ACCOUNTANCY

HIGHER SECONDARY – SECOND YEAR

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PREFACE

The book on Accountancy has been written strictly in accordance with the new syllabus framed by the Directorate of School Education, Government of Tamil Nadu.

As curriculum renewal is a continuous process, Accountancy Curriculum has been improved from time to time in accordance with the changing needs of the society. The present effort of reframing and updating the curriculum in Accountancy at the Higher Secondary level is an exercise based on the feed back.

The text book for Higher Secondary - First year deals with the basic framework of accounting in all its aspects. The next step is the logical application of the subject matter in maintaining records in different forms of business enterprises.

The text books for Higher Secondary - Second year has been dealt with the preparation of financial statements and their analysis. The two chapters Financial Statement Analysis - Ratio Analysis and Cash Budget are included in the new syllabus, because of its significance in the sphere of decision making in business.

The significance of Partneship and Companies in the sphere of business as also in the field of accounting can in no way be over-stressed especially when the latter has become the primary vehicle of economic and industrial growth. Therefore, all the facts of Partnership and Company accounts, according to the syllabus of the second year, has been presented in four chapters.

Each chapter starts with a simple and lucid discussion of the topic followed by properly arranged worked out illustrations and ends with theoretical questions and practical exercises.

Students are strongly advised to go through the “Reference Books” as **Questions for examinations need not be restricted to the exercises alone.**

R.Amutha
Chairperson

SYLLABUS

1. Final Accounts - Adjustments **[** *24 Periods* **]**

Adjustments - Closing Stock - Outstanding Expenses - Prepaid Expenses - Accrued Incomes - Incomes received in Advance - Interest on Capital - Interest on Drawings - Interest on Loan - Interest on Investments - Depreciation - Bad Debts - Provision for Bad & Doubtful Debts - Provision for Discount on Debtors - Provision for Discount on Creditors - Preparation of Final Accounts.

2. Accounts from Incomplete Records (Single Entry) **[** *21 Periods* **]**

Features of Single Entry - Limitations of Single Entry - Difference between Double Entry System and Single Entry - Distinction between Statement of Affairs and Balance Sheet - Methods of ascertaining Profit or Loss - Statement of Affairs Method - Procedure - Conversion Method - Procedure for converting Single Entry into Double Entry System - Calculation of missing figures - Ascertainment of Total Purchases - Ascertainment of Total Sales - Ascertainment of Balances of Sundry debtors and Sundry Creditors.

3. Depreciation Accounting **[** *14 Periods* **]**

Definition - Need for Providing Depreciation - Causes of Depreciation - Terms used for Depreciation - Methods of calculating Depreciation - Straight Line Method - Written Down Value Method - Annuity Method - Depreciation Fund Method - Insurance Policy Method - Revaluation Method - Recording Depreciation - Calculation of Profit or Loss on Sale of Asset.

4. Financial Statement Analysis - Ratio Analysis **[** *28 Periods* **]**

Significance of Financial Statement Analysis - Limitation of Financial Statement Analysis - Ratio Analysis - Definition - Objectives - Classification of Ratios - Liquidity Ratios - Current Ratio, Liquid Ratio and Absolute Liquid Ratio - Solvency Ratios - Debt-Equity Ratio and Proprietory Ratio - Profitability Ratios - Gross Profit Ratio, Net Profit Ratio, Operating Profit Ratio and Operating Ratio - Activity Ratios - Capital Turnover Ratio, Fixed Asset Turnover Ratio, Stock Turnover Ratio, Debtors Turnover Ratio and Creditors Turnover Ratio.

5. Cash Budget **[** *7 Periods* **]**

Budget - Definition - Characteristics - Cash Budget - Advantages - Preparation of Cash Budget - Receipts and Payments Method.

6. Partnership - Basic Concepts **[** *14 Periods* **]**

Definition - Features - Accounting rules applicable in the absence of Partnership Deed - Partners Capital Account - Fluctuating Capital Method - Fixed Capital Method - Difference between Fixed & Fluctuating Capital Account - Distribution of Profit - Interest on Capital - Interest on Drawings - Salary, Commission to Partner - Preparation of Profit and Loss Appropriation Account - Goodwill - Method of valuing Goodwill - Average Period Method - Super Profit Method.

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8. Partnership - Retirement of a Partner **[** *19 Periods* **]**

Introduction - Adjustments - New Profit Sharing Ratio - Gaining Ratio - Calculation of New Profit Sharing Ratio and Gaining Ratio - Revaluation of Assets and Liabilities - Undistributed Profit or Loss - Accumulated Reserve - Treatment of Goodwill - Payment to the Retiring Partner - Preparation of Revaluation Account, Capital Accounts, Bank Account and Balance Sheet of the Reconstituted Partnership Firm.

9. Company Accounts **[** *35 Periods* **]**

Introduction - Characteristics - Types of Share Capital - Kinds of Shares - Issue of Shares - For consideration - For cash - Issue of Shares at Par - Issue of Shares at Premium - Issue of Shares at Discount - Calls in Advance - Calls in Arrears - Forfeiture of Shares - Reissue of Forfeited Shares - Capital Reserve

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CHAPTER -1

FINAL ACCOUNTS – ADJUSTMENTS

Learning Objectives

After studying this Chapter, you will be able to

- *understand the need for making adjustments in final accounts.*
- *know the items in respect of which adjustments are usually made in the books of account.*
- *pass necessary journal entries for different adjustments.*
- *prepare final accounts with adjustments.*

When a person starts a business he wishes to know the financial performance of his business. A convinient and universally accepted method of knowing this is to ascertain the profit or loss at yearly intervals (1^{st} April to 31^{st} March) and the financial position of the business on a given date. He can ascertain these by preparing the Final Accounts, which is prepared on the basis of the Trial Balance. The preparation of Final Accounts is the last step in the accounting cycle and that is why they are called Final Accounts.

Final Accounts include the preparation of

i) Trading and Profit and Loss Account; and

ii) Balance sheet.

Final accounts are the means of conveying the profitability and financial position to management, owners and interested outsiders of the business. Final accounts have to be prepared every year, to make a continuous assessment of the business for a completed period. It must be kept in mind that expenses and incomes for the full accounting period are to be taken into account.

Suppose, the firm closes its books on 31^{st} March and rent for the month of March has not been paid, this expense (rent) has been incurred and yet to be paid. Therefore, it would be proper to include the rent for the month (March) along with the rent of the year to know the true profit. In a firm there will be a number of items, both expenses and incomes, which have to be adjusted. If such items are not adjusted, the final accounts will not reveal the true and fair picture of the business performance. All such items which need to be brought into books of account at the time of preparing final accounts are called **"adjustments"**. Journal entries passed to effect the required adjustments are known as **adjusting entries**.

1.1 Adjustments

Some important and common items, which need to be adjusted at the time of preparing the final accounts are discussed below.

1. Closing stock
2. Outstanding expenses
3. Prepaid Expenses
4. Accrued incomes
5. Incomes received in advance
6. Interest on capital
7. Interest on drawings
8. Interest on loan
9. Interest on investment
10. Depreciation
11. Bad Debts
12. Provision for bad and doubtful debts
13. Provision for discount on debtors
14. Provision for discount on creditors.

Note : All adjustments are given outside the trial balance.

1.1.1 Closing Stock

The unsold goods in stock at the end of the accounting period is called as closing stock. This is to be valued at cost or market price whichever is lower.

Example:

The value of closing stock shown outside the trial balance on 31.3.2004 is Rs.1,00,000.

Adjusting Entry

Date	Particulars		L.F	Debit Rs.	Credit Rs.
2004 Mar 31	Closing stock A/c	Dr		1,00,000	
	To Trading A/c				1,00,000
	(closing stock recorded)				

Value of closing stock will appear

i) on the credit side of trading account and

ii) on the assets side of balance sheet.

Trading account for the year ending 31st March, 2004

Dr. Cr.

Particulars	Rs.	Particulars	Rs.
		By Closing Stock	1,00,000

Balance Sheet as on 31st March, 2004

Liabilities	Rs.	Assets	Rs.
		Closing Stock	1,00,000

1.1.2 Outstanding Expenses

Expenses which have been incurred but not yet paid during the accounting period for which the final accounts are being prepared are called as **outstanding expenses.**

Example: Trial balance shows salaries paid Rs.22,000. Adjustment: Salary for March 2004, Rs.2,000 not yet paid.

Adjusting Entry

Date	Particulars	L.F	Debit Rs.	Credit Rs.
2004 Mar 31	Salaries A/c Dr To Salaries outstanding A/c (March salary outstanding)		2,000	2,000

Outstanding expenses will be shown

i) on the debit side of Profit and Loss account by way of additions to the particular expenses and

ii) on the liabilities side of the Balance Sheet.

Profit and Loss account for the year ending 31st March, 2004

Dr. Cr.

Particulars	Rs.	Rs.	Particulars	Rs.	Rs.
To Salaries A/c Add: Outstanding	22,000 2,000	24,000			

Balance Sheet as on 31st March, 2004

Liabilities	Rs.	Assets	Rs.
Outstanding Salaries	2,000		

1.1.3 Prepaid Expenses

Expenses which have been paid in advance are called as **prepaid (unexpired) expenses.**

Example: Trial Balance for the period ending 31st March, 2004 shows Rs.15,000 as insurance premium. Adjustment: Prepaid Insurance premium Rs.7,500.

Adjusting Entry

Date	Particulars	L.F	Debit Rs.	Credit Rs.
2004 Mar 31	Prepaid Insurance Premium A/c Dr To Insurance Premium A/c (Insurance premium paid in advance)		7,500	 7,500

Prepaid expenses will be shown

i) on the debit side of the Profit and Loss account by way of deduction from the particular expenses and

2) on the assets side of the Balance Sheet.

Profit and Loss account for the year ending 31st March, 2004

Dr. Cr.

Particulars	Rs.	Rs.	Particulars	Rs.	Rs.
To Insurance premium A/c Less: Prepaid	15,000 7,500	7,500			

Balance Sheet as on 31st March, 2004

Liabilities	Rs.	Assets	Rs.
		Prepaid Insurance premium	7,500

1.1.4 Accrued Incomes or Outstanding Incomes

Income which has been earned but not received during the accounting period is called as **accrued income.**

Example: Credit side of Trial Balance (31.3.2004) shows commission received Rs.8,000. Adjustment: Commission accrued but not yet received Rs.2,000.

Adjusting Entry

Date	Particulars		L.F	Debit Rs.	Credit Rs.
2004 Mar 31	Accrued commission A/c To Commission A/c (commission earned but not received)	Dr		2,000	 2,000

Accrued income will be shown

i) on the credit side of Profit and Loss account by way of addition to particular income and

ii) on the assets side of the Balance Sheet

Profit and Loss account for the year ending 31st March, 2004

Dr. Cr.

Particulars	Rs.	Rs.	Particulars	Rs.	Rs.
			By Commission received Add: Accrued Commission	8,000 2,000	
					10,000

Balance Sheet as on March 31, 2004

Liabilities	Rs.	Assets	Rs.
		Accrued Commission	2,000

1.1.5 Incomes Received in Advance

Income received during a particular accounting period for the work to be done in future period is called as **income received in advance.**

Example: Trial Balance for the period ending 31st March, 2004 shows Rent received Rs.25,000. Adjustment: Rent received in advance Rs.5,000.

Adjusting Entry

Date	Particulars		L.F	Debit Rs.	Credit Rs.
2004 Mar 31	Rent received A/c To Rent received in advance A/c (rent received in advance)	Dr		5,000	 5,000

Incomes received in advance will be shown

i) on the credit side of the Profit and Loss account by way of deducting from the particular income and

ii) on the liabilities side of the Balance sheet.

Profit & Loss Account for the year ending 31st March, 2004

Dr. Cr.

Particulars	Rs.	Rs.	Particulars	Rs.	Rs.
			By Rent received Less: Rent received in advance	25,000 5,000	
					20,000

Balance Sheet as on 31st March, 2004

Liabilities	Rs.	Assets	Rs.
Rent received in advance	5,000		

1.1.6 Interest on Capital

In order to see whether the business is really earning profit or not, it is desirable to charge interest on capital at a certain rate.

Example: As per Trial Balance, capital as on 31.3.2004 is Rs.4,00,000. Adjustment: Provide 6% interest on capital.

Adjusting Entry

Date	Particulars	L.F	Debit Rs.	Credit Rs.
2004 Mar 31	Interest on capital A/c Dr To Capital A/c (6% interest on capital)		24,000	24,000

To bring interest on capital to Profit and Loss account, the following transfer entry is required.

Transfer Entry

Date	Particulars	L.F	Debit Rs.	Credit Rs.
2004 Mar 31	Profit & Loss A/c Dr To Interest on Capital A/c (Interest on capital transferred to Profit & Loss A/c)		24,000	24,000

Interest on capital will be shown

i. on the debit side of Profit and Loss account and

ii. on the liabilities side of the Balance Sheet by way of addition to the capital.

Profit & Loss Account for the year ending 31st March, 2004

Dr. Cr.

Particulars	Rs.	Rs.	Particulars	Rs.	Rs.
To Interest on Capital A/c		24,000			

Balance Sheet as on March 31, 2004

Liabilities	Rs.	Rs.	Assets	Rs.	Rs.
Capital Add: Interest on capital	4,00,000 24,000	4,24,000			

1.1.7 Interest on Drawings

Amount withdrawn by the owner for his personal use is called as **drawings**. When interest on capital is allowed, then interest on drawings is charged from the owner. Interest on drawings is an income for the business and will reduce the capital of the owner.

Example: The trial balance shows the following:

	Rs.
Capital as on 31.3.2004	4,00,000
Drawings as on 31.3.2004	30,000

Adjustment : Charge interest on drawings @ 5%.

Adjusting Entry

Date	Particulars	L.F	Debit Rs.	Credit Rs.
2004 Mar 31	Capital A/c Dr To Interest on Drawings A/c (Interest on drawings)		1,500	1,500

To bring interest on drawings to Profit and Loss account the following transfer entry is required.

Transfer Entry

Date	Particulars	L.F	Debit Rs.	Credit Rs.
2004 Mar 31	Interest on drawings A/c Dr To Profit & Loss A/c (Interest on drawings)		1,500	1,500

Interest on drawings will be shown

i) on the credit side of Profit and Loss account and

ii) on the liabilities side of the Balance Sheet by way of addition to the drawings which are ultimately deducted from the capital.

Profit & Loss Account for the year ending 31st March, 2004

Dr. Cr.

Particulars	Rs.	Particulars	Rs.
		By Interest on drawings	1,500

Balance Sheet as on 31st March, 2004

Liabilities		Rs.	Rs.	Assets	Rs.	Rs.
Capital		4,00,000				
Less: Drawings	30,000					
Interest on drawings	1,500	31,500				
			3,68,500			

1.1.8 Interest on Loan (Outstanding)

Borrowings from banks, financial institutions and outsiders for business are called loans. Amount payable towards interest on loan is an expense for the business.

Example: The trial balance (31.3.2004) shows the following:

Bank loan @ 10% on 1.4.03 Rs. 4,00,000

Interest paid Rs. 14,000

Adjustment: Provide for interest on bank loan outstanding.

Adjusting Entry

Date	Particulars	L.F	Debit Rs.	Credit Rs.
2004 Mar 31	Interest on Bank loan A/c Dr To Interest outstanding A/c (the interest on bank loan)		26,000	26,000

Interest on loan outstanding will be shown

i) on the debit side of the Profit and Loss account by way of addition to the appropriate interest account and

ii) on the liability side of the Balance sheet by way of addition to the particular loan account.

Profit & Loss Account for the year ending 31st March, 2004

Dr. Cr.

Particulars	Rs.	Rs.	Particulars	Rs.	Rs.
To Interest on loan Add: Interest outstanding	14,000 26,000	40,000			

Balance Sheet as on 31st March, 2004

Liabilities	Rs.	Rs.	Assets	Rs.	Rs.
Bank loan @ 10% Add: Interest outstanding	4,00,000 26,000	4,26,000			

Note: Interest on Bank loan @ 10% on Rs.4,00,000 for the year

= Rs.4,00,000 x 10/100	Rs.	40,000
Less: Interest paid as per Trial balance	Rs.	14,000
Interest outstanding (Yet to be paid)	Rs.	26,000

1.1.9 Interest on Investment

Interest receivable on investments is an income for the business.

Example: The Trial Balance (31.03.04) shows the following:

Investments @10%	Rs.	5,00,000
Interest received on investments	Rs.	40,000

Adjustment:

Provide for accrued interest on investments Rs.10,000.

Adjusting Entry

Date	Particulars	L.F	Debit Rs.	Credit Rs.
2004 Mar 31	Accrued interest on investments A/c Dr To Interest received A/c (Accrued interest on investments provided)		10,000	10,000

Accrued interest on investments (outstanding interest receivable) will be shown

i) On the credit side of the Profit and Loss account by way of addition to the appropriate interest account and

ii) On the assets side of the balance sheet by way of addition to the investments account.

Profit and loss account for the period year 31st March, 2004

Dr. Cr.

Particulars	Rs.	Rs.	Particulars	Rs.	Rs.
			By Interest received	40,000	
			Add: Accrued interest	10,000	
					50,000

Balance Sheet as on 31st March, 2004

Liabilities	Rs.	Rs.	Assets	Rs.	Rs.
			Investments	5,00,000	
			Add: Accrued interest	10,000	
					5,10,000

1.1.10 Depreciation

Depreciation is the reduction in the value of fixed assets due to its use or obsolescence. Generally depreciation is charged at some percentage on the value of fixed asset.

Example: The Trial balance shows the value of furniture on 31.3.2004 as Rs.60,000. Adjustment: Furniture is to be depreciated at 10%.

Adjusting Entry

Date	Particulars	L.F	Debit Rs.	Credit Rs.
2004 Mar 31	Depreciation A/c Dr		6,000	
	To Furniture A/c			6,000
	(10% depreciation on furniture)			

To bring depreciation into Profit and Loss account the following transfer entry is required.

Transfer Entry

Date	Particulars	L.F	Debit Rs.	Credit Rs.
2004 Mar 31	Profit & Loss A/c Dr To Depreciation A/c (10% depreciation on furniture transferred to Profit and Loss account)		6,000	6,000

Depreciation will be shown

i) on the debit side of Profit and Loss account and

ii) on the assets side of the Balance Sheet by way of deduction from the value of concerned asset.

Profit & Loss Account for the year ending 31st March, 2004

Dr. Cr.

Particulars	Rs.	Particulars	Rs.
To Depreciation on Furniture	6,000		

Balance Sheet as on 31st March, 2004

Liabilities	Rs.	Rs.	Assets	Rs.	Rs.
			Furniture	60,000	
			Less: Depreciation @10%	6,000	
					54,000

1.1.11 Bad Debts

Debts which cannot be recovered are called **bad debts.** It is a loss for the business.

Example: The trial balance as on 31st March 2004 shows, Sundry debtors Rs.52,500. Adjustment: Write off Rs. 2,500 as bad debts.

Adjusting Entry

Date	Particulars	L.F	Debit Rs.	Credit Rs.
2004 Mar 31	Bad debts A/c Dr To Sundry debtors A/c (Bad debts written off)		2,500	2,500

To transfer bad debts to Profit and Loss account the following transfer entry is required.

Transfer Entry

Date	Particulars	L.F	Debit Rs.	Credit Rs.
2004 Mar 31	Profit & Loss A/c Dr To Bad debts A/c (Bad debts transferred to Profit & Loss A/c)		2,500	2,500

Bad debts will be shown

i) on the debit side of Profit and Loss account and

ii) on the assets side of the Balance Sheet by way of deduction from sundry debtors.

Profit & Loss Account for the year ending 31st March, 2004

Dr. Cr.

Particulars	Rs.	Particulars	Rs.
To Bad debts A/c	2,500		

Balance Sheet as on 31st March, 2004

Liabilities	Rs.	Rs.	Assets	Rs.	Rs.
			Sundry debtors	52,500	
			Less: Bad debts written off	2,500	
					50,000

Note:

Bad Debts Account

Dr. Cr.

Particulars	Rs.	Particulars	Rs.
To Sundry debtors A/c	2,500	By Profit & Loss A/c	2,500
	2,500		2,500

1.1.12 Provision for Bad and Doubtful Debts

Every business suffers a percentage of bad debts over and above the debts definitely known as irrecoverable and written off as Bad (Bad debts written off). If Sundry debtors figure is to be shown correctly in the Balance sheet provision for bad and doubtful debts must be adjusted. This Provision for bad and doubtful debts is generally provided at a certain percentage on Debtors, based on past experience.

While preparing final accounts, the bad debts written off given in adjustment is first deducted from the Sundry debtors then on the balance amount (Sundry debtors – Bad debt written off) provision for bad and doubtful debts calculated.

Example: The trial balance shows on 31.3.2004, Sundry Debtors as Rs.60,000.

Adjustment: Provide 5% provision for bad & doubtful debts on Sundry debtors.

Adjusting Entry

Date	Particulars	L.F	Debit Rs.	Credit Rs.
2004 Mar 31	Profit & Loss A/c Dr To Provision for bad & doubtful A/c (5% provision for bad and doubtful debts)		3,000	3,000

Provision for bad and doubtful debts will be shown

i) on the debit side of Profit and Loss Account and

ii) on the assets side of the Balance sheet by way of deduction from Sundry debtors (after Bad debts written off if any).

Profit & Loss Account for the year ending 31st March, 2004

Dr. Cr.

Particulars	Rs.	Particulars	Rs.
To Provision for bad and doubtful debts A/c	3,000		

Balance Sheet as on 31st March, 2004

Liabilities	Rs.	Rs.	Assets	Rs.	Rs.
			Sundry debtors	60,000	
			Less: Provision for bad and doubtful debts	3,000	
					57,000

Example : The Trial Balance as on 31st March 2004 shows the following:

Sundry Debtors Rs. 81,200

Adjustment: Write off Rs.1,200 as bad debts. Create a provision for Bad and doubtful debts @ 5% on Sundry Debtors.

Adjusting Entry

Date	Particulars		L.F	Debit Rs.	Credit Rs.
2004					
Mar 31	Bad debts A/c	Dr		1,200	
	To Sundry debtors A/c				1,200
	(Bad debts written off)				
”	Profit and Loss A/c	Dr		4,000	
	To Provision for Bad & doubtful debts				4,000
	(5% provision for bad & doubtful debts)				

Note: 5% should be calculated on Rs.80,000 (i.e. The amount of Sundry debtors after writing off Bad Debts).

Profit and loss account for the year ending 31st March, 2004

Dr. Cr.

Particulars	Rs.	Rs.	Particulars	Rs.	Rs.
To Bad Debts A/c	1,200				
To Provision for Bad & doubtful debts A/c	4,000				

Balance Sheet as on 31st March, 2004

Liabilities	Rs.	Rs.	Assets	Rs.	Rs.
			Sundry Debtors	81,200	
			Less: Bad debts written off	1,200	
				80,000	
			Less: Provision for Bad & Doubtful debts	4,000	
					76,000

Note:

Bad Debts Account

Dr. Cr.

Particulars	Rs.	Particulars	Rs.
To Sundry debtors A/c	1,200	By Profit & Loss A/c	1,200

1.1.13 Provision for Discount on Debtors

To motivate the debtors to make prompt payments, cash discount may be allowed to them. After providing provision for bad and doubtful debts, the remaining debtors are called as **good debtors.** They may pay their dues in time and avail themselves of the cash discount permissable. So a provision for discount on good debtors at a certain percentage may have to be created.

Example: The Trial Balance as on 31st March 2004 shows the following:

Sundry debtors   Rs. 45,000

Adjustment: Create 2% provision for discount on Debtors.

Adjusting Entry

Date	Particulars	L.F	Debit Rs.	Credit Rs.
2004 Mar 31	Profit and Loss Account Dr To Provision for discount on Debtors		900	 900

Profit and Loss Account for the period ended 31st March, 2004

Dr. Cr.

Particulars	Rs.	Particulars	Rs.
To Provision for discount on debtors	900		

Balance Sheet as on 31st March, 2004

Liabilities	Rs.	Rs.	Assets	Rs.	Rs.
			Sundry Debtors Less: Provision for discount on debtors	45,000 900	 44,100

Example: The trial balance shows on 31.03.2004,

Sundry debtors Rs. 85,000

Adjustments: Bad debts written off Rs. 5,000. Provide @ 5% provision for bad and doubtful debts and @ 2% provision for discount on debtors.

Note:

	Rs.
Debtors as per Trial Balance	85,000
Less: Bad debts	5,000
Amount for which Bad & doubtful debts is to be calculated	80,000
Less: 5% Provision for bad and doubtful debts	4,000
Estimated value of good debtors	76,000
Less: 2% Provision for discount on debtors	1,520
	74,480

Adjusting Entries

Date	Particulars	L.F	Debit Rs.	Credit Rs.
2004 Mar 31	Bad debts A/c Dr To Sundry debtors A/c (Bad debts written off)		5,000	 5,000
”	Profit and Loss A/c Dr To Provision for Bad & doubtful debts A/c (5% provision for bad & doubtful debts)		4,000	 4,000
”	Profit and Loss A/c Dr To Provision for discount on debtors A/c (2% Provision for discount on debtors)		1,520	 1,520

Provision for discount on debtors will be shown

i) on the debit side of Profit and Loss account and

ii) on the asset side of the Balance sheet by way of deduction from Sundry debtors (after deducting bad debts written off and provision for bad and doubtful debts).

Profit and Loss Account for the year ended 31st March, 2004

Dr. Cr.

Particulars	Rs.	Particulars	Rs.
To Bad debts A/c	5,000		
To Provision for Bad and doubtful debts A/c	4,000		
To Provision for discount on debtors	1,520		

Balance Sheet as on 31st March, 2004

Liabilities	Rs.	Rs.	Assets	Rs.	Rs.
			Sundry Debtors	85,000	
			Less: Bad debts	5,000	
				80,000	
			Less: Provision for Bad & Doubtful debts	4,000	
				76,000	
			Less: Provision for discount on debtors	1,520	
					74,480

Note :

Transfer Entry

Date	Particulars	L.F	Debit Rs.	Credit Rs.
2004 Mar 31	Profit & Loss A/c Dr To Bad debts A/c (Bad debts A/c closed by transfer to Profit & Loss A/c)		5,000	 5,000

Bad Debts Account

Dr. Cr.

Date	Particulars	Rs.	Date	Particulars	Rs.
2004 Mar 31	To Sundry Debtors A/c	5,000	2004 Mar 31	By Profit & Loss A/c	5,000
		5,000			5,000

1.1.14 Provision for Discount on Creditors

Similar to cash discount allowed to debtors, the firm may have a chance to receive the cash discount from the creditors for prompt payment. Provision for discount on Creditors is calculated at a certain percentage on Sundry Creditors.

Example: The Trial balance for the year ended 31st March, 2004 shows Sundry Creditors Rs.50,000.

Adjustment:

Create a provision for discount on creditors @ 2%.

Adjusting Entry

Date	Particulars	L.F	Debit Rs.	Credit Rs.
2004 Mar 31	Provision for discount on creditors A/c Dr To Profit and Loss A/c (2% Provision for discount on creditors)		1,000	 1,000

Provision for discount on creditors will be shown

i) on the credit side of Profit and Loss account and

ii) on the liabilities side of the Balance sheet by way of deduction from Sundry creditors.

Profit and Loss Account for the year ended 31st March, 2004

Dr. Cr.

Particulars	Rs.	Particulars	Rs.
		By Provision for discount on Creditors	1,000

Balance Sheet as on 31st March, 2004

Liabilities	Rs.	Rs.	Assets	Rs.	Rs.
Sundry creditors	50,000				
Less: Provision for discount on creditors	1,000				
		49,000			

Chart showing the treatment of adjustments in the preparation of Final Accounts

			How dealt with in →	
Sl. No.	Type of Adjustment	Adjustment Entry	Trading or Profit and Loss account	Balance Sheet
1.	Closing stock	Closing Stock A/c Dr To Trading A/c	Credit side of the Trading A/c	Asset side.
2.	Outstanding Expenses: (Wages, Rent, Salaries etc.)	Respective Expenses A/c Dr To Respective outstanding expenses A/c Example: Wages A/c To Wages outstanding A/c Salaries A/c Dr To Salaries outstanding A/c	i. If the outstanding is an item chargeable to Trading A/c, add the outstanding expenses with relevant expenses in the debit side of the Trading A/c. ii. If it is an item chargeable to Profit and Loss A/c, add the outstanding expenses to the relevant expenses in the debit side of the Profit and Loss A/c.	Liabilities side.
3.	Prepaid Expenses: (Insurance Premium)	Respective prepaid Expenses A/c Dr To Respective Expenses A/c Example: Prepaid Insurance Premium A/c Dr To Insurance Premium A/c	Debit side of Trading & Profit and Loss A/c by way of deduction from respective expenses A/c.	Assets side.
4.	Accrued Income (Commission)	Accrued Income A/c Dr To Respective Income A/c Example: Accrued Commission A/c To Commission A/c	Credit side of Profit and Loss A/c by way of addition to respective Income A/c.	Assets side.
5.	Income received in advance (Rent)	Respective Income A/c Dr To Respective Income received in advance A/c Example: Rent received A/c Dr To Rent received in advance A/c	Credit side of Profit and Loss A/c by way of deduction from the respective income A/c.	Liabilities side.

6.	Interest on Capital	Interest on Capital A/c Dr To Capital A/c	Debit side of Profit and Loss A/c	Liabilities side by way of addition to the Capital
7.	Interest on Drawings	Capital A/c Dr To Interest on drawings A/c	Credit side of the Profit and Loss A/c	Liabilities side by way of addition to the d r a w i n g s which are ultimately deducted from the Capital.
8.	Interest on Loan (Interest on Bank Loan)	Interest A/c Dr To Interest Outstanding A/c Example: Interest on Bank Loan A/c To Interest Outstanding A/c	Debit side of Profit and Loss A/c by way of addition to the appropriate interest A/c	Liabilities side by way of addition to the particular loan A/c
9.	Interest on Investments	Accrued Interest on investments A/c Dr To Interest received A/c	Credit side of Profit and Loss A/c by way of addition to the appropriate interest A/c.	Assets side by way of addition to the particular investment A/c
10.	Depreciation on Fixed Asset	Depreciation A/c Dr To Fixed Asset A/c Example: Depreciation A/c Dr To Machinery A/c	Debit side of Profit and Loss A/c.	Assets side by way of deduction from the concerned as set account.
11.	Bad debts	Bad debts A/c Dr To Sundry debtors A/c	Debit side of Profit and Loss A/c	Assets side by way of deduction from Sundry debtors
12.	Provision for Bad and doubtful debts.	Profit and Loss A/c Dr To Provision for Bad and doubtful debts A/c	i. If the provision for bad and doubtful debts is given outside the Trial balance, then it is shown on the debit side of Profit and Loss account. ii. If provision for bad and doubtful debts is given in the Trial Balance (Old) and also in the adjustment (New): Add new provision for bad and doubtful debts with bad debts written off. a) If the old provision for bad and doubtful debts is less than the above total, then the difference will be shown on the debit side of the Profit and Loss account. b) If the old provision for bad and doubtful debts is more than the above total, then the difference should be shown on the credit side of the Profit and Loss account.	Assets side by way of deducting New Provision alone from Sundry debtors

13.	Provision for Discount on Debtors	Profit and Loss A/c Dr To Provision for discount on debtors A/c	Debit side of Profit and Loss A/c (Amount of provision for discount is ascertained on good debtors)	Assets side by way of deduction from Sundry debtors (after deduction of bad debts and new provision for bad and doubt- ful debts)
14.	Provision for Discount on Creditors	Provision for Discount on Creditors A/c Dr To Profit and Loss A/c	Credit side of Profit and Loss A/c	Liabilities side by way of deduction from Sundry Creditors.

Format :

Trading and Profit and Loss Account of
Thiru............ for the year ending 31st March, ...

Dr. Cr.

Particulars	Rs.	Rs.	Particulars	Rs.	Rs.
To Opening stock		xxx	By Sales	xxx	
To Purchases	xxx		Less: Sales returns	xxx	
Less: Purchases returns	xxx				xxx
		xxx	By Closing Stock		xxx
To Wages	xxx				
Add: Outstanding wages	xxx				
		xxx			
To Factory rent	xxx				
Less: Prepaid Factory rent	xxx				
		xxx			
To Gross Profit c/d (Transferred to Profit & Loss A/c)		xxx			
		xxx			xxx
To Salaries	xxx		By Gross Profit b/d (Transferred from Trading A/c)		xxx
Add : Outstanding Salaries	xxx				
		xxx			
Insurance premium	xxx		By Commission received	xxx	
Less: Prepaid Insurance Premium	xxx		Add: Commission accrued but not yet received	xxx	
		xxx			xxx
To Interest on Capital		xxx	By Rent Received	xxx	
To Interest on loan	xxx				
Add: Interest on loan outstanding	xxx		Less: Rent received in advance	xxx	
		xxx			xxx

			By Interest on drawings		xxx
To Depreciation on: Fixed Assets, Buildings, Machinery, Furniture etc.		xxx	By Discount received		xxx
			By New provision for discount on creditors (given in adjustment)	xxx	
			Less: Old provision	xxx	
To Bad debts	xxx				xxx
Add: New Bad Debts (given in adjustment)	xxx				
	xxx				
Add: New Provision for bad & doubtful debts (given in adjustment)	xxx				
	xxx				
Less: Old Provision	xxx				
		xxx			
To Discount allowed		xxx			
To New Provision for discount on debtors (given in adjustment)	xxx				
Less: Old Provision	xxx				
		xxx			
To Net profit (Transferred to Capital A/c)		xxx			
		xxx			xxx

Balance Sheet of Thiru............ as on 31st March, ...

Liabilities	Rs.	Rs.	Assets	Rs.	Rs.
Capital	xxx		Cash in Hand		xxx
Add: Net Profit (or) Less: Net Loss	xxx		Cash at Bank		xxx
			Sundry debtors	xxx	
	xxx		Less: Bad debts written off	xxx	
				xxx	
Less: Drawings xxx			Less: Provision for Bad &		
Interest on drawings xxx			doubtful debts	xxx	
	xxx			xxx	
	xxx		Less: Provision for discount		
Less: Income Tax	xxx		on debtors	xxx	
		xxx			xxx
Sundry Creditors	xxx		Land and Buildings	xxx	
Less: Provision for Discount on Creditors	xxx		Less: Depreciation	xxx	xxx
		xxx	Plant & Machinery	xxx	
Loan	xxx		Less: Depreciaton	xxx	xxx

Add: Interest on loan outstanding	xxx		Furniture	xxx	
			Less: Depreciation	xxx	
		xxx			xxx
Outstanding Expenses		xxx			
Incomes received in advance		xxx	Goodwill	xxx	
			Less: Written off	xxx	
					xxx
			Closing stock		xxx
			Prepaid expenses		xxx
			Accrued Commission		xxx
		xxx			xxx

2.2 Preparation of Final Accounts

Illustration : 1

Pass necessary adjustment entries for the following adjustments:

1. Salaries outstanding Rs.20,000
2. Prepaid Insurance Rs.400
3. Interest accrued on investments Rs.1000
4. Commission received in advance Rs.2,000
5. To provide 10% interest on capital of Rs.5,00,000
6. Closing Stock Rs.4,00,000

Solution:

Adjustment Entries

Date	Particulars	L.F	Debit Rs.	Credit Rs.
1.	Salaries A/c Dr To Salaries outstanding A/c (Salaries outstanding)		20,000	20,000
2.	Prepaid Insurance A/c Dr To Insurance A/c (Insurance prepaid)		400	400
3.	Accrued Interest A/c Dr To Interest A/c (Interest accrued on investments)		1,000	1,000
4.	Commission received A/c Dr To Commission received in advance A/c (Commission received in advance)		2,000	2,000

5.	Interest on Capital A/c Dr To Capital A/c (10% interest on capital)		50,000	50,000
6.	Closing Stock A/c Dr To Trading A/c (Closing stock recorded)		4,00,000	4,00,000

Illustration : 2

Pass necessary adjusting entries for the following adjustments:

1. Interest charged on drawings Rs.5,000
2. Interest on loan outstanding Rs.3,000
3. Depreciation at 10% is to be charged on Machinery Rs.3,00,000.
4. Write off bad debts Rs.2,000
5. To provide provision for Bad & doubtful debts at 2% on Sundry debtors Rs.60,000
6. To provide Provision for discount on creditors at 2% on Sundry Creditors worth Rs.1,00,000

Solution:

Journal Entries

Date	Particulars	L.F	Debit Rs.	Credit Rs.
1.	Capital A/c Dr To Interest on drawings A/c (Interest charged on drawings)		5,000	5,000
2.	Interest on loan A/c Dr To Interest outstanding A/c (Interest due on loan)		3,000	3,000
3.	Depreciation A/c Dr To Machinery A/c (Depreciation on Machinery)		30,000	30,000
4.	Bad debts A/c Dr To Sundry debtors A/c (Bad debts written off)		2,000	2,000
5.	Profit and Loss A/c Dr To Provision for Bad & doubtful debts A/c (2% provision for Bad & doubtful debts)		1,200	1,200
6.	Provision for discount on creditors A/c Dr To Profit & Loss A/c (2% provision for discount on Creditors)		2,000	2,000

Illustration : 3

The Trial Balance as on 31st March 2004 shows Sundry debtors as Rs.12,000 and bad debts as Rs.300.

No adjustment given.

Solution:

Profit and Loss Account for the year ended 31st March 2004

Dr. Cr.

Particulars	Rs.	Particulars	Rs.
To Bad Debts	300		

Balance Sheet as on 31st March 2004

Liabilities	Rs.	Assets	Rs.
		Sundry debtors	12,000

Illustration : 4

The Trial Balance as on 31st March 2004 shows the following:

	Dr.	Cr.
Sundry Debtors	40,800	—
Bad debts written off	1,400	—

Adjustment: Write off Rs.800/- as bad debts.

Solution:

Adjusting Entry

Date	Particulars	L.F	Debit Rs.	Credit Rs.
	Bad debts A/c Dr. To Sundry debtors A/c (bad debts written off)		800	800

Note:

In the above example, Trial Balance shows Rs.1,400 as Bad debts. This means the double entry in respect of Rs.1,400 i.e.debiting Bad debts and crediting Sundry debtors is already completed. Hence Rs.1,400 found in the Trial Balance will not affect the sundry debtors of Rs.40,800.

But for the adjustment given outside the Trial Balance, the adjustment has to be done after the preparation of Trial Balance and this would result in increasing bad debts by Rs.800 and decreasing debtors by Rs.800.

Profit and Loss Account for the year ending 31st March 2004

Dr. Cr.

Particulars	Rs.	Rs.	Particulars	Rs.	Rs.
To Bad Debts	1,400				
Add: Bad debts Written off	800				
		2,200			

Balance Sheet as on 31st March, 2004

Liabilities	Rs.	Rs.	Assets	Rs.	Rs.
			Sundry Debtors	40,800	
			Less: Bad debts written off	800	
					40,000

Note:

Bad Debts Account

Dr. Cr.

Particulars	Rs.	Particulars	Rs.
To Balance b/d	1,400	By Profit & Loss	2,200
To Sundry Debtors	800		
	2,200		2,200

Illustration : 5

The following items are found in the Trial Balance of Mr.Vivekanandan as on 31st March 2004.

Sundry debtors	Rs.	64,000
Bad debts	Rs.	1,200
Provision for Bad & doubtful debts	Rs.	2,800

Adjustment:

Provide for bad & doubtful debts at 5% on Sundry debtors.

Give necessary entries and show how these items will appear in the final accounts.

Solution:

Step :1

Transfer of bad debts

Date	Particulars	L.F	Debit Rs.	Credit Rs.
2004 Mar 31	Provision for bad & doubtful debts A/c Dr. To Bad debts A/c (Transfer of bad debts)		1,200	 1,200

Note:

If Provision for bad and doubtful debts account is maintained, the loss on account of bad debts is taken to Profit and Loss Account not directly but via provision for bad and doubtful debts account.

Step 2:

Apply the rule:

	Rs.
Bad debts	1,200
Add: New Provision required 5% on 64,000	3,200
Total required	4,400
Less: Existing provision	2,800
Amount required	1,600

Adjusting Entry

Date	Particulars	L.F	Debit Rs.	Credit Rs.
2004 Mar 31	Profit and Loss A/c Dr. To Provision for bad and doubtful debts A/c (Additional provision for bad and doubtful debts)		1,600	 1,600

Profit and Loss Account for the Period ended 31st March 2004

Dr. Cr.

Particulars	Rs.	Rs.	Particulars	Rs.	Rs.
To Provision for bad & doubtful debts A/c					
Bad debts	1,200				
Add: New provision	3,200				
	4,400				
Less: Old provision	2,800				
		1,600			

Balance Sheet as on 31st March, 2004

Liabilities	Rs.	Rs.	Assets	Rs.	Rs.
			Debtors	64,000	
			Less: Provision for Bad & doubtful debts (New)	3,200	
					60,800

Note:

When the existing provision is larger than what is required even after the transfer of bad debts, **the second step will give a negative figure, which indicates that the profit and loss account is to be credited with the excess.**

Illustration : 6

Following are the balances extracted from the Trial Balance of Mr.Mohan as on 31st March, 2002.

Trial Balance as on 31st March, 2002

Particulars	Debit Rs.	Credit Rs.
Sundry debtors	60,000	
Bad debts	5,000	
Provision for bad & doubtful debts		10,000

Adjustment

Create provision for bad & doubtful debts @ 5% on Sundry Debtors.

Pass adjusting entry and show how these items will appear in the final accounts.

Adjusting Entry

Date	Particulars	L.F	Debit Rs.	Credit Rs.
2002 Mar 31	Provision for Bad and Doubtful debts A/c Dr To Profit & Loss A/c (5% Provision for bad and doubtful debts)		3,000	 3,000

Profit and Loss Account for the year ending 31st March, 2002

Dr. Cr.

Particulars	Rs.	Rs.	Particulars	Rs.	Rs.
			By Provision for bad and doubtful debts: Old Provision for bad & doubtful debts Less:Bad debts 5000 New Provision 3000	 10,000 8,000	 2,000

Balance Sheet as on 31st March, 2002

Liabilities	Rs.	Rs.	Assets	Rs.	Rs.
			Sundry debtors Less: New Provision	60,000 3,000	 57,000

Illustration : 7

The following balances have been extracted from the trial balance of Mr.Ashok as on 31.3.2002.

Trial Balance of Mr.Ashok as on 31st March, 2002

Particulars	Debit Rs.	Credit Rs.
Debtors	2,01,200	
Bad debts	9,400	
Provision for bad & doubtful debts		24,000
Provision for Discount on debtors		1,200
Discount allowed	18,600	

Adjustments:

1. Write off additional bad debts Rs.4,800
2. Create Provision of 10% for bad & doubtful debts on debtors.
3. Create Provision of 2% for discount on debtors.

Show how these items will appear in the Profit and Loss Account and Balance Sheet

Solution:

Profit and Loss Account of Mr.Ashok for the year ending 31st March, 2002

Dr. Cr.

Particulars	Rs.	Rs.	Particulars	Rs.	Rs.
To Provision for bad & doubtful debts A/c					
Bad debts	9,400				
Add: Bad debts written off	4,800				
	14,200				
Add: New provision	19,640				
	33,840				
Less: Old provision	24,000	9,840			
To Provision for discount on debtors					
Discount allowed	18,600				
Add: New provision	3,535				
	22,135				
Less: Old provision	1,200				
		20,935			

Balance Sheet as on 31st March, 2002

Liabilities	Rs.	Rs.	Assets	Rs.	Rs.
			Sundry debtors	2,01,200	
			Less: Bad debts written off	4,800	
				1,96,400	
			Less: New provision for bad & doubtful debts	19,640	
				1,76,760	
			Less: New Provision for discount on debtors	3,535	
					1,73,225

Illustration : 8

From the following trial balance of a trader, make out a Trading and Profit and Loss account and Balance Sheet as on 31st March, 2000.

Particulars	Debit Rs.	Credit Rs.
Sales		4,20,000
Purchases	1,05,000	
Printing Charges	2,500	
Wages	77,500	
Salaries	12,500	
Opening Stock	2,25,000	
Carriage Inwards	8,800	
General Expenses	26,250	
Trade Marks	5,000	
Rates and Taxes	2,500	
Capital		1,74,800
Discount received		1,250
Loan		1,75,000
Buildings	2,00,000	
Furniture	25,000	
Machinery	50,000	
Cash	1,000	
Bank	30,000	
	7,71,050	7,71,050

Adjustments:

1. The closing stock was valued at Rs.3,20,000.
2. Outstanding Salaries Rs.10,000.
3. Prepaid rates & taxes Rs.500.

Solution:

Trading and Profit and Loss Account for the year ending 31st March, 2000

Dr. Cr.

Particulars	Rs.	Rs.	Particulars	Rs.	Rs.
To Opening Stock		2,25,000	By Sales		4,20,000
To Purchases		1,05,000	By Closing Stock		3,20,000
To Wages		77,500			
To Carriage inwards		8,800			
To Gross Profit c/d		3,23,700			
(Transferred to Profit and Loss A/c)					

		7,40,000			7,40,000
To Printing charges		2,500	By Gross Profit b/d (Transferred from Trading A/c)		3,23,700
To Salaries	12,500				
Add: Outstanding	10,000				
		22,500	By Discount received		1,250
To General expenses		26,250			
To Rates and Taxes	2,500				
Less: Prepaid	500	2,000			
To Net Profit (Transferred to Capital A/c)		2,71,700			
		3,24,950			3,24,950

Balance Sheet as on 31st March, 2000

Liabilities	Rs.	Rs.	Assets	Rs.	Rs.
Outstanding Salary		10,000	Cash		1,000
Loans		1,75,000	Bank		30,000
Capital	1,74,800		Closing Stock		3,20,000
Add: Net Profit	2,71,700	4,46,500	Prepaid rates & taxes		500
			Building		2,00,000
			Furniture		25,000
			Machinery		50,000
			Trade Marks		5,000
		6,31,500			6,31,500

Illustration : 9

The following Trial Balance has been extracted from the books of Mr.Bhaskar on 31.03.2003.

Trial Balance

Particulars	Debit Rs.	Credit Rs.
Machinery	40,000	
Cash at Bank	10,000	
Cash in Hand	5,000	
Wages	10,000	
Purchases	80,000	
Stock (01.04.2002)	60,000	
Sundry debtors	40,000	
Bills Receivable	29,000	

Rent	4,000	
Interest on Bank Loan	500	
Commission received		3,000
General Expenses	12,000	
Salaries	7,500	
Discount received		4,000
Capital		90,000
Sales		1,20,000
Bank Loan		40,000
Sundry Creditors		40,000
Purchase returns		5,000
Sales returns	4,000	
	3,02,000	3,02,000

Adjustments:

1. Closing Stock Rs.80,000
2. Interest on Bank loan not yet paid Rs.400
3. Commission received in advance Rs.1,000

Prepare Trading and Profit and loss Account for the year ended 31.03.2003 and Balance Sheet as on that date after giving effect to the above adjustments.

Solution:

Trading and Profit and Loss Account of Mr.Bhaskar
for the year ending 31st March, 2003

Dr. Cr.

Particulars	Rs.	Rs.	Particulars	Rs.	Rs.
To Opening Stock		60,000	By Sales	1,20,000	
To Purchases	80,000		Less: Returns	4,000	1,16,000
Less: Returns	5,000	75,000	By Closing stock		80,000
To Wages		10,000			
To Gross Profit c/d		51,000			
(Transferred to Profit and Loss A/c)					
		1,96,000			1,96,000
To Rent		4,000	By Gross Profit b/d (Transferred from Trading A/c)		51,000
To Interest on Bank Loan	500				
Add: Outstanding	400		By Commission received	3,000	
		900	Less: Received in advance	1,000	2,000

To General Expenses To Salaries		12,000 7500	By Discount received		4,000
To Net Profit (Transferred to Capital A/c)		32,600			
		57,000			57,000

Balance Sheet as on 31st March, 2003

Liabilities	Rs.	Rs.	Assets	Rs.	Rs.
Sundry Creditors		40,000	Cash in hand		5,000
Bank Loan	40,000		Cash in Bank		10,000
Add: Outstanding			Bills receivable		29,000
interest on loan	400	40,400	Sundry debtors		40,000
			Closing Stock		80,000
Commission received in advance		1,000	Machinery		40,000
Capital	90,000				
Add: Net Profit	32,600				
		1,22,600			
		2,04,000			2,04,000

Illustration : 10

The following are the balances extracted from the books of Mrs.Suguna as on 31st March, 2004.

Debit Balances	Rs.	Credit Balances	Rs.
Drawings	40,000	Capital	2,00,000
Cash at Bank	17,000	Sales	1,60,000
Cash in hand	60,000	Sundry Creditors	45,000
Wages	10,000		
Purchases	20,000		
Stock (31.03.03)	60,000		
Buildings	1,00,000		
Sundry debtors	44,000		
Bills Receivable	29,000		
Rent	4,500		
Commission	2,500		
General Expenses	8,000		
Furniture	5,000		
Suspense Account	5,000		
	4,05,000		4,05,000

Adjustments:

1. Closing Stock Rs.40,000 valued as on 31.03.04.
2. Interest on Capital at 6% to be provided.
3. Interest on Drawings at 5% to be provided.
4. Depreciate buildings at the rate of 10% per annum.
5. Write off Bad debts Rs.1,000.
6. Wages yet to be paid Rs.500

Prepare Trading and Profit & Loss Account and Balance Sheet as on 31st March 2004.

Solution:

Trading and Profit and Loss Account of
Mrs. Suguna for the year ending 31st March, 2004

Dr. Cr.

Particulars	Rs.	Rs.	Particulars	Rs.	Rs.
To Opening Stock		60,000	By Sales		1,60,000
To Purchases		20,000	By Closing Stock		40,000
To Wages	10,000				
Add: Outstanding	500	10,500			
To Gross Profit c/d (Transferred to Profit & Loss A/c)		1,09,500			
		2,00,000			2,00,000
To Rent		4,500	By Gross Profit b/d (Transferred from Trading A/c)		1,09,500
To Commission		2,500			
To General Expenses		8,000			
To Interest on Capital		12,000	By Interest on Drawings		2,000
To Depreciation on buildings		10,000			
To Bad debts written off		1,000			
To Net Profit (Transferred to Capital A/c)		73,500			
		1,11,500			1,11,500

Balance Sheet of Mrs.Suguna as on 31st March, 2004

Liabilities	Rs.	Rs.	Assets	Rs.	Rs.
Sundry Creditors		45,000	Cash in hand		60,000
Outstanding wages		500	Cash at Bank		17,000
Capital	2,00,000		Bills receivable		29,000
Add: Net Profit	73,500		Sundry Debtors	44,000	
	2,73,500		Less: Bad debts written off	1,000	
Add: Interest on Capital	12,000				43,000
	2,85,000		Closing Stock		40,000
Less: Drawings	40,000		Buildings	1,00,000	
	2,45,500		Less: Depreciation	10,000	
Less: Interest on					90,000
Drawings	2,000		Furniture		5,000
		2,43,500	Suspense Account		5,000
		2,89,000			2,89,000

Illustration : 11

Mr.Senthil's book shows the following balances. Prepare his Trading and Profit and Loss account for the year ended 31st March 2005 and Balance Sheet as on that date.

Particulars	Debit Rs.	Credit Rs.
Stock on 1.4.2004	1,50,000	
Purchases	1,30,000	
Sales		3,00,000
Carriage inwards	2,000	
Salaries	50,000	
Printing and Stationery	8,000	
Drawings	17,000	
Sundry Creditors		20,000
Sundry debtors	1,80,000	
Furniture	10,000	
Capital		2,50,000
Postage & Telephone	7,500	
Interest paid	4,000	
Machinery	41,500	
Loan Account		25,000
Suspense A/c		5,000
	6,00,000	6,00,000

Adjustments:

1. Closing Stock Rs.1,20,000
2. Provide 5% for bad & doubtful debts on debtors
3. Depreciate machinery & furniture by 5%
4. Allow interest on capital at 5%
5. Prepaid printing charges Rs.2,000

Solution:

Trading and Profit and Loss Account of Mr.Senthil for the period ending 31st March 2005

Dr. Cr.

Particulars	Rs.	Rs.	Particulars	Rs.	Rs.
To Opening Stock		1,50,000	By Sales		3,00,000
To Purchases		1,30,000	By Closing Stock		1,20,000
To Carriage inwards		2,000			
To Gross Profit c/d (Transferred to Profit & Loss A/c)		1,38,000			
		4,20,000			4,20,000
To Salaries		50,000	By Gross Profit b/d (Transferred from Trading A/c)		1,38,000
To Printing & Stationery	8,000				
Less: Prepaid	2,000				
		6,000			
To Postage & Telephone		7,500			
To Interest paid		4,000			
To Provision for Bad & doubtful debts		9,000			
To Depreciation on:					
Machinery	2,075				
Furniture	500				
		2,575			
To interest on Capital		12,500			
To Net Profit (Transferred to Capital A/c)		46,425			
		1,38,000			1,38,000

Balance Sheet of Mr.Senthil as on 31st March, 2004

Liabilities	Rs.	Rs.	Assets	Rs.	Rs.
Sundry Creditors		20,000	Sundry Debtors	1,80,000	
Loan Account		25,000	Less: Provision for		
Capital	2,50,000		bad & doubtful debts	9,000	
Add: Net Profit	46,425				1,71,000
	2,96,425		Closing Stock		1,20,000
Add: Interest on Capital	12,500		Prepaid Printing charges		2,000
	3,08,925		Furniture	10,000	
Less: Drawings	17,000				
		2,91,925	Less: Depreciation	500	9,500
Suspense Account		5,000			
			Machinery	41,500	
			Less: Depreciation	2,075	
					39,425
		3,41,925			3,41,925

Illustration : 12

From the Trial Balance of Mr.Raghuraman as on 31st March, 2003 prepare Final accounts.

Particulars	Debit Rs.	Credit Rs.
Capital		3,60,000
Drawings	6,400	
Stock (1.4.2002)	18,000	
Purchases	1,29,000	
Sales		2,38,000
Sales Returns	4,000	
Wages	32,000	
Insurance Premium	3,000	
Packing Expenses	4,000	
Postage	200	
Advertisement	2,000	
Carriage outwards	16,000	
Bad debts	600	

Commission received		1,000
Bills Payable		18,000
Bank overdraft		6,000
Land & Buildings	2,61,000	
Plant & Machinery	1,80,000	
Sundry Debtors	50,800	
Sundry Creditors		84,000
	7,07,000	7,07,000

Adjustments:

1. Closing Stock on 31.03.2003, Rs.15,000.
2. Write off bad debts Rs.800 and make provision for Bad & doubtful debts @ 5% on Sundry debtors.
3. Commission accrued but not received Rs.2,000.

Solution:

Trading and Profit and Loss Account of Mr.Raguraman
for the year ending 31st March, 2003

Dr. Cr.

Particulars	Rs.	Rs.	Particulars	Rs.	Rs.
To Opening Stock		18,000	By Sales	2,38,000	
To Purchase		1,29,000	Less: Sales Returns	4,000	
To Wages		32,000			2,34,000
To Packing Expenses		4,000	By Closing Stock		15,000
To Gross Profit c/d (Transferred to Profit & Loss A/c)		66,000			
		2,49,000			2,49,000
To Insurance To Postage		3,000 200	By Gross Profit b/d (Transferred from Trading A/c)		66,000
To Advertisement		2,000			
To Carriage outwards		16,000	By Commission received	1,000	
To Bad debts Add: Bad debts written off	600 800		Add: Accrued Commission	2,000	
		1,400			3,000

To Provision for Bad & doubtful debts		2,500			
To Net Profit (Transferred to Capital A/c)		43,900			
		69,000			69,000

Balance Sheet of Mr.Raghuraman as on 31st March, 2003

Liabilities	Rs.	Rs.	Assets	Rs.	Rs.
Sundry Creditors		84,000	Sundry Debtors	50,800	
Bills Payable		18,000	Less: Bad debts		
Bank Overdraft		6,000	written off	800	
Capital	3,60,000			50,000	
Add: Net Profit	43,900		Less: Provision for Bad & Doubtful debts	2,500	47,500
	4,03,900				
Less: Drawings	6,400		Closing Stock		15,000
			Accrued Commission		2,000
		3,97,500	Land & Buildings		2,61,000
			Plant & Machinery		1,80,000
		5,05,500			5,05,500

Illustration : 13

From the following particulars of Mrs.Sulochana, prepare Trading and Profit and Loss Account and Balance Sheet for the year ending 31st March, 2004.

Trial Balance

Particulars	Debit Rs.	Credit Rs.
Capital		7,50,000
Cash	40,000	
Buildings	4,00,000	
Salary	1,10,000	
Rent & Taxes	21,000	
Opening Stock	1,20,000	
Machinery	1,20,000	
Drawings	40,000	

Purchases	5,00,000	
Sales		7,50,000
Carriage inwards	5,000	
Fuel, Gas	37,000	
Sundry Debtors	2,50,000	
Sundry Creditors		1,20,000
Bills Receivable	53,000	
Dividend		28,000
Loan		60,000
Bad debts	2,000	
Advertisement	16,000	
Provision for Bad & Doubtful Debts		6,000
	17,14,000	17,14,000

Adjustments:

i) Closing stock Rs.1,40,000.

ii) Write off Rs.10,000 as bad debts; Provide 5% for Bad and Doubtful debts.

iii) Make provision for discount on Debtors at 2%.

iv) Provisions for discount on creditors at 2%

Solution:

Trading and Profit and Loss Account of Mrs. Sulochana
for the year ending 31st March, 2004

Dr. Cr.

Particulars	Rs.	Rs.	Particulars	Rs.	Rs.
To Opening Stock		1,20,000	By Sales		7,50,000
To Purchase		5,00,000	By Closing Stock		1,40,000
To Carriage inwards		5,000			
To Fuel Gas		37,000			
To Gross Profit c/d (Transferred to Profit & Loss A/c)		2,28,000			
		8,90,000			8,90,000
To Salary To Rent & Taxes To Advertisement		1,10,000 21,000 16,000	By Gross Profit b/d (Transferred from Trading A/c)		2,28,000
			By Dividend		28,000

To Provision for Bad & doubtful debts A/c Bad Debts	2,000		By Provision for discount on Creditors		2,400
Add: Bad debts written off	10,000				
	12,000				
Add: New Provision	12,000				
	24,000				
Less: Old Provision	6,000				
		18,000			
To Provision for discount on debtors		4,560			
To Net Profit (Transferred to Capital A/c)		88,840			
		2,58,400			2,58,400

Balance Sheet of Mrs.Sulochana as on 31st March, 2004

Liabilities	Rs.	Rs.	Assets	Rs.	Rs.
Sundry Creditors	1,20,000		Cash		40,000
Less: Provision for discount on creditors	2,400		Bills Receivable Sundry Debtors	2,50,000	53,000
		1,17,600	Less: Bad debts written off	10,000	
Loan		60,000		2,40,000	
Capital Add: Net Profit	7,50,000 88,840		Less: New Provision for Bad & doubtful debts	12,000	15,000
	8,38,840			2,28,000	
Less: Drawings	40,000		Less: New Provision for discount on debtors	4,560	
		7,98,840			2,23,440
			Closing Stock		1,40,000
			Buildings		4,00,000
			Machinery		1,20,000
		9,76,440			9,76,440

Illustration : 14

Prepare Trading, Profit and Loss A/c and Balance Sheet as on 31.3.2005 from the following Trial Balance of Mr.Imran.

Particulars	**Debit Rs.**	**Credit Rs.**
Capital		1,50,000
Bank Overdraft		25,200
Sales		9,03,000
Furniture	30,600	
Business Premises	1,20,000	
Creditors		79,800
Opening Stock	1,32,000	
Debtors	1,08,000	
Rent		6,000
Purchases	6,60,000	
Discount		2,400
Insurance	16,000	
Wages	24,000	
Salaries	54,000	
Advertisement	13,200	
Carriage on Purchases	10,800	
Provision for bad and doubtful debts		7,000
Bad debts	800	
Income tax	4,000	
	11,73,400	11,73,400

Adjustments:

1. Closing Stock on 31.03.2005 was Rs.1,20,000
2. Make a provision of 5% on Sundry debtors for bad and doubtful debts.
3. Rent received in advance Rs.2,000
4. Provide 10% depreciation on Furniture and Business Premises.

Solution:

Trading and Profit and Loss Account of Mr.Imran
for the year ending 31st March, 2005

Dr. Cr.

Particulars	**Rs.**	**Rs.**	**Particulars**	**Rs.**	**Rs.**
To Opening Stock		1,32,000	By Sales		9,03,000
To Purchase		6,60,000	By Closing Stock		1,20,000

To Wages		24,000			
To Carriage on Purchases		10,800			
To Gross Profit c/d (Transferred to Profit & Loss A/c)		1,96,200			
		10,23,000			10,23,000
To Insurance		16,000	By Gross Profit b/d (Transferred from Trading A/c)		1,96,200
To Salaries		54,000			
To Advertisement		13,200	By Rent	6,000	
To Depreciation on: Furniture	3,060		Less: Received in advance	2,000	
					4,000
Business premises	12,000				
		15,060			
To Net Profit (Transferred to Capital A/c)		1,05,140	By Discount		2,400
			By Provision for bad & doubtful debts Old Provision	7,000	
			Less: Bad debts 800 New Provision 5,400	6,200	
					800
		2,03,400			2,03,400

Balance Sheet of Mr.Imran as on 31st March, 2004

Liabilities	Rs.	Rs.	Assets	Rs.	Rs.
Sundry Creditors		79,800	Sundry Debtors	1,08,000	
Bank Overdraft		25,200	Less: New Provision for bad and doubtful debts	5,400	
Rend received in advance		2,000			
Capital	1,50,000				1,02,600
Add: Net profit	1,05,140		Closing Stock		1,20,000
	2,55,140		Furniture	30,600	
Less: Income Tax	4,000		Less: Depreciation	3,060	
		2,51,140			27,540
			Business Premises	1,20,000	

			Less: Depreciation	12,000	
					1,08,000
		3,58,140			3,58,140

Note:

Total of Bad debts written off and new provision for bad and doubtful debts is (Rs.800 + Rs.5,400) Rs.6,200. Old provision for bad and doubtful debts given in the Trial Balance is Rs.7,000 which is greater than Rs. 6,200. So the difference will appear on the credit side of the Profit and Loss account as follows:

Old provision	Rs. 7,000	
Less: Total of bad debts and new provision for bad and doubtful debts	Rs. 6,200	
(Rs.800 + Rs. 5,400)		Rs.800

QUESTIONS

I. Objective type:

a) Fill in the blanks:

1. Net Profit is transferred from Profit and loss account to ________ account.
2. Closing stock is valued at Cost Price or ________ price whichever is lower.
3. Outstanding expenses are shown on the ______ side of the balance sheet.
4. Prepaid expenses are shown on the ________ side of the balance sheet.
5. Income accrued but not received will be shown on the ________ side of the Balance sheet.
6. Income received in advance will be shown on the ________ side of the Balance sheet
7. Interest on capital is debited in ________ account
8. Interest on drawings is credited in ________ account.
9. Interest on loan borrowed unpaid is shown on the ________ side of the Balance sheet.
10. Depreciation is deducted from the concerned ______ in the Balance sheet.
11. Provision for Bad and Doubtful debts is deducted from ________ in the Balance sheet.

12. Provision for discount on creditors is deducted from ________in the Balance sheet.

13. Debts which are not recoverable from Sundry debtors are termed as ________.

(***Answers:*** 1. Capital, 2. Market, 3. Liabilities, 4. Assets, 5. Assets, 6. Liabilities, 7.Profit & Loss A/c., 8.Capital, 9. Liabilities, 10. Fixed asset, 11. Sundry debtors, 12. Sundry creditors, 13. Bad debts).

b) Choose the correct answer:

1. Returns inwards are deducted from

   a) Purchases b) Sales c) Returns outward

2. The Profit and Loss account shows

   a) Financial position of the concern b) Net profit or Net loss

   c) Gross profit or Gross Loss

3. Rent outstanding is

   a) a liability b) an asset c) an income

4. Closing stock is shown in

   a) Profit and loss account b) Trading account and Balance sheet

   c) None of the above.

5. Opening stock is shown in

   a) Balance sheet b) Profit and Loss account c) Trading account

6. Gross Profit is transferred to

   a) Capital account b) Profit and loss account c) None of the above

7. Interest on capital is added to

   a) Expense A/c b) Income A/c c) Capital A/c

8. Interest on drawings is deducted from

   a) Income A/c b) Capital A/c c) Expense A/c

9. Outstanding interest on loan borrowed is to be added to

   a) Asset A/c b) Income A/c c) Loan A/c

10. All the items given in the adjustment will appear at in the Final accounts.

    a) Three places b) Two places c) One Place

(***Answers:*** 1. (b); 2. (b); 3. (a); 4. (b); 5. (c); 6. (b); 7. (c); 8. (b): 9. (c); 10. (b))

II. Other Questions :

1. What is outstanding expense?
2. What is prepaid expense?
3. What is accrued income?
4. What is income received in advance?
5. What is bad debt?
6. Write notes on Provision for bad and Doubtful debts.
7. Write notes on Provision for discount on Debtors.
8. Write notes on Provision for discount on Creditors.
9. What is adjusting entry?
10. Write notes on

    a) Trading Account b) Profit and loss account and c) Balance sheet.

III. Problems:

1. Pass necessary adjusting entries for the following adjustments:
    a) Closing stock Rs. 6,00,000.
    b) Provide 6% interest on capital of Rs. 16,00,000
    c) Rent received in advance Rs. 5,000
    d) Interest accrued on investments Rs. 2,000
    e) Insurance premium prepaid Rs. 1,000
    f) Wages outstanding Rs. 15,000.
2. Pass necessary adjusting entries for the following adjustments:
    a) Interest on drawings Rs. 10,000.
    b) Interest on loan outstanding Rs.5,000.
    c) Depreciation at 5% on furniture Rs.50,000.
    d) Write off bad and doubtful debts Rs.3,000.
    e) Provide provision for bad and doubtful debts at 5% on Sundry debtors Rs.4,00,000.
    f) Provide provision for discount on creditors at 2% on Sundry creditors Rs. 3,50,000.

3. Give adjusting entry and transfer entry for the following adjustments:

   a) Interest on drawings Rs. 5,000.

   b) Depreciation on machinery Rs.4,000.

   c) Write off bad debts Rs.2,000.

4. The value of closing stock shown outside the Trial Balance (31.3.05) is Rs.2,50,000. Pass adjusting entry. Show how this item will appear in the Final accounts as on 31.3.05.

5. Trial Balance (31.3.05) shows salaries paid Rs.1,50,000. Salary for March 2005 Rs.4,000 not yet paid. Pass adjusting entry and show how this item will appear in the Final accounts.

6. Trial Balance as on 31.3.05 shows Rs.40,000 as Insurance premium paid. Unexpired insurance premium Rs.5,000. Pass adjusting entry and show how this item will appear in the Final accounts.

7. Credit side of Trial Balance as on 31.4.05 shows 'Commission received Rs.10,000.' Commission accrued but not yet received Rs.4,000. Pass adjusting entry and show how this item will appear in the Final accounts.

8. Trial balance as on 31.3.05 shows 'Rent received Rs.30,000.' Rent received in advance Rs.6,000. Pass adjusting entry and show how this item will appear in the Final accounts.

9. As per Trial Balance (31.3.05) capital is Rs. 6,00,000. Provide 6% interest on capital. Pass adjusting and transfer entries. Show how this item will appear in the Final accounts.

10. The Trial Balance shows the followings

Capital as on 31.3.03	–	Rs.6,00,000
Drawing as on 31.3.03	–	Rs.50,000

    Charge interest on drawings @ 5%. Pass adjusting and transfer entry. Show how this item will appear in the Final accounts.

11. The Trial Balance (31.3.04) shows the following:

	Dr.	Cr.
Bank loan @ 10% (1.4.03)	----	Rs. 10,00,000
Interest paid	Rs. 60,000	

    Provide interest outstanding. Pass adjusting entry and show how this item will appear in the Final accounts.

12. The trial balance shows the following as on 31.3.98.

Capital	Rs.	5,00,000
Drawings (1.7.98)	Rs.	50,000

Charge interest on drawings @ 5% . Pass adjusting and transfer entry. Show how this item will appear in the Final accounts. *(Oct. 2000)*

13. Rent received shown in the Trial Balance as on 31st December 2001, Rs.10,000. Rent received in advance is Rs.1,000. You are required to show how it appears in the Profit and Loss account and Balance sheet. *(June 2002)*

14. How will the following adjustment appear in the Balance sheet as on 31.12.2000.

Sundry debtors	Rs.	21,000
Bad debts to be written off	Rs.	1,000

Provide @ 5% provision for Bad and Doubtful debts and @2% Provision for discount on Debtors.

(Answer: Rs.18,620 - March 2003)

15. Commission received given in Trial Balance is Rs.1,000 as on 31st March 1994. Commission accrued but not yet received Rs.150. Show the adjusting entry.

(June 2003)

16. The Trial Balance shows the value of machinery on 31.3.04 as Rs.50,000. Machinery is to be depreciated at 10%. Pass adjustment entry and show how this item will appear in the Final accounts.

17. The Trial Balance as on 31st March 2003 show Sundry debtors Rs.60,000. Write off bad debts Rs.4,000. Pass adjusting and transfer entry. Show how this item will appear in the Final accounts.

18. The Trial Balance shows on 31.3.2002, Sundry debtors Rs.1,50,000. Provide 5% provision for bad and doubtful debts on Sundry debtors. Pass adjusting entry and how this item will appear in the Final accounts.

19. The Trial Balance shows on 31.3.2002, Sundry debtors Rs.1,25,000.

Adjustment:

1. Bad debts to be written off Rs.5,000.
2. Provide @ 5% Provision for bad and doubtful debts and
3. Provide @ 2% Provision for discount on debtors.

Pass entries and show how these items will appear in the Final accounts.

20. The Trial Balance as on 31st March 2003 shows.

Sundry debtors 90,000 ---

Adjustment: Create 2% Provision for discount on Debtors.

Pass Journal entry and show how this item will appear in the Final accounts.

21. The Trial Balance shows sundry creditors at Rs.10,000 on 31.3.2000.

Adjustment: It is desired to make a provision for discount on Sundry creditors at 2½ %.

You are required to show how it appears in Profit and Loss account and Balance sheet. *(March 2002)*

22. The following is the Trial Balance extracted from the books of Mr.Kumar as on 31.3.96.

Prepare Trading and Profit and Loss account and Balance sheet on 31.3.96.

Debit Balances	Rs.	Credit Balances	Rs.
Buildings	30,000	Capital	40,000
Machinery	31,400	Purchase returns	2,000
Furniture	2,000	Sales	2,80,000
Motor Car	16,000	Sundry Creditors	9,600
Purchases	1,88,000	Discount received	1,000
Sales returns	1,000	Provision for bad and	
Sundry Debtors	30,000	doubtful debts	600
General Expenses	1,600		
Cash at Bank	9,400		
Rates and Taxes	1,200		
Bad Debts	400		
Insurance premium	800		
Discount allowed	1,400		
Opening stock	20,000		
	3,33,200		3,33,200

Adjustments:

i) Outstanding rates and taxes Rs.1,600.

ii) Insurance Premium Prepaid Rs.200.

iii) Maintain Provision for bad and doubtful debts at 5% on debtors.

iv) Depreciate Motor car by 10%., Furniture by 4% and Buildings by 3%.

v) Stock on 31.3.96 Rs.20,000.

(Modified :March, 2000)

(Answer: G.P. Rs. 93,000; N.P. Rs. 83,720; B/s Rs. 1,34,920)

23. From the undermentioned Trial Balance of Mr.Saleem as on 31.3.2001, prepare Trading and Profit and Loss Account and Balance sheet as on that date.

Trial Balance

Debit Balances	Rs.	Credit Balances	Rs.
Cash in Hand	1,500	Capital	80,000
Purchases	1,20,000	Bank loan @ 4%	20,000
Opening Stock	40,000	Bills payable	25,000
Sundry Debtors	60,000	Sundry Creditors	25,000
Plant and Machinery	50,000	Sales	2,00,000
Furniture	20,000	Provision for bad and	
Bills Receivable	15,000	doubtful debts	1,500
Rent and Taxes	10,000	Interest	1,000
Wages	16,000		
Salaries	20,000		
	3,52,500		3,52,500

Additional information supplied:

i) Closing stock Rs.50,000.

ii) Provide for outstanding liabilities.

Rent and taxes Rs.2,000.

Wages Rs.3,000.

Salaries Rs.4,000.

iii) Depreciation on Plant and Machinery @5% and on furniture @ 10%.

iv) Provide 4% interest on Bank loan.

v) Write off bad debts Rs.2,000.

(Answer: G.P. Rs. 71,000; N.P. Rs.30,200; B/s Rs. 1,90,000)

24. Trial Balance of Anuradha Agencies as on 31.03.2001:

Debit Balances	Rs.	Credit Balances	Rs.
Drawings	1,800	Capital	80,000
Buildings	15,000	General Reserve	20,000
Furniture & Fittings	7,500	Loan from Hari@6%	15,000
Computer	25,000	Sales	1,00,000
Interest on loan	900	Commission received	7,500
Loose tools	6,100	Sundry Creditors	10,000
Purchases	75,000		
Stock on 1.4.2000	25,000		
General Expenses	15,000		
Freight inward	2,000		
Freight outward	1,000		
Sundry Debtors	28,000		
Bank	20,200		
Goodwill	10,000		
	2,32,500		2,32,500

Adjustments:

i) Closing stock is Rs.32,000.

ii) Depreciate Computer @10%.; Buildings @ 5%.; Furniture and Fittings @ 10%

iii) Provide for bad and doubtful debts @ 5% and for discount on debtors @2%.

iv) Provide interest on drawings @6% and on Capital @ 8%.

Prepare final accounts for the said period after giving effect to the adjustments.

(October - 2002)

(Answer: G.P. Rs.30,000; N.P. Rs.8,376; B/s Rs. 1,37,868)

25. Trial Balance of Mr.Velu as on 31st March 1994.

Particulars	Debit Rs.	Credit Rs.
Capital		2,00,000
Drawings	3,600	
Buildings	30,000	
Furniture & Fittings	15,000	
Computer	50,000	
Loan from Mr.Ravi at 6%		30,000
Interest on Loan	1,800	
Sales		2,00,000
Loose tools	32,200	
Purchases	1,50,000	
Stock on 1.4.94	50,000	
General Expenses	30,000	
Freight inward	4,000	
Freight outward	2,000	
Commission received		15,000
Sundry Debtors	56,000	
Bank	40,400	
Sundry Creditors		20,000
	4,65,000	4,65,000

Adjustments:

i) Closing stock Rs.64,000.

ii) Depreciate computer at 10%; Buildings at 5%,; Furniture and Fittings at 10%

iii) Provide for Bad and doubtful Debts at 5% and for Discount on Debtors at 2%.

iv) Provide interest on Drawings at 6% and on Capital at 6%.

Prepare Trading and profit and Loss Account and Balance sheet as on 31st March, 1994.

(October - 1994)

(Answer: G.P. Rs. 60,000; N.P. Rs.17,552; B/s Rs.2,75,736)

26. The following balances have been extracted from the books of Mrs.Padma as on 31st March, 2002.

Debit Balances	Rs.	Credit Balances	Rs.
Furniture	30,000	Capital	2,00,000
Cash in Hand	8,000	Commission	14,000
Opening Stock	1,00,000	Sales	6,00,000

Purchases	3,20,000	Creditors	1,00,000
Investments @10%	20,000	Interest	1,500
Drawings	60,000		
Bad debts	12,000		
Salaries	60,000		
Carriage inwards	20,000		
Insurance	12,000		
Rent	26,000		
Debtors	1,80,000		
Advertising	40,000		
Printing & Stationery	12,000		
General Expenses	15,500		
	9,15,500		9,15,500

The following adjustments are to be made:

1. Closing stock was valued at Rs.80,000.
2. Provide for accrued interest on investments Rs.500.
3. Commission received in advance Rs.4,000.
4. A provision for Bad and Doubtful Debts is to be created to the extent of 5% on Sundry Debtors.
5. A provision for discount on Sundry creditors is to be created to the extent of 2% on Sundry creditors.

(Answer: G.P. Rs.2,40,000; N.P. Rs. 67,500; B/s Rs.3,09,500)

27. The Trial Balance of Mrs.Kalpana shows thefollowing balances on March 31, 2001.

Debit Balances	Rs.	Credit Balances	Rs.
Purchases	1,40,000	Capital	2,40,000
Sales Returns	10,000	Sales	3,00,000
Opening Stock	40,000	Discount received	2,000
Discount allowed	4,000	Commission received	8,000
Bank charges	1,000	Sundry Creditors	58,000
Salaries	9,000		
Wages	10,000		
Freight inwards	8,000		
Freight outwards	2,000		
Rent, Rates & Taxes	10,000		
Advertising	12,000		

Cash in hand	2,000		
Plant & Machinery	1,00,000		
Sundry Debtors	1,20,000		
Cash at Bank	1,40,000		
	6,08,000		6,08,000

Adjustment: The Closing stock was valued at Rs.60,000.

You are required to prepare the Profit and Loss Account for the year ending 31st March 2001 and the Balance Sheet as on that date.

(Answer: G.P. Rs. 1,52,000; N.P. Rs. 1,24,000; B/s Rs.4,22,000)

28. From the following Trial Balance of Mr.Joseph, prepare Trading and Profit and Loss Account for the year ended 31st March, 2003 and a Balance Sheet as on that date.

Trial Balance

Particulars	**Debit Rs.**	**Credit Rs.**
Capital		1,20,000
Sales		75,000
Purchases	45,000	
Salaries	6,000	
Rent	4,500	
Insurance Premium	900	
Drawings	15,000	
Machinery	84,000	
Bank	13,500	
Cash	13,500	
Stock (1.4.2002)	15,600	
Sundry Debtors	7,500	
Sundry Creditors		10,500
	2,05,500	2,05,500

Adjustments required:

1. Stock on 31.3.2003 Rs. 14,700
2. Salaries unpaid Rs. 1,000
3. Rent paid in advance Rs. 750
4. Create 5% Provision for bad and doubtful debts on Sundry debtors.

(Answer: G.P. Rs. 29,100; N.P. Rs. 17,075; B/s Rs. 1,33,575)

29. The following balances are extracted from the books of Mr.Venugopal as on 31^{st} March 2004. Prepare Trading, Profit and Loss Account and the Balance Sheet.

Particulars	Debit Rs.	Credit Rs.
Capital		1,20,000
General expenses	16,500	
Drawings	16,000	
Commission		11,000
Bank Overdraft		25,000
Cash in Hand	2,500	
Stock (1.4.2003)	1,00,000	
Furniture	80,000	
Purchases	3,00,000	
Sales		5,00,000
Wages	50,000	
Insurance Premium	1,000	
Salaries	15,000	
Sundry Creditors		50,000
Sundry Debtors	1,50,000	
Bills Payable		25,000
	7,31,000	7,31,000

Adjustments:

1. Closing Stock Rs. 1,00,000
2. Write off bad debts Rs. 20,000
3. Create provision for Bad and doubtful debts @ 5%
4. Create provision for discount on debtors @ 2%
5. Create provision for discount on creditors @ 2%

(Answer: G.P. Rs.1,50,000; N.P. Rs.1,00,530; B/s Rs. 3,03,530)

30. The following are the balances extracted from the books of Mrs.Nandhini as on 31.03.2002.

Debit Balances	Rs.	Credit Balances	Rs.
Drawings	40,000	Capital	2,00,000
Cash in Hand	17,000	Sales	1,60,000

Cash at Bank	65,000	Sundry Creditors	45,000
Wages	10,000		
Purchases	20,000		
Stock (1.4.2001)	60,000		
Buildings	1,00,000		
Sundry Debtors	44,000		
Bills Receivable	29,000		
Rent	4,500		
Commission	2,500		
General Expenses	8,000		
Furniture	5,000		
	4,05,000		4,05,000

Adjustments:

1. Closing stock Rs.40,000
2. Interest on Capital at 6% to be provided.
3. Interest on Drawings at 5% to be provided.
4. Wages yet to be paid Rs.1,000
5. Rent Prepaid Rs.900

Prepare Trading and Profit and Loss Account and Balance sheet as on 31.3.2002.

(Answer : G.P. Rs. 1,09,000; N.P. Rs.84,900; B/s Rs. 3,00,900)

31. From the following Trial Balance of Mr. Ravi, prepare Trading and Profit and Loss Account for the year ended 31st March, 2002 and a Balance Sheet as on that date.

Trial Balance

Particulars	Debit Rs.	Credit Rs.
Capital		40,000
Sales		25,000
Purchases	15,000	
Salaries	2,000	
Rent	1,500	
Insurance	300	
Drawings	5,000	

Machinery	28,000	
Bank Balance	4,500	
Cash	2,000	
Stock (1.4.2001)	5,200	
Debtors	2,500	
Creditors		1,000
	66,000	66,000

Adjustments required:

a) Stock on 31.3.02 Rs. 4,900
b) Salaries unpaid Rs. 300
c) Rent paid in advance Rs. 200
d) Insurance prepaid Rs. 90

(Answer: G.P. Rs.9,700; N.P. Rs.5,890; B/s Rs. 42,190)

32. From the following Trial Balance, Prepare Trading, Profit and Loss Account for the year ended 31.3.1981 and a Balance Sheet as on that date.

Trial Balance

Debit Balances	Rs.	Credit Balances	Rs.
Purchases	11,870	Capital	8,000
Debtors	7,580	Bad debts recovered	250
Return inwards	450	Creditors	1,250
Bank deposit	2,750	Return Outwards	350
Rent	360	Bank Overdraft	1,570
Salaries	850	Sales	14,690
Travelling expenses	300	Bills payable	1,350
Cash	210		
Stock (1.4.1980)	2,450		
Discount allowed	40		
Drawings	600		
	27,460		27,460

Adjustments:

a) The closing stock on 31.3.81 was Rs.4,200.

b) Write off Rs.80 as bad debts.

c) Create a provision for bad and doubtful debts at 5% on Sundry debtors.

d) Rent outstanding Rs.120.

(Answer: G.P. Rs. 4,470; N.P Rs. 2,595; B/s Rs. 14,285)

33. The following are the balances extracted from the books of Ganesh as on 31.3.1999. Prepare Trading and Profit and Loss account for the year ending 31.3.1999 and a Balance Sheet as on that date.

Trial Balance as on 31.3.1999

Debit Balances	Rs.	Credit Balances	Rs.
Drawings	4,000	Capital	20,000
Cash at Bank	1,700	Sales	16,000
Cash in Hand	6,500	Sundry Creditors	4,500
Wages	1,000		
Purchases	2,000		
Stock (1.4.1998)	6,000		
Buildings	10,000		
Sundry Debtors	4,400		
Bills receivable	2,900		
Rent	450		
Commission	250		
General expenses	800		
Furniture	500		
	40,500		40,500

The following adjustments are to be made:

a) Stock on 31.3.99 was Rs.4,000.

b) Interest on capital at 6% to be provided.

c) Interest on Drawings at 5% to be provided.

d) Wages yet to be paid Rs.100.

e) Rent prepaid Rs. 50.

(Answer: G.P. Rs.10,900; N.P. Rs. 8,450; B/s Rs.30,050)

34. From the following Trial Balance of Thiru. Rehman as on 31st March 1995, prepare Trading and Profit and Loss account and Balance sheet taking into account the adjustments.

Trial Balance

Debit Balances	Rs.	Credit Balances	Rs.
Land and Building	42,000	Capital	62,000
Machinery	20,000	Sales	98,780
Patents	7,500	Returns outwards	500
Stock (1.4.1994)	5,760	Sundry creditors	15,300
Sundry debtors	14,500		
Purchases	40,675		
Cash at Bank	3,170		
Return Inwards	680		
Wages	8,480		
Fuel & Power	4,730		
Carriage inwards	2,040		
Carriage outwards	3,200		
Salaries	15,000		
General expenses	8,245		
Insurance	600		
	1,76,580		1,76,580

Adjustments:

a) Stock on 31.3.1995 was Rs. 6,800.

b) Salary outstanding Rs.1,500

c) Insurance prepaid Rs.150.

d) Depreciate machinery @ 10% and patents @ 20%.

e) Create a provision of 2% on debtors for bad debts.

(Answer: G.P. Rs. 43,715; N.P. Rs. 11,530; B/s Rs. 90,330).

35. From the following Trial Balance of Tmt.Selvapriya as on 31st March 2005, prepare Trading and Profit and Loss account and Balance sheet taking into account the adjustments.

Trial Balance

Debit Balances	Rs.	Credit Balances	Rs.
Purchases	2,00,000	Capital	3,00.000
Salaries	10,000	Sales	2,50,000
Rent	7,500	Sundry creditors	1,05,000
Insurance premium	1,500		
Drawings	50,000		
Machinery	1,40,000		
Cash at bank	22,500		
Computers	1,25,000		
Furniture	50,000		
Cash	10,000		
Opening Stock	26,000		
Sundry debtors	12,500		
	6,55,000		6,55,000

Adjustments:

1. Closing stock as on 31.3.2005 Rs. 39,000
2. Rent outstanding Rs. 1,000
3. Provide interest on capital @ 10% and on Drawings @ 8%.

(Answer: G.P. Rs. 63,000; N.P. Rs. 17,000; B/s Rs. 3,99,000)

CHAPTER - 2

ACCOUNTS FROM INCOMPLETE RECORDS

(Single Entry)

Learning Objectives

After studying this chapter, you will be able to :

- understand the meaning, definition, features and limitations of single entry system.
- see the relationship between double entry and single entry.
- estimate the capital by preparing statement of affairs.
- determine the profit or loss by preparing the statement of Profit or Loss.

  prepare the final accounts.

Single Entry System is an incomplete, inaccurate, unscientific and unsystematic system of book keeping. The name of the system itself shows that the double aspects of business transactions are not recorded. This system makes use of Double Entry System partially. It maintains only personal and cash accounts. Real and nominal accounts are not maintained. It is a system, adopted by certain business houses which, for their convenience and more practical approach, reject the strict rules of the double entry system and maintain only the bare essential records. In other words, it is a defective double entry system manipulated to meet the needs of small trading concerns.

According to **Kohler** "Single Entry System is a system of book- keeping in which as a rule, only records of cash and personal accounts are maintained. It is always incomplete double entry varying with circumstances".

Thus, single entry actually refers to incomplete double entry system or the defective double entry system. It is not based on dual aspect concept. Hence it is incomplete, inaccurate and unscientific.

2.1 Features of Single Entry

1. **Suitable for sole traders and partnership firms:** The single entry system is suitable only for sole traders and partnership firms. Companies cannot keep books on single entry system because of legal provisions.

2. **Only personal accounts and cash accounts are kept:** In this system it is very common to keep only personal accounts and to avoid real and nominal accounts. It also keeps one cash book which mixes up business as well as private transactions.

3. **All transactions are not recorded:** All business transactions are not recorded in the books of account. Some of them are recorded in the books of accounts, certain transactions are noted in the diary and some of them are in the memories.

4. **Lack of uniformity:** This system lacks uniformity as it is a mere adjustment of double entry system, according to the convenience of the individual.

5. **Collection of information from original documents:** It is quite often seen that for information one has to depend on original vouchers. For example to know total purchases and sales, one has to depend on copies of invoices.

6. **Profit only an estimate:** Profit under this system is only an estimate.

7. **True financial position can not be ascertained:** True financial position can not be ascertained as Balance Sheet is not prepared due to the absence of nominal and real accounts.

8. **Not accepted by Tax Authoritiess:** Due to incompleteness, inaccuracy, and unsystematic nature, it is not accepted by tax authorities.

2.2 Limitations of Single Entry

1. **Incomplete and unscientific method:** This system is incomplete, because real and nominal accounts are not prepared and also due to the fact that the debit and credit aspect of all transactions are not recorded.

2. **Trial Balance can not be prepared:** Quite often this system does not record both the aspects of transactions, therefore, at the end of the year arithmetical accuracy of the books cannot be checked by preparing a trial balance.

3. **Performance of the business cannot be ascertained:** Trading, profit and loss account cannot be prepared and hence the gross profit, net profit and rate of net profit on sales cannot be known.

4. **True financial position cannot be ascertained:** It is very difficult to prepare balance sheet, so the true financial position cannot be ascertained.

5. **Comparison with previous years performance is not possible:** Due to incomplete information and non-availability of previous years' information, comparison between the current and previous years' performance cannot be made. Comparison is required to identify the areas of weakness and rectification.

6. **Unacceptable to tax authorities:** Tax authorities (income tax and sales tax) do not accept accounts prepared according to single entry system for computation of taxes.

7. **Difficulty in obtaining loan:** Accounts prepared according to this system are not accepted by banks and other money lending institutions, so it is very difficult to obtain loan.

8. **Difficult to locate frauds:** It is difficult to locate frauds under this system and so employees may become dishonest and negligent. It encourages misappropriation, fraud and carelessness.

9. **Difficult to determine the price of the business:** Due to the absence of true and reliable net profit or assets and liabilities, it is difficult to determine the price of the business at the time of its sale.

2.3 Differences between Double Entry System and Single Entry System

Basis of Distinction	Double Entry System	Single Entry System
1. Principle	For every debit there is a corresponding credit and vice versa	Debit and credits do not agree.
2. Recording of transaction	Debit and credit aspects of all transactions are recorded.	Debit and credit aspects of all transactions are not recorded.
3. Nature of accounts maintained	Maintains complete record of personal, real and nominal accounts.	An incomplete record. Only personal and cash accounts are maintained.
4. Trial Balance	Arithmatical accuracy of the records can be checked by preparing a Trial Balance	Trial Balance cannot be prepared.
5. Determination of profit or loss and financial position	A Profit and Loss Account and Balance sheet can be conveniently prepared since the book of accounts present a complete picture.	A Profit & Loss Account and Balance sheet cannot be conveniently prepared since the accounting records are incomplete.
6. Suitability	It is suitable for all types of traders.	It is suitable for only small traders.
7. Dependability	It is the only scientific system of keeping books of accounts.	It is not a system. It is incomplete and unscientific

8. Acceptability	Records are acceptable for the purpose of tax, loans etc.	Records are not acceptable for the purpose of tax claims, loans etc.
9. Internal check	Internal check is possible	Internal check is not possible.

2.4 Distinction between Statement of Affairs and Balance Sheet

Statement of affairs which looks like a balance sheet differs from the balance sheet in the following respects

Basis of Distinction	Balance Sheet	Statement of Affairs
1. Objectives	To Know the financial position of the business	To find out the capital of business
2. Accounting method	When accounting is maintained under double entry system, balance sheet is prepared	Statement of affairs is prepared when accounts are maintained under single entry system of accounting
3. Basis of preparation	It is prepared exclusively on the basis of ledger accounts	It is prepared on the basis of some ledger accounts and estimates.
4. Reliability	It is regarded as a reliable statement	It is not regarded as reliable.
5. Missing of Facts	Since both the aspects of all transactions are duly recorded, no chance for missing of facts.	There remains always a possibility for missing of facts, because the accounts are incomplete.

2.5 Methods of ascertaining profit or loss

When accounts are kept under single entry system, the following methods are adopted to find out profit or loss of the business.

1. Statement of affairs method or Net worth method or Capital comparison method
2. Conversion method

2.5.1 Statement of Affairs Method:

The following procedures are adopted to calculate profit.

Step 1 → **Ascertain opening capital:** A statement of affairs at the beginning of the year is prepared to find out the amount of capital in the beginning. A statement affairs is like a Balance sheet. The difference between assets and liabilities side represents “Opening Capital”.

Format of statement of affairs

Liabilities	Rs.	Assets	Rs.
Sundry Creditors	xxxx	Cash in Hand	xxxx
Bills Payable	xxxx	Cash at Bank	xxxx
Outstanding Expenses	xxxx	Sundry Debtors	xxxx
Bank Overdraft	xxxx	Bills Receivable	xxxx
Capital (Balancing figure)	xxxx	Stock in trade	xxxx
		Prepaid Expenses	xxxx
		Fixed Assets	xxxx
	xxxx		xxxx

Step 2 → **Ascertainment Closing Capital:** Prepare a statement of affairs (after all adjustments*) at the end of the accounting period, to ascertain closing capital.

Step 3 → **Add the amount of drawings** (whether in cash or in kind) to the closing capital.

Step 4 → **Deduct the amount of Additional Capital** introduced, from the above, to get Adjusted capital.

Step 5 → **Ascertainment profit or loss** by deducting opening capital from the adjusted closing capital.

Adjusted closing capital = Closing capital + Drawings - Additional capital introduced during the year.

*** Adjustments:** Depreciation, interest on capitals, interest on drawings, Provision for Bad debts etc.

Statement of Profit or Loss for the year________

		Rs.
	Closing Capital	x x x
Add:	Drawings	x x x
		x x x
Less:	Additional capital introduced	x x x
	Adjusted closing capital	x x x
Less:	Opening capital	x x x
Net Profit or loss for the year		x x x

Note : If adjusted closing capital is more than opening capital = Profit

If adjusted closing capital is less than opening capital = Loss

Illustration : 1

Find out profit or loss from the following information.

	Rs.
Opening Capital	4,00,000
Drawings	90,000
Closing Capital	5,00,000
Additional Capital during the year	30,000

Solution:

Statement of profit or loss

		Rs.
	Closing Capital	5,00,000
Add:	Drawings	90,000
		5,90,000
Less:	Additional Capital	30,000
	Adjuted closing capital	5,60,000
Less:	Opening capital	4,00,000
	Profit for the year	1,60,000

Illustration : 2

Calculate the missing information from the following.

	Rs.
Profit made during the year	4,800
Capital at the end	?
Additional Capital introduced during the year	4,000
Drawings	2,400
Capital in the beginning	9,600

Solution:

		Rs.
	Closing capital (Balancing figure)	16,000
Add:	Drawings	2,400
		18,400
Less:	Additional Capital	4,000
	Adjusted closing capital	14,400
Less:	Opening capital	9,600
	Profit made during the year	4,800

Ans: Capital at the end Rs.16,000.

Note:

Step 1 → Add Profit of Rs.4,800 with opening capital Rs.9,600 = Adjusted closing capital Rs.14,400.

Step 2 → Add Additional capital of Rs.4,000 with Adjusted closing capital Rs.14,400 = Rs.18,400

Step 3 → Deduct drawings Rs.2,400 from the total amount arrived (Step 2) Rs. 18,400 = Closing capital Rs.16,000.

Illustration : 3

Mr.Suresh started business with Rs.2,00,000 on 1st April 2003. His books are kept under single entry. On 31st March, 2004 his position was as under:

Liabilities	Rs.	Assets	Rs.
Sundry Creditors	40,000	Cash in Hand	6,000
Bills Payable	5,000	Cash at Bank	10,000
Outstanding creditors	7,500	Furniture	30,000
		Plant & Machinery	1,00,000
		Sundry Debtors	50,000
		Stock	90,000
		Bills Receivable	15,000

Ascertain the profit or loss made by Mr.Suresh for the year ended 31st March 2004.

Solution:

Calculation of closing capital:

Statement of affairs of Mr.Suresh as on 31.3.2004

Liabilities	Rs.	Assets	Rs.
Sundry creditors	40,000	Cash in hand	6,000
Bills payable	5,000	Cash at Bank	10,000
Outstanding creditors	7,500	Furniture	30,000
		Plant & Machinery	1,00,000
		Sundry Debtors	50,000
		Stock	90,000
Closing Capital (Balancing Figure)	2,48,500	Bills receivable	15,000
	3,01,000		**3,01,000**

Statement of profit or loss for the year ended 31.3.2004

	Rs.
Closing capital	2,48,500
Less: Opening capital	2,00,000
Profit for the year	48,500

Illustration : 4

Prakash keeps his books by 'Single Entry System'. His position on 1.4.2003 and 31.3.2004 was as follows

	1.4.2003 Rs.	**31.3.2004 Rs.**
Cash	500	6,000
Bank Balance	10,000	15,000
Stock	7,000	10,000
Sundry Debtors	30,000	40,000
Furniture	6,000	6,000
Sundry Creditors	6,000	12,000

He introduced an additional capital of Rs.8,000 during the financial year. He withdrew Rs.14,000 for domestic purpose. Find out the profit for the year ended 31.3.2004.

Solution:

i) Calculation of opening capital:

Statement of affairs of Mr.Prakash as on 1.4.2003

Liabilities	Rs.	Assets	Rs.
Sundry creditors	6,000	Cash	500
		Bank Balance	10,000
		Stock	7,000
		Sundry Debtors	30,000
		Furniture	6,000
Opening Capital (Balancing figure)	47,500		
	53,500		53,500

i) Calculation of closing capital:

Statement of affairs of Mr.Prakash as on 31.3.2004

Liabilities	Rs.	Assets	Rs.
Sundry creditors	12,000	Cash	6,000
		Bank Balance	15,000
		Stock	10,000
		Sundry Debtors	40,000
		Furniture	6,000
Closing capital (Balancing figure)	65,000		
	77,000		77,000

Statement of Profit or Loss for the period ended 31.3.2004

		Rs.
	Closing capital	65,000
Add:	Drawings	14,000
		79,000
Less:	Additional Capital	8,000
	Adjusted closing capital	71,000
Less:	Opening capital	47,500
	Profit for the year 2003-2004	23,500

Illustration : 5

Mrs. Vanitha keeps her books on singly entry basis. Find out the profit or loss made for the period ending 31.3.2004.

Assets & Liabilities	**1.4.2003** **Rs.**	**31.3.2004** **Rs.**
Bank Balance	3,500 (Cr.)	4,500 (Dr.)
Cash on hand	200	300
Stock	3,000	4,000
Sundry Debtors	8,500	7,600
Plant	20,000	20,000
Furniture	10,000	10,000
Sundry Creditors	15,000	18,000

Mrs.Vanitha had withdrawn Rs.10,000 for her personal use and had introduced fresh capital of Rs.4,000. A provision of 5% on debtors is necessary. Write off depreciation on plant at 10% and furniture at 15%.

Solution:

i) Calculation of Opening Capital:

Statement of affairs of Mrs.Vanitha as on 1.4.2003

Liabilities	Rs.	Assets	Rs.
Bank Balance (O/d)	3,500	Cash on hand	200
Sundry Creditors	15,000	Stock	3,000
		Sundry Debtors	8,500
		Plant	20,000
Opening capital	23,200	Furnitue	10,000
(Balancing figure)			
	41,700		41,700

ii) Calculation of closing capital:

Statement of affairs of Mrs.Vanitha as on 31.3.2004

Liabilities	Rs.	Rs.	Assets	Rs.	Rs.
Sundry creditors		18,000	Bank balance		4,500
			Cash on hand		300
			Stock		4,000
			Sundry Debtors	7,600	
			Less: Provision	380	7,220
			Plant	20,000	
Closing capital		24,520	Less: Depreciation	2,000	18,000
(Balanceing figure)			Furniture	10,000	
			Less: Depreciation	1,500	8,500
		42,520			42,520

Statement of Profit or Loss for the period ended 31.3.2004

	Rs.
Closing capital	24,520
Add: Drawings	10,000
	34,520
Less: Additional Capital	4,000
Adjusted closing capital	30,520
Less: Opening capital	23,200
Profit made during the year	7,320

Illustration 6:

Ram and Laxman are equal partners in a business in which the books are kept by single entry. On 1.4.2004 their position was as under:

Liabilities	Rs.	Assets	Rs.
Capital accounts:		Cash in hand	5,000
Ram 2,50,000		Cash at Bank	15,000
Laxman 2,50,000	5,00,000	Bills receivable	30,000
Bills payable	20,000	Stock	1,00,000
Sundry Creditors	30,000	Sundry Debtors	25,000
		Furniture	1,25,000
		Plant & Machinery	2,50,000
	5,50,000		5,50,000

On 31.3.2005 their position was as under:

	Rs.
Cash in hand	2,000
Sundry Creditors	35,000
Sundry Debtors	30,000
Bills receivable	26,000
Cash at Bank	10,000
Stock	1,10,000
Bills payable	10,000

Plant & Machinery and furniture are to be depreciated by 10%.

Drawings: Ram	30,000
Laxman	25,000

Ascertain the profit for the year ended 31.3.2005.

Solution:

Calculation of closing capital:

Statement of affairs of Ram & Laxman as on 31.3.2005

Liabilities	Rs.	Rs.	Assets	Rs.	Rs.
Sundry creditors		35,000	Cash in hand		2,000
Bills payable		10,000	Cash at bank		10,000
			Sundry debtors		30,000

			Bills receivable		26,000
			Stock		1,10,000
Closing capital		4,70,500	Plant & Machinery	2,50,000	
(Combined capital of			Less: Depreciation	25,000	2,25,000
of Ram & Laxman)			Furniture	1,25,000	
			Less: Depreciation	12,500	1,12,500
		5,15,500			5,15,500

Statement of profit or loss for the year ended 31.3.2005

			Rs.
	Combined Closing capital		4,70,500
Add:	Drawings		
	Ram	30,000	
	Laxman	25,000	55,000
	Adjusted closing capital		5,25,500
Less:	Combined opening capital		5,00,000
	Profit for the year		25,500

2.5.2 Conversion Method : (Conversion of single entry into double entry system)

If it is desired to calculate profit by preparing Trading and Profit and Loss account under single entry then it is called conversion method. Following steps are necessary to prepare Trading and Profit and Loss account and Balance Sheet from the incomplete information.

Step 1 → **Opening Statement of Affairs:** Prepare statement of affairs in the beginning so as to calculate capital in the beginning.

Step 2 → **Other Accounts:** Then prepare (i) Total debtors account, and (ii) Total Creditors account, to find out credit sales, credit purchases, creditors or debtors balance either in the beginning or at the end.

Step 3 → **Total sales and total purchase:** After preparing these accounts, calculate

(1) Total sales, by adding cash sales and credit sales, and

(2) Total purchases by adding cash purchases and credit purchases.

Step 4 → **Final Account:** Now prepare Trading, Profit and Loss account and Balance Sheet.

Calculation of Missing Figures:

The information which is needed for preparing the final accounts is not directly available from the incomplete records. Hence, we need to find out such missing figures by preparing relevant accounts. Let us learn how such missing figures can be extracted from incomplete records by preparing the relevant accounts.

The important ones are discussed below:

1. Calculation of total purchases or creditors in the beginning or at the end of the year.
2. Calculation of total sales or debtors in the beginning or at the end of the year.

(i) Ascertainment of Total Purchases:

Total purchases are calculated by adding cash and credit purchases. Cash purchases, are given in Cash Book. Credit purchases are calculated by preparing total creditors account. The specimen of Total Creditors Account is given below:

Dr. **Total Creditors Account** **Cr.**

Particulars	Amount Rs.	Particulars	Amount Rs.
To Cash paid	....	By Balance b/d (Opening Balance)	....
To Discount Received	....	By Credit Purchases (balancing figure)	....
To Purchases Returns	....		
To Balance c/d (Closing Balance)	....		
	....		....

Look at the following illustration and see how total purchases have been found out.

Illustration 7:

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

	Rs.
Cash purchases	17,000
Creditors as on April 1, 2002	8,000
Cash paid to creditors	31,000
Purchases return	1,000
Creditors as on March 31,2003	13,400

Solution:

Dr. **Total Creditors Account** **Cr.**

Particulars	Amount Rs.	Particulars	Amount Rs.
To Cash paid	31,000	By Balance b/d	8,000
To Purchases return	1,000	(Opening Balance)	
To Balance c/d		By Credit Purchases	
(Closing Balance)	13,400	(Balancing Figure)	37,400
	45,400		**45,400**

Total Purchases = Cash purchases + Credit purchases

= 17,000 + 37,400

= Rs. 54,400

(ii) Ascertainment of Total Sales:

Total sales are calculated by adding cash and credit sales. Cash sales are given in cash book. For ascertaining the amount of credit sales, the total debtors account should be prepared. The specimen of total debtors account is given below:

Dr. **Total Debtors Account** **Cr.**

Particulars	Amount Rs.	Particulars	Amount Rs.
To Balance b/d (Op.Bal.)	………	By Cash received	………
To Creidt Sales (Bal.Fig.)	………	By Discount Allowed	………
		By Sales Returns	………
		By Balance c/d (Clo.Bal)	………
	………		………

Illustration 8:

From the following facts you are required to calculate total sales made during the period:

	Rs.		Rs.
Sundry Debtors as on April 1, 2002	20,400	Sundry Debtors as on March 31,2003	27,600
Cash received from Sundry Debtors	60,800	Cash Sales	56,800
Sales Return	5,400		

Dr. **Total Debtors Account** **Cr.**

Particulars	Amount Rs.	Particulars	Amount Rs.
To Balance b/d (Op.Bal.)	20,400	By Cash received	60,800
To Credit Sales (Bal.Fig.)	73,400	By Sales Return	5,400
		By Balance c/d (Clo.Bal.)	27,600
	93,800		93,800

Total Sales = Cash Sales + Credit Sales

= Rs. 56,800 + Rs. 73,400

= Rs. 1,30,200

(iii) Ascertainment of balances of sundry debtors and sundry creditors:

If credit sales and credit purchases are given, the opening or closing balances of debtors and/or creditors can be ascertained by preparing total debtors account and total creditors accounts.

Illustration : 9

From the following particulars, calculate closing balances Debtors and Creditors:

	Rs.
Sundry Debtors as on 1.4.2001	28,680
Sundry Creditors as on 1.4.2001	41,810
Credit purchases	1,51,400
Credit sales	1,65,900
Discount earned	5,200
Discount allowed	4,800
Return outwards	7,440
Return inwards	6,444
Cash received from debtors	1,50,536
Cash paid to creditors	1,43,765

Solution :

Dr. **Total Debtors Account** **Cr.**

Particulars	Amount Rs.	Particulars	Amount Rs.
To Balanced b/d (1.4.2001)	28,680	By Return inwards	6,444

To Credit Sales	1,65,900	By Cash received	1,50,536
		By Discount allowed	4,800
		By Balance c/d	32,800
		(Balancing Figure)	
	1,94,580		1,94,580
To Balance b/d	32,800		

Dr. **Total Creditors Account** **Cr.**

Particulars	Amount Rs.	Particulars	Amount Rs.
To Return outwards	7,440	By Balance b/d (1.4.2001)	41,810
To Cash paid	1,43,765	By Credit Purchases	1,51,400
To Discount received	5,200		
To Balance c/d			
(Balancing figures)	36,805		
	1,93,210		1,93,210
		By Balance b/d	36,805

Illustration : 10

From the following details, find out Credit Sales for the year.

	Rs.
Opening balance of Sundry Debtors	30,000
Cash received during the year	2,05,000
Closing balance of Sundry debtors	48,000
Discount allowed	13,000
Goods returned by Customers	14,000

Solution:

Dr. **Total Debtors Account** **Cr.**

Particulars	Rs.	Particulars	Rs.
To Balance b/d	30,000	By Cash received	2,05,000
To Credit sales	2,50,000	By Discount allowed	13,000
(Balancing figure)		By Sales Return	14,000
		By Balance c/d	48,000
	2,80,000		2,80,000

Illustration : 11

From the following details find out Credit Purchases.

	Rs.
Opening balance of Sundry Creditors	50,000
Closing balance of Sundry Creditors	60,000
Cash paid	2,65,000
Discount received	15,000
Purchase returns	15,000

Solution:

Dr. **Total Creditors Account** **Cr.**

Particulars	Rs.	Particulars	Rs.
To Cash paid	2,65,000	By Balance c/d	50,000
To Discount received	15,000	By Credit Purchases	3,05,000
To Purchase return	15,000	(Balancing figure)	
To Balance c/d	60,000		
	3,55,000		3,55,000

Illustration : 12

Find out total purchases and total sales from the following details by making necessary accounts:

	Rs.
Opening balance of Sundry debtors	50,000
Opening balance of Sundry creditors	30,000
Cash collected from Sundry debtors	3,00,000
Discount received	1,500
Cash Paid to Sundry creditors	20,000
Discount allowed	5,000
Return inwards	6,000
Return outwards	8,000
Closing balance of Sundry debtors	35,000
Closing balance of Sundry creditors	25,000
Cash Purchases	12,000
Cash Sales	24,000

Solution:

i) Calculation of Credit Sales

Dr. **Total Debtors Account** **Cr.**

Particulars	Rs.	Particulars	Rs.
To Balance b/d	50,000	By Cash received	3,00,000
		By Discount allowed	5,000
To Credit Sales	2,96,000	By Returns Inwards	6,000
(Balancing figure)		By Balance c/d	35,000
	3,46,000		3,46,000

ii) Calculation of Credit Purchases

Dr. **Total Creditors Account** **Cr.**

Particulars	Rs.	Particulars	Rs.
To Discount received	1,500	By Balance b/d	30,000
To Cash paid	20,000		
To Return outwards	8,000		
To Balance c/d	25,000	By Credit Purchases	24,500
		(Balancing figure)	
	54,500		54,500

Total Purchases	=	Cash purchases + Credit Purchases
	=	Rs. 12,000 + Rs. 24,500
	=	Rs. 36,500
Total Sales	=	Cash sales + Credit sales
	=	Rs. 24,000 + Rs. 2,96,000
	=	Rs. 3,20,000

Illustration : 13

Mr.James commenced business on 1.4.2004 with a Capital of Rs.75,000. He immediately bought furniture for Rs.12,000. During the year, he borrowed Rs.15,000 from his wife as loan. He has withdrawn Rs.21,600 for his family expenses. From the following particulars you are required to prepare Trading and Profit & Loss A/c and Balance Sheet as on 31.3.2005.

	Rs.
Cash received from Sundry debtors	1,21,000
Cash paid to Sundry creditors	1,75,000
Cash Sales	1,00,000

Cash Purchases	40,000
Carriage inwards	4,500
Discount allowed to Sundry debtors	4,000
Salaries	5,000
Office Expenses	4,000
Advertisement	5,000
Closing balance of Sundry debtors	75,000
Closing balance of Sundry creditors	50,000
Closing Stock	35,000
Closing cash balance	43,900

Provide 10% depreciation on furnitures

Solution:

i) Calculation of Credit Sales

Dr. Total Debtors Account Cr.

Particulars	Rs.	Particulars	Rs.
To Balance b/d	—	By Cash received	1,21,000
		By Discount allowed	4,000
To Credit Sales	2,00,000		
(Balancing figure)		By Balance c/d	75,000
	2,00,000		2,00,000

ii) Calculation of Credit Purchases

Dr. Total Creditors Account Cr.

Particulars	Rs.	Particulars	Rs.
To Cash paid	1,75,000	By Balance b/d	—
To Balance c/d	50,000	By Credit Purchases (Balancing figure)	2,25,000
	2,25,000		2,25,000

Trading and Profit and Loss Account

Dr of Mr.James for the year ended 31.3.2005 Cr

Particulars	Rs.	Rs.	Particulars	Rs.	Rs.
To Opening Stock		—	By Sales		
To Purchases:			Cash	1,00,000	

Cash	40,000		Credit	2,00,000	
Credit	2,25,000				3,00,000
		2,65,000			
To Carriage inwards		4,500	By Closing Stock		35,000
To Gross Profit c/d		65,500			
		3,35,000			3,35,000
To Discount allowed		4,000	By Gross Profit b/d		65,500
To Salaries		5,000			
To Office expenses		4,000			
To Advertisement		5,000			
To Depreciation on furniture		1,200			
To Net Profit		46,300			
(transferred to Capital A/c)					
		65,500			65,500

Balance Sheet of Mr.James as on 31.3.2005

Liabilities	Rs.	Rs.	Assets	Rs.	Rs.
Capital	75,000		Furniture	12,000	
Add: Net Profit	46,300		Less: Depreciation	1,200	10,800
	1,21,300				
Less: Drawings	21,600	99,700	Sundry Debtors		75,000
Loan from wife		15,000	Closing Stock		35,000
Sundry Creditors		50,000	Cash		43,900
		1,64,700			1,64,700

Illustration : 14

Mrs.Malathy maintained her account books on single entry system. On 1.4.2003 her capital was Rs.2,50,000.

Additional information:

	Rs.
Opening stock	1,25,000
Cash received from Sundry debtors	25,000
Cash sales	1,00,000
Cash paid to Sundry creditors	30,000

Opening Sundry debtors	20,000
Opening Sundry creditors	91,500
Business expenses	60,400
Free hold premises (31.3.2004)	2,00,000
Furniture (31.3.2004)	3,600
Closing stock	1,30,000
Closing Sundry debtors	40,000
Closing Sundry creditors	1,00,000
Closing cash balance	27,500

Prepare trading and profit & loss account for the year ended 31.03.2004 and balance sheet as on that date.

Solution:

i) Calculation of credit sales:

Dr. **Total Debtors Account** **Cr.**

Particulars	Rs.	Particulars	Rs.
To Balance b/d	20,000	By Cash received	25,000
To Credit sales (Balancing figure)	45,000	By Balance c/d	40,000
	65,000		65,000

ii) Calculation of credit purchases:

Dr. **Total Creditors Account** **Cr.**

Particulars	Rs.	Particulars	Rs.
To Cash paid	30,000	By Balance b/d	91,500
To Balance c/d	1,00,000	By Credit Purchases (Balancing figure)	38,500
	1,30,000		1,30,000

Trading and Profit & Loss Account of Mrs.Malathy

Dr **for the year ended 31.3.2004** **Cr**

Particulars	Rs.	Particulars		Rs.
To Opening Stock	1,25,000	By Sales:		
To Purchases – Credit	38,500	Cash	1,00,000	

To Gross Profit c/d	1,11,500	Credit 45,000	1,45,000
		By Closing STock	1,30,000
	2,75,000		2,75,000
To Business expenses	60,400	By Gross Profit b/d	1,11,500
To Net Profit	51,100		
(transferred to Capital A/c)			
	1,11,500		1,11,500

Balance Sheet of Mrs.Malathy as on 31.3.2004

Liabilities	Rs.	Rs.	Assets	Rs.	Rs.
Capital	2,50,000		Free hold premises		2,00,000
Add: Net Profit	51,100		Furniture		3,600
		3,01,100	Closing stock		1,30,000
Sundry Creditors		1,00,000	Sundry Debtors		40,000
			Cash in hand		27,500
		4,01,100			4,01,100

Illustration 15:

From the following details, prepare Trading and Profit & Loss account for the period ended 31.3.2004 and a Balance sheet on that date.

	As on 1.4.2003	As on 31.3.2004
Stock	50,000	25,000
Sundry Debtors	1,25,000	1,75,000
Cash	12,500	20,000
Furniture	5,000	5,000
Sundry Creditors	75,000	87,500

Other Details:

	Rs.
Drawings	20,000
Discount received	7,500
Discount allowed	5,000
Sundry expenses	17,500
Cash paid to creditors	2,25,000

Cash received from debtors	2,67,500
Sales return	7,500
Purchase return	2,500
Cash sales	2,500

Solution:

i) Calculation of opening capital:

Statement of affairs as on 1.4.2003

Liabilities	Rs.	Assets	Rs.
Sundry Creditors	75,000	Stock	50,000
		Sundry Debtors	1,25,000
		Cash	12,500
Opening capital	1,17,500	Furniture	5,000
(Balancing figure)			
	1,92,500		1,92,500

ii) Calculation of Credit Sales:

Dr. **Total Debtors Account** **Cr.**

Particulars	Rs.	Particulars	Rs.
To Balance b/d	1,25,000	By Discount allowed	5,000
To Credit sales	3,30,000	By Cash received	2,67,500
(Balancing figure)		By Sales returns	7,500
		By Balance c/d	1,75,000
	4,55,000		4,55,000

iii) Calculation of Credit Purchases:

Dr. **Total Creditors Account** **Cr.**

Particulars	Rs.	Particulars	Rs.
To Discount received	7,500	By Balance b/d	75,000
To Cash paid	2,25,000	By Credit purchases	2,47,500
To Purchases return	2,500	(Balancing figure)	
To Balance c/d	87,500		
	3,22,500		3,22,500

Trading and Profit and Loss Account

Dr **for the year ended 31.3.2004** **Cr**

Particulars	Rs.	Rs.	Particulars	Rs.	Rs.
To Opening Stock		50,000	By Sales		
To Purchases:	2,47,500		Cash 2,500		
Less: Purchase			Credit 3,30,000		
Returns	2,500				
		2,45,000		3,32,500	
To Gross Profit c/d		55,000	Less: Sales		
			Returns	7,500	3,25,000
			By Closing Stock		25,000
		3,50,000			3,50,000
To Discount allowed		5,000	By Gross Profit b/d		55,000
To Sundry expeneses		17,500	By Discount received		7,500
To Net Profit		40,000			
(transferred to Capital A/c)					
		62,500			62,500

Balance Sheet as on 31.3.2004

Liabilities	Rs.	Rs.	Assets	Rs.	Rs.
Capital	1,17,500		Furniture		5,000
Add: Net Profit	40,000		Sundry Debtors		1,75,000
	1,57,500		Closing stock		25,000
Less: Drawings	20,000		Cash		20,000
		1,37,500			
Sundry Creditors		87,500			
		2,25,000			2,25,000

QUESTIONS

I. Objective type:

a) Fill in the blanks:

1. Incomplete records are those records which are not kept under _______ system.
2. Statement of affairs method is also called as _______ method.
3. _______ capital can be found by preparing a statement of affairs at the beginning of the year.
4. A statement of affairs resembles a _______.
5. Closing capital can be found by preparing a statement affairs at the _______ of the year.
6. In _______ system, only personal and cash accounts are opened.
7. Credit purchase can be ascertained as the balancing figure in the _______.
8. The excess of assets over liabilities is _______.
9. The total assets of a proprietor are Rs.5,00,000. His liabilities Rs.3,50,000. Then his capital in the business is _______.
10. A firm has assets worth Rs.60,000 and capital Rs.45,000. Then it's liabilities is _______.

(***Answers:*** 1) Double Entry; 2) Net worth; 3) Opening; 4) Balance Sheet; 5) end; 6) Single entry; 7) Total creditors A/c.; 8) Capital; 9) Rs. 1,50,000; 10) Rs.15,000)

b) Choose the correct answer:

1. Under the networth method the basis for ascertaining the profit is
   a) the difference between the capital on two dates.
   b) the difference between the liabilities on two dates.
   c) the difference between the gross assets on two dates
2. Incomplete records are generally used by
   a) Small traders   b) Company   c) Government
3. Credit sales is obtained from
   a) Bills Receivable account   b) Total debtors account
   c) Total creditors account

4. Single Entry System is
   a) a scientific method
   b) an Incomplete Double Entry System
   c) None of the above
5. The capital of a business is ascertained by preparing
   a) Trading account b) Statement of profit or loss
   c) Statement of affairs

(***Answers:*** 1.(a); 2.(a); 3.(b); 4. (b); 5.(c))

II. Other Questions :

1. What is the meaning for incomplete records?
2. Define Single Entry System.
3. What are the features of Single Entry?
4. What are the limitations of Single Entry System?
5. What is networth method?
6. What is conversion method?
7. What is statement of affairs?
8. What are the differences between single entry and Double Entry?
9. Mention the procedure to calculate profit by statement of affairs method.
10. Mention the procedure to calculate profit by conversion method.

III. Problems:

Statement of Affairs method:

1. What shall be the profits of the concern if:

Opening capital	Rs. 1,60,000
Closing capital	Rs. 1,80,000
Drawings	Rs. 36,000
Additional Capital	Rs. 10,000

(Answer: Rs.46,000)

2. Calculate the missing information

Closing capital	Rs. 32,000
Drawings	Rs. 4,800

Additional Capital	Rs. 8,000
Profit made during the year	Rs. 9,600

(Answer: Opening capital Rs.19,200)

3. Calculate the missing information when there is no drawings:

Capital at the end	Rs. 91,000
Capital in the beginning	Rs. 35,000
Profit made during the year	Rs. 14,000

(Answer: Capital introduced Rs.42,000)

4. Calculate the missing information:

Closing capital	Rs. 1,63,800
Additional Capital	Rs. 42,300
Drawings	Rs. 25,200
Loss	Rs. 12,600

(Answer: Opening Capital Rs.1,59,300)

5. Mr.Rajesh maintains his books on single entry system. He gives you the following information.

	Rs.
Capital as on 1.4.2003	4,80,000
Capital as on 31.3.2004	5,40,000
Drawings during the financial year	1,50,000
Capital introduced during the financial year	90,000

You are required to calculate profit or loss made by Mr.Rajesh during 2003 - 04.

(Answer: Profit Rs. 1,20,000)

6. Calculate the missing information:

	Rs.
Capital in the beginning	24,000
Profits made during the year	9,000
Capital introduced during the year	12,000
Capital at the end	39,000

(Answer: Drawings Rs.6,000)

7. Calculate the missing information:

Drawings	Rs.	50,000
Additional Capital	Rs.	10,000
Opening Capital	Rs.	1,00,000
Profit made during the year	Rs.	25,000

(Answer: Closing capital Rs.85,000)

8. Find out the profit of the business for the year 1996 from the particulars given below:

	Rs.
Capital on 1.4.1996	30,000
Capital introduced during 1996	6,000
Capital as on 31.3.1997	42,000
Drawings	3,000

(Answer: Profit Rs.9,000 - October 2000)

9. Calculate the missing figure:

	Rs.
Profit made during the year	2,500
Capital at the end	6,000
Capital introduced during the year	2,000
Drawings	1,200
Capital at the beginning	?

(Answer: Rs.2,700 - Oct. 2001)

10. Calculate the missing figure:

	Rs.
Capital at the beginning	15,000
Profits made during the year	8,000
Capital at the end	20,000
Drawings	?

(Answer: Rs.3,000 - March 2002)

11. Mrs. Sheela keeps her books by single entry. She started business on 1st April 2002 with Rs. 3,00,000. On 31st March 2003 her position was as under:

	Rs.
Cash in hand	8,000
Sundry Creditors	50,000
Cash at Bank	20,000
Bills payable	10,000
Furniture	40,000
Outstanding expenses	8,000
Plant	2,00,000
Sundry Debtors	1,50,000
Stock	1,50,000
Bills Receivable	15,000

Ascertain the profit or loss made by Mrs.Sheela during 2002 – 03.

(Answer: Profit Rs. 2,15,000)

12. Mrs.Revathi started business with Rs.1,20,000 as capital on 1.4.2003. During the year she has withdrawn at the rate of Rs.1,000 per month. She introduced Rs.20,000 as additional capital. Her position on 31.3.2004 was as follows:

	Rs.
Bank balance	8,000
Stock	80,000
Sundry Debtors	50,000
Furniture	2,500
Cash in hand	2,000
Sundry Creditors	25,000
Expenses outstanding	1,000

She keeps her books under single entry system. Determine her profit or loss for the year 2003-04.

(Answer: Loss Rs.11,500)

13. Mr.Murali keeps his books under single entry system. Assets and liabilities on 31.3.2002 and 31.3.2003 stood as follows:

	31.3.2002 Rs.	31.3.2003 Rs.
Sundry Creditors	15,000	30,000
Furniture	15,000	15,000
Sundry Debtors	75,000	1,00,000
Stock	35,000	50,000
Cash Balance	5,000	60,000

He introduced an additional capital of Rs.15,000 during the year. He withdrew Rs.35,000 for domestic purpose. Find out the profit or loss for 2002-03.

(Answer: Profit Rs.1,00,000)

14. The balances appear in Bharanidharans' books which are kept on single entry basis:

	1st April 2000 Rs.	31st March 2001 Rs.
Furniture	2,000	2,000
Stock	5,000	6,000
Sundry Debtors	6,000	4,000
Cash	10,000	20,000
Sundry Creditors	2,000	3,500
Bills receivable	1,000	500
Loan (Dr)	—	1,000
Investment	—	4,000

His drawings during the year were Rs.2,000. Depreciate furniture by 10% and provide a reserve for bad and doubtful debts at 5% on Sundry debtors.

Prepare a statement showing profit for the year.

(Answer : Profit Rs.13,600 – Mar. 2002)

15. Vijayan maintains books on single entry. He gives you the following information:

	1st April, 2001 Rs.	31st March, 2002 Rs.
Cash in hand	4,000	6,000
Cash at Bank	2,000	4,000

Stock in trade	24,000	24,000
Furniture	6,000	10,000
Sundry debtors	20,000	25,000
Sundry creditors	10,000	14,000

He has taken Rs.4,000 from the business to meet his personal expenses. Depreciate furniture by 10% p.a.

Prepare a statement showing profit or loss for the year.

(June - 2002), (Answer: Profit Rs.12,000)

Hint: Depreciation is calculated for one year on opening balance and for the difference Rs.4,000 for six months.

16. A trader has not kept proper books of accounts. His position as on 31.3.2003 and 31.3.2004 was as follows:

	31.3.2003 Rs.	31.3.2004 Rs.
Cash at Bank	75,000	50,000
Cash in hand	5,000	10,000
Stock	5,00,000	3,25,000
Sundry Debtors	2,00,000	4,00,000
Furniture	50,000	50,000
Machinery	4,00,000	4,00,000
Sundry Creditors	6,00,000	7,00,000

During the year he introduced Rs.1,00,000 as additional capital and withdrew Rs.10,000 per month for domestic purpose. Depreciate furniture and machinery by 10% per year. Ascertain profit or loss for the year ended 31.3.2004.

(Answer: Loss Rs.1,20,000)

17. Vani and Veni were partners sharing profits and losses equally. The accounts are maintained on single entry system. On 31.3.2002 their position was as follows:

Liabilities	Rs.	Assets	Rs.
Sundry Creditors	1,00,000	Cash at Bank	40,000
Loan	40,000	Sundry Debtors	1,60,000
Capital:		Stock	40,000
Vani	80,000	Plant & Machinery	60,000
Veni	80,000		
	3,00,000		3,00,000

The position of the firm on 31.3.2003 was follows:

	Rs.
Sundry Creditors	1,20,000
Stock	80,000
Plant & Machinery	1,00,000
Sundry Debtors	1,50,000
Cash at Bank	60,000

Depreciate plant & Machinery by 10% p.a. Drawings: Vani Rs.10,000; Veni Rs.6,000.

Find out the profit or loss made during the year 2002-03.

(Answer: Profit Rs.1,18,000)

Conversion method:

18. From the following, find out credit sales:

	Rs.
Opening Sundry debtors	50,000
Cash received from Sundry debtors	80,000
Discount allowed to Sundry debtors	2,000
Sales Return	5,000
Closing Sundry debtors	75,000

(Answer: 1,12,000)

19. From the following details, calculate credit sales made during the year 2004.

	Rs.
Sundry Debtors (1.4.2004)	87,125
Sundry Debtors (31.3.2005)	76,500
Cash received from Sundry debtors	2,46,000
Sales return	18,500
Discount allowed	9,000

(Answer : Rs. 2,62,875)

20. Calculate Closing Sundry debtors :

	Rs.
Opening Sundry debtors	2,00,000
Credit Sales	7,00,000
Cash received from Sundry debtors	3,00,000
Returns inward	5,000

(Answer: Rs. 5,95,000)

21. From the following details, find out credit purchases:

	Rs.
Opening Sundry creditors	75,000
Closing Sundry creditors	90,000
Cash paid to Sundry creditors	22,500
Discount received	15,000
Purchased returns	7,500

(Answer: Rs. 60,000)

22. From the following details, calculate the Sundry debtors at the end.

	Rs.
Sundry Debtors (1.1.2000)	17,425
Credit sales	60,075
Cash received from Sundry Debtors	49,200
Sales Returns	3,700
Discount allowed	4,300
Cash sales	12,000

(Answer: Clo. Drs. Rs. 20,300)

23. Calculate the Sundry debtors at the end.

	Rs.
Opening Sundry Debtors	40,000
Total sales	1,60,000
Cash sales	20,000
Cash received from Sundry Debtors	78,000
Returns Inward	5,000

(Answer: Clo. Drs. Rs. 97,000)

24. From the following, find out Sundry creditors at the end.

	Rs.
Opening Sundry creditors	19,000
Cash paid to Sundry creditors	40,000
Discount received	1,000
Return outwards	4,800
Credit purchases	51,200

(Answer: Clo. Crs. Rs. 24,400)

25. Find out total purchases and total sales from the following details by preparing necessary accounts:

	Rs.
Opening Sundry debtors	1,00,000
Opening Sundry creditors	65,000
Cash received from Sundry debtors	5,90,000
Discount received	3,000
Cash paid to Sundry creditors	40,000
Discount allowed	5,000
Returns outward	10,000
Returns inward	6,000
Closing Sundry debtors	70,000
Closing Sundry creditors	50,000
Cash sales	50,000
Cash purchases	25,000

(Answer: Total Sales Rs. 6,21,000; Total Purchases Rs. 63,000)

26. From the following particulars calculate closing balance of Sundry debtors and Sundry creditors.

	Rs.
Sundry debtors as on 1.4.2002	30,000
Sundry creditors as on 1.4.2002	41,000
Credit purchases	1,50,000
Credit sales	1,70,000

Discount earned	5,000
Discount allowed	6,000
Purchase returns	7,500
Sales returns	6,500
Cash received from Sundry debtors	1,50,000
Cash paid to Sundry creditors	1,40,000

(Answer: Clo. Drs. Rs.37,500; Clo. Crs. Rs.38,500)

27. Mr.Kannan started business with Rs.2,62,500 on 1.4.2003. He bought furniture for Rs.42,000. He borrowed Rs.52,500 from bank. He had withdrawn for personal expenses Rs.75,600. From the details given below prepare Trading and Profit and Loss account and Balance Sheet on 31.4.2004.

	Rs.
Credit sales	7,00,000
Cash sales	3,50,000
Credit purchases	7,87,500
Cash purchases	1,40,000
Wages	15,750
Discount allowed	3,500
Salaries	17,500
Business expenses	14,000
Advertisement	17,500
Closing Sundry debtors	2,62,500
Closing Sundry creditors	1,75,000
Closing stock	1,22,500
Closing cash balance	1,64,150

Depreciation to be provided on furniture @ 10%.

(Answer: Cash receipts from Drs. Rs.4,34,000; Cash payments to Crs. Rs.6,12,500; G.P. Rs.2,29,250; N.P. Rs.1,72,550; B/s Rs.5,86,950)

28. Mrs.Pramila maintained her account books on single entry system. From the following information available in her records, prepare Trading, Profit and Loss account for the year ending 31.3.2003 and a Balance Sheet as on that date, depreciating machinery at 10% per annum.

Cash Book

Receipts	Rs.	Payments	Rs.
To Balance b/d	16,000	By (Cash) Purchases	28,000
To (Cash) Sales	80,000	By Sundry Creditors	40,000
To Sundry Debtors	60,000	By General Expenses	12,000
		By Wages	4,000
		By Drawings	16,000
		By Balance c/d	56,000
	1,56,000		1,56,000

Other Information:

	31.3.2002	31.3.2003
	Rs.	Rs.
Sundry Debtors	18,000	????
Sundry Creditors	28,800	????
Stock	20,000	32,000
Machinery	80,000	80,000
Furniture	6,000	6,000

Additional information:

Discount allowed	2,800	
Discount received		3,400
Credit Sales	68,800	
Credit purchases	28,200	

(Answer: Clo. Drs. Rs.24,000; Clo. Crs. Rs.13,600; Op. capital Rs.1,11,200; G.P Rs.1,00,600; N.P. Rs.81,200; B/s Rs.1,90,000)

29. From the following details, prepare Trading and Profit & Loss account and Balance Sheet for the year ended 31.3.04.

	As on 1.4.2003	As on 31.03.2004
	Rs.	Rs.
Sundry Stock	50,000	25,000
Sundry Debtors	1,25,000	1,75,000
Furniture	5,000	5,000

Cash	12,500	20,000
Sundry Creditors	75,000	87,500

Other Details:

Discount received	7,500
Discount allowed	5,000
Sundry expenses	15,000
Cash paid to Sundry creditors	2,25,000
Cash received from Sundry debtors	2,67,500
Drawings	20,000
Sales Returns	7,500
Purchase Returns	2,500

Charge depreciation on furniture @ 5%.

(Ans: Op. capital Rs.1,17,500; Cr. Sales Rs.3,30,000; Cr. Purchases Rs.2,47,500; G.P. Rs. 52,500; N.P. Rs.39,750; B/s Rs.2,24,750)

30. From the following information, prepare Trading and Profit and Loss account and a Balance Sheet as on 31.3.98.

	As on 1.4.1997	As on 31.3.1998
	Rs.	Rs.
Sundry creditors	37,500	43,750
Furniture	2,500	2,500
Cash	6,250	10,000
Sundry debtors	62,500	87,500
Stock	25,000	12,500

Other Details:	Rs.
Drawings	10,000
Discount received	3,750
Discount allowed	2,500
Cash received from Sundry debtors	1,35,000
Cash paid to creditors	1,12,500
Sales returns	3,750
Purchase returns	1,250

Sundry expenses paid	8,750
Charge depreciation on furniture	5%

(Ans: Op. Capital Rs.58,750; Cr. sales Rs.1,66,250; Cr. Purchase Rs.1,23,750; G.P. Rs.27,500; N. P. Rs. 19,875; B/s Rs.1,12,375)

31. The books of Mr.Ravishankar revealed the following information on 1.4.2000.

Liabilities	Rs.	Assets	Rs.
Capital	83,030	Goodwill	18,540
Sundry creditors	9,010	Furniture	14,010
		Sundry debtors	46,830
		Cash at bank	12,660
	92,040		92,040

Other information:

	Rs.
Cash received from Sundry debtors	2,12,460
Drawings	81,600
Salaries paid	18,300
Rent paid	9,450
Cash paid to Sundry creditors	90,360
Sundry expenses paid	3,840
Closing stock (31.3.2001)	32,000
Sundry debtors (31.3.2001)	56,700
Sundry creditors (31.3.2001)	16,000
Cash at bank (31.3.2001)	21,570

Prepare Trading account and Profit and Loss account and a Balance Sheet as on 31.3.2001.

(Ans: Cr. sales Rs. 2,22,330; Cr. purchases Rs. 97,350; G.P. Rs.1,56,980; N.P Rs. 1,25,390; B/s Rs.1,42,820)

CHAPTER - 3

DEPRECIATION ACCOUNTING

Learning Objectives

After studying this Chapter, you will be able to:

- *understand the meaning and definition of depreciation.*
- *recognise the reasons and causes for providing depreciation.*
- *identify various methods of depreciation.*
- *determine the profit or loss at the time of sale of asset.*
- *prepare asset account and depreciation account under straight line and written down value methods.*

All assets whose benefit is derived for a long period of time, usually more than one year period are called as **Fixed Assets.** These assets decrease in value year after year due to wear and tear or lapse of time. This reduction in value of Fixed Assets is called Depreciation.

Generally, the term 'depreciation' is used to denote decrease in value, but in accounting, this term is used to denote decrease in the book value of a fixed asset. Depreciation is the permanent and continuous decrease in the book value of a fixed asset due to use, effluxion of time, obsolescence, expiration of legal rights or any other cause.

For instance, a factory owner, owns a machinery worth Rs.1,00,000, may estimate the life of the machinery as five years. This means that the value of the asset is reducing every year. Hence, it is necessary to spread the cost over five years during which the benefit of the asset is derived. Thus depreciation Rs.20,000 (Rs.1,00,000 / 5 years) is to be treated as an expense, which is debited to Profit and Loss account.

3.1 DEFINITION

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

Carter defines depreciation as "the gradual and permanent decrease in the value of an asset from any cause".

According to ICMA (Institute of Cost and Management Accountants - London) Terminology "Depreciation is the diminution in intrinsic value of asset due to use and / lapse of time".

The above definitions reveal that when fixed assets are used in business to generate income, they lose their production capacity or earning capacity and at a particular point of time they render themselves useless. This reduction in the production capacity or earning capacity is termed as depreciation.

3.2 NEED FOR PROVIDING DEPRECIATION

The need for providing depreciation in accounting records arises due to any one or more of the following reasons.

1. To ascertain correct profit / loss

For proper matching of cost with revenues, it is necessary to charge depreciation against revenue in each accounting year, to calculate the correct net profit or net loss.

2. To present a true and fair view of the financial position

If the amount of depreciation is not provided on fixed assets in the books of account, the value of fixed assets will be shown at a higher value than it's real value in the balance sheet. As such it will not reflect the true and fair financial position of the business. Hence, to present a true and fair view of the financial position of the business, it is necessary that depreciation must be deducted from the book value of the assets in the balance sheet.

3. To ascertain the real cost of production

For ascertaining the real cost of production, it is necessary to provide depreciation.

4. To comply with legal requirements

As per Section 205(1) of the Companies Act 1956, it is compulsory for companies to provide depreciation on fixed assets before it declares dividend.

5. To replace assets

Depreciation is provided to replace the assets when it becomes useless.

3.3 CAUSES OF DEPRECIATION

Class of Depreciation

Internal

1. Wear and Tear
2. Disuse
3. Maintenance
4. Depletion

External

1. Obsolescence
2. Effluxion of time
3. Time factor

The causes of depreciation may be internal or external. The internal causes arise from operation of any cause natural to or inherent in the asset itself. External causes arise from the operation of forces outside the business. These are being discussed below:

I. Internal Causes

1. **Wear and tear:** Wear and tear is an important cause of depreciation in case of tangible fixed asset. It is due to use of the asset.
2. **Disuse:** When a machine is kept continuously idle, it becomes potentially less useful.
3. **Maintenance:** The value of machine deteriorates rapidly because of lack of proper maintenance.
4. **Depletion:** It refers to the physical deterioration by the exhaustion of natural resources eg., mines, quarries, oil wells etc.

II. External Causes

1. **Obsolescence:** The old asset will become obsolete (useless) due to new inventions, improved techniques and technological advancement.
2. **Effluxion of time:** When assets are exposed to forces of nature, like weather, wind, rain, etc., the value of such assets may decrease even if they are not put into any use.
3. **Time Factor:** Lease, copy-right, patents are acquired for a fixed period of time. On the expiry of the fixed period of time, the assets cease to exist.

3.4 TERMS USED FOR DEPRECIATION

1. **Amortization:** This refers to loss in the value of intangible assets such as goodwill, patents and preliminary expenses.
2. **Depletion:** Decrease in the value of mineral wealth such as coal, oil, iron ore, etc. is termed as depletion. The more we extract mineral wealth, the more they are depleted.
3. **Obsolescence:** When an asset becomes useless due to new inventions, improved techniques and technological advances, it is termed as obsolescence.

3.5 FACTORS DETERMINING THE AMOUNT OF DEPRECIATION

1. **Original cost of the asset** It implies the cost incurred on its acquisition, installation, commissioning and for additions or improvements thereof which are of capital nature
2. **Estimated life:** It implies the period over which an asset is expected to be used.
3. **Residual value :** It implies the value expected to be realised on its sale on the expiry of its useful life. This is otherwise known as **scrap value** or **turn-in value**.

3.6 METHODS OF CALCULATING DEPRECIATION

1. Straight line method or fixed instalment method.
2. Written down value method or diminishing balance method
3. Annuity method.
4. Depreciation Fund method.
5. Insurance Policy method.
6. Revaluation method

Let us discuss these methods in detail.

3.6.1 Straight Line Method or Fixed Instalment Method or Original Cost Method

Under this method, the same amount of depreciation is charged every year throughout the life of the asset. The amount and rate of depreciation is calculated as under.

1) Amount of depreciation

$$= \frac{\text{Total cost} - \text{Scrap value}}{\text{Estimated Life}}$$

2) Rate of depreciation

$$= \frac{\text{Amount of Depreciation}}{\text{Original Cost}} \times 100$$

Illustration : 1

A company purchased Machinery for Rs.1,00,000. Its installation costs amounted to Rs.10,000. It's estimated life is 5 years and the scrap value is Rs.5,000. Calculate the amount and rate of depreciation

Solution:

Total cost	=	Purchase Price + Installation Charges
	=	Rs.1,00,000 + Rs.10,000
	=	Rs. 1,10,000
Amount of depriciation	=	$\frac{\text{Total cost - Scrap value}}{\text{Estimated life}}$
	=	$\frac{\text{Rs.1,10,000-Rs.5,000}}{5}$
	=	$\frac{\text{Rs.1,05,000}}{5}$ = Rs.21,000

$$\text{Rate of depreciation} = \frac{\text{Amount of depreciation}}{\text{Original cost}} \times 100$$

$$= \frac{\text{Rs.}21{,}000}{\text{Rs.}1{,}10{,}000} \times 100$$

$$= 19.09\%$$

Note: Under straight line method, for each of the five years, the amount of depreciation to be charged will be Rs.21,000.

Merits:

1. **Simplicity:** It is very simple and easy to understand.
2. **Easy to calculate:** It is easy to calculate the amount and rate of depreciation.
3. **Assets can be completely written off:** Under this method, the book value of the asset becomes zero or equal to its scrap value at the expiry of its useful life.

Demerits:

The amount of depreciation is same in all the years, although the usefulness of the machine to the business is more in the initial years than in the later years.

3.6.2. Written Down Value Method or Diminishing Balance Method or Reducing Balance Method

Under this method, depreciation is charged at a fixed percentage each year on the reducing balance (i.e., cost less depreciation) of asset. The amount of depreciation goes on decreasing every year. For example, if the asset is purchased for Rs.1,00,000 and depreciation is to be charged at 10% p.a. on reducing balance method, then

Depreciation for the 1st year	=	10% on Rs.1,00,000, ie., Rs.10,000
Depreciation for the 2nd year	=	10% on Rs.90,000
		(Rs.1,00,000 – Rs.10,000)
	=	Rs. 9,000
Depreciation for the 3rd year	=	10% on Rs.81,000
		(Rs.90,000 - Rs.9,000)
	=	Rs.8,100 and so on.

Merits:

1. **Uniform effect on the Profit and Loss account of different years:** The total charge (i.e., depreciation plus repairs and renewals) remains almost uniform year after year, since in earlier years the amount of depreciation is more and the amount of repairs and renewals is less, whereas in later years the amount of depreciation is less and the amount of repairs and renewals is more.

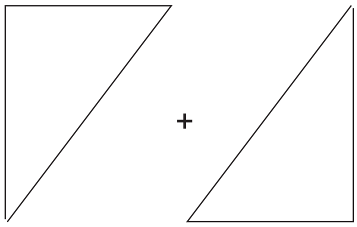
Depreciation Amount

Repairs & renewals amount

Ist Year

IInd Year

IIIrd Year, etc.



Ist Year

IInd Year

IIIrd Year, etc.

$\Big\}$ The total charge is more or less equal

2. **Recognised by the Income Tax authorities:** This method is recognised by the Income Tax authorities

3. **Logical Method:** It is a logical method as the depreciation is calculated on the diminished balance every year.

Demerits:

It is very difficult to determine the rate by which the value of asset could be written down to zero.

3.6.3 Annuity Method:

The annuity method considers that the business besides loosing the original cost of the asset in terms of depreciation and also looses interest. On the amount used for buying the asset. This is based on the assumption that the amount invested in the asset would have earned in case the same amount would have been invested in some other form of investment. The annual amount of depreciation is determined with the help of annuity table. This method is used to calculate depreciation amount on lease.

3.6.4 Depreciation Fund Method or Sinking Fund Method :

Under this method, funds are made available for the replacement of asset at the end of its useful life. The depreciation remains the same year after year and is charged to Profit and Loss account every year through the creation of depreciation fund. The amount of annual depreciation is invested in good securities bearing interest at a specified rate. The aggregate amount of interest and annual provision is invested every year. When the asset is completely written off or is to be replaced, the securities are sold and the amount so realised by selling securities is used to replace the old asset.

3.6.5 Insurance Policy Method:

According to this method, an Insurance policy is taken for the amount of the asset to be replaced. The amount of the policy is such that it is sufficient to replace the asset when it is worn out. A sum equal to the amount of depreciation is paid as premium every year. The amount goes on accumulating at a certain rate of interest and is received on maturity. The amount so received is used for the purchase of new asset, replacing the old one.

3.6.6 Revaluation Method:

Under this method, the assets like loose tools are revalued at the end of the accounting period and the same is compared with the value of the asset at the beginning of the year. The difference is considered as depreciation.

3.7 RECORDING DEPRECIATION

Depreciation is directly charged against the asset by debiting Depreciation account and crediting the Asset account. Depreciation account is closed by transferring to Profit and Loss account at the end of the year. The entries will be as under:

1) For the amount of depreciation to be provided at the end of the year:

Depreciation A/c .... Dr.	with the amount	}
To Asset A/c	of depreciation	

2) For transferring the amount of depreciation at the end of the year.

Profit and Loss A/c Dr.	with the amount	}
To Depreciation A/c	of depreciation transferred	

Asset Account will be shown at cost less depreciation i.e., written down value at the end of the year in the Balance sheet.

Illustration : 2

Raheem & Co. purchased a fixed asset on 1.4.2000 for Rs.2,50,000. Depreciation is to be provided @10% annually according to the Straight line method. The books are closed on 31st March every year.

Pass the necessary journal entries, prepare Fixed asset Account and Depreciation Account for the first three years.

Solution:

$$\text{Amount of Depreciation} = 2{,}50{,}000 \times \frac{10}{100}$$
$$= \text{Rs.}25{,}000$$

In the Books of Raheem & Co.

Journal Entries

Date	Particulars		L.F	Debit Rs.	Credit Rs.
2000 Apr 1	Fixed asset A/c	Dr		2,50,000	
	To Bank A/c				2,50,000
	(Fixed asset purchased)				
2001 Mar 31	Depreciation A/c	Dr		25,000	
	To Fixed asset A/c				25,000
	(Depreciation provided)				
”	Profit & Loss A/c	Dr		25,000	
	To Depreciation A/c				25,000
	(Depreciation transferred to Profit & Loss A/c)				
2002 Mar 31	Depreciation A/c	Dr		25,000	
	To Fixed asset A/c				25,000
	(Depreciation provided)				
”	Profit & Loss A/c	Dr		25,000	
	To Depreciation A/c				25,000
	(Depreciation transferred to Profit & Loss account)				
2003 Mar 31	Depreciation A/c	Dr		25,000	
	To Fixed asset A/c				25,000
	(Depreciation provided)				
”	Profits & Loss A/c	Dr		25,000	
	To Depreciation A/c				25,000
	(Depreciation transferred to Profit & Loss A/c)				

Ledger Accounts

Fixed Asset Account

Dr. **Cr.**

Date	Particulars	Rs.	Date	Particulars	Rs.
2000			2001		
Apr 1	To Bank A/c	2,50,000	Mar 31	By Depreciation A/c	25,000
			,,	By Balance c/d	2,25,000
		2,50,000			2,50,000
2001			2002		
Apr 1	To Balance b/d	2,25,000	Mar 31	By Depreciation A/c	25,000
			,,	By Balance c/d	2,00,000
		2,25,000			2,25,000
2002			2003		
Apr 1	To Balance b/d	2,00,000	Mar 31	By Depreciation A/c	25,000
			,,	By Balance c/d	1,75,000
		2,00,000			2,00,000
2003					
Apr 1	To Balance c/d	1,75,000			

Depreciation Account

Dr. **Cr.**

Date	Particulars	Rs.	Date	Particulars	Rs.
2001			2001		
Mar 31	To Fixed Asset A/c	25,000	Mar 31	By Profit & Loss A/c	25,000
		25,000			25,000
2002			2002		
Mar 31	To Fixed Asset b/d	25,000	Mar 31	By Profit & Loