...  |

It should be noted that the totals of two sides in the **first part** of the Hire Purchase Trading Account will be equal. If they are not equal, it would mean that there is some mistake. Not only that, the first part can also help us in finding out the amount of any item which is missing (being the balancing figure) provided all the other figures are given.

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**UNIT V**

**ROYALTY ACCOUNT**

Royalty is payable by a user to the owner of the property or something on which an owner has some special rights. A royalty agreement is prepared between the owner and the user of such property or rights. If payment is made to purchase the right or property that will be treated as capital expenditure instead of a Royalty.

Payment made by the lessee on account of a royalty is normal business expenditure and will be debited to the Royalty account. It is a nominal account and at the end of the accounting year, balance of Royalty account need to be transferred to the normal Trading and Profit & Loss account. Royalty, based on the production or output, will strictly go to the Manufacturing or Production account. In case, where the Royalty is payable on sale basis, it will be part of the selling expenses.

**Minimum Rent**

According to the lease agreement, minimum rent, fixed rent, or dead rent is a type of guarantee made by the lessee to the lessor, in case of shortage of output or production or sale. It means, lessor will receive a minimum fix rent irrespective of the reason/s of the shortage of production.

Payment of royalty will be minimum rent or actual royalty, whichever is higher for example –

M/s Hyderabad publication printed a book on Java on the minimum rent of Rs. 1,000,000/- per annum royalty being payable @ Rs. 20 per book sold. In the first year of publication, Hyderabad publication sold 75,000 copy of the books and in the second year, number of sold books fell down to 45,000 only. Amount of royalty will be payable as under –

|   | <b>Minimum Rent</b> | <b>Royalty Payable</b> |
|---|---------------------|------------------------|
| <b>Ist Year</b><br><br>75,000 Books X Rs. 20 per book = Rs.<br>1,5,00,000 | 1,00,000            | Rs. 1,5,00,000         |
| <b>IInd Year</b><br><br>45,000 Books X Rs. 20 per book = Rs.<br>9,00,000  | 1,00,000            | Rs. 1,00,000           |

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**Short workings**

**Difference** of minimum rent and actual royalty is known as short workings where payment of Royalty is payable on the basis of minimum rent due to shortage in the production or sale. For example, if calculated royalty is Rs. 900,000/- as per sale of books based on the above example, but royalty payable is Rs. 1000,000 as per minimum rent, short working will be Rs. 100,000 (Rs. 1,000,000 – Rs. 9,00,000).

**Ground Rent**

The rent, paid to the landlord for the use of land or surface on the yearly or half yearly basis is known as **Ground Rent** or **Surface Rent**.

**Right of Recouping**

It may contain in the royalty agreement that excess of minimum rent paid over the actual royalty (i.e. short workings), may be recoverable in the subsequent years. So, when the royalty is in excess of the minimum rent is called the right of recoupment (of short workings).

Right of recoupment will be decided for the fixed period or for the floating period. When the right of recoupment is fixed for the certain starting years from the date of royalty agreement, it is said to be fixed or restricted. On the other hand, when the lessee is eligible to recoup the short workings in next 2 or 3 years from the year of its commencement, it is said to be floating.

Short working will be shown on the asset side of Balance sheet up to allowable year of recouping after that it will be transferred to profit & loss account (after expiry of allowable period).

**Lease Premium**

An **Extra payment** in addition to royalty, if any, paid by lessee to lessor is called Lease premium and will be treated as capital expenditure and it will be written off on yearly basis through profit and loss account as per the suitable method.

**TDS (Tax Deducted at Source)**

If there is an applicability of TDS (Tax deducted at source) as per Income Tax Act, lessee will make the payment to lessor after deducting TDS as per applicable rate and lessee is liable to deposit it to the credit of Central Government. Amount of royalty will be gross amount of royalty (inclusive of TDS), that will be charged to profit and loss account.

For example, if royalty amount is 1,000,000/- & rate of TDS is 10%, then lessee will pay Rs. 900,000/- to lessor. Amount of royalty charge to profit and loss account will be Rs. 1,000,000/- and balance amount of Rs. 100,000/- will be deposited in the credit of central Government account.

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**Stoppage of Work**

Sometime, there may be stoppage of work due to conditions beyond control like strike, flood, etc. in this case, minimum rent is required to be revised as provided in the agreement.

Revision of the minimum rent will be –

- Reduction of minimum rent in the proportion of the stoppage of work;
- On the basis of fixed percentage; or
- By a fixed amount in the year of stoppage.

**Sub Lease**

Sometime, landlord or lessor allows lessee to sublet some part of the mine or land as a sub-lessee. In this case, lessee will become lessor for sub lessee and lessee for main landlord.

In such a case, as Lessee, he will maintain the following books of accounts –

| <b>As a Lessee</b>   | <b>As a Sub Lessor</b>   |
|--|--|
| <ul style="list-style-type: none"><li>• Landlord Account</li><li>• Minimum Rent Account</li><li>• Royalty Account</li><li>• Short workings Recoupable Accounts</li></ul> | <ul style="list-style-type: none"><li>• Royalties receivable</li><li>• Royalties receivable</li><li>• Sub Lessee account</li><li>• Short working Allowable Account</li></ul> |

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Accounting Entries

|  |   |
|--|---|
| When there is no royalty in the year   | (a) Minimum Rent A/c<br>Dr<br>To Landlord A/c<br><br>(b) Short working A/c Dr<br>To Minimum Rent A/c  |
| Where Royalties are less than minimum rent and short workings are recoverable in next years. | (c) Minimum Rent A/c<br>Dr<br>To Landlord A/c<br><br>(d) Royalties A/c Dr<br>Short workings A/c Dr<br>To Minimum Rent A/c<br><br>(e) Landlord A/c Dr<br>To Bank A/c<br><br>(f) Profit & Loss A/c Dr<br>To Royalty A/c |
| When Short workings are recouped   | (g) Royalties A/c Dr<br>To short workings A/c<br>To Landlord A/c<br><br>(h) Landlord A/c Dr<br>To Bank A/c  |
| Transfer of irrecoverable Short workings   | (i) Profit & Loss A/c Dr<br>To Short workings A/c   |



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**Illustration**

From the below given information's, please open prepare the necessary accounts in the books of M/s Black Diamond Limited.

- Company leased a colliery on 01-01-2010 at a minimum rent of Rs. 75,000.
- Royalty Rate@ Rs. 1/- per ton.
- Right of recouping of short workings is restricted to first 3 years.
- Output for the first four years of the lease was 40,000, 65,000, 1,05,000, and 90,000 tons respectively.

**Solution –**

**Analytical Table**

| Year | Output<br>(Tons) | Royalties<br>@ Rs. 1<br>Per ton | Short<br>workings | Surplus | Recoupment | Un<br>recoupable<br>Short<br>workings | Payable<br>to<br>Landlord |
|------|------------------|---------------------------------|-------------------|---------|------------|---------------------------------------|---------------------------|
| 2010 | 40,000           | 40,000                          | 35,000            |         | --         |                                       | 75,000                    |
| 2011 | 65,000           | 65,000                          | 10,000            |         | --         |                                       | 75,000                    |
| 2012 | 105,000          | 105,000                         | --                | 30,000  | 30,000     |                                       | 75,000                    |
| 2013 | 90,000           | 90,000                          |                   | 15,000  |            | 15,000                                | 90,000                    |
|      | 300,000          | 300,000                         | 45,000            | 45,000  | 30,000     | 15,000                                | 315,000                   |

**In the books Books of M/s Black Diamonds Ltd**

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**Royalties Account**

| Date       | Particulars     | Amount           | Date       | Particulars       | Amount           |
|------------|-----------------|------------------|------------|-------------------|------------------|
| 31-12-2010 | To Landlord A/c | 40,000<br>=====  | 31-12-2010 | By Production A/c | 40,000<br>=====  |
| 31-12-2011 |                 | 65,000<br>=====  |            |                   | 65,000<br>=====  |
|            | To Landlord A/c | 105,000<br>===== | 31-12-2011 | By Production A/c | 105,000<br>===== |
| 31-12-2012 |                 | 90,000<br>=====  |            |                   | 90,000<br>=====  |
|            | To Landlord A/c | =====            | 31-12-2012 | By Production A/c |                  |
| 31-12-2013 | To Landlord A/c |                  | 31-12-2013 | By Production A/c |                  |

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**Landlord Account**

| Date       | Particulars           | Amount   | Date       | Particulars                               | Amount  |
|------------|-----------------------|--|------------|---|---|
| 31-12-2010 | To Bank A/c           | 75,000<br>-----<br><b>75,000</b><br>-----<br>75,000  | 31-12-2010 | By Royalties A/c<br>By Shortworkings A/c  | 40,000<br>35,000<br>-----<br><b>75,000</b><br>----- |
| 31-12-2011 | To Bank A/c           | -----<br><b>75,000</b>                               | 31-12-2011 | By Royalties A/c<br>By Short workings A/c | 65,000<br>10,000<br>-----<br><b>75,000</b><br>----- |
| 31-12-2012 | To Short workings A/c | 30,000   | 31-12-2012 | By Royalties A/c                          | 105,000   |
| 31-12-2012 | To Bank A/c           | 75,000<br>-----<br><b>105,000</b><br>-----<br>90,000 |            |   | -----<br><b>105,000</b><br>-----<br>90,000          |
| 31-12-2013 | To Bank A/c           | 90,000<br>-----<br><b>90,000</b><br>-----            | 31-12-2013 | By Royalties A/c                          | -----<br><b>90,000</b><br>-----                     |

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| Date       | Particulars     | Amount        | Date       | Particulars          | Amount        |
|------------|-----------------|---------------|------------|----------------------|---------------|
| 31-12-2010 | To Landlord A/c | 35,000        | 31-12-2010 | By Balance C/d       | 35,000        |
|            |                 | -----         |            |                      | -----         |
|            |                 | <b>35,000</b> |            |                      | <b>35,000</b> |
|            |                 | -----         |            |                      | -----         |
|            |                 | 35,000        |            |                      | 45,000        |
|            |                 | 10,000        |            | By Balance C/d       | -----         |
| 01-01-2011 | To Balance b/d  | -----         | 31-12-2011 |                      | <b>45,000</b> |
|            |                 | <b>45,000</b> |            |                      | -----         |
|            | To Landlord A/c | -----         |            |                      | 30,000        |
|            |                 | 45,000        |            |                      | 15,000        |
|            |                 | -----         |            | By Landlord A/c      | -----         |
|            |                 | <b>45,000</b> |            |                      | <b>45,000</b> |
|            |                 | -----         |            | By Profit & Loss A/c | -----         |
| 01-01-2012 | To Balance b/d  |               | 31-12-2012 |                      |               |
|            |                 |               | 31-12-2010 |                      |               |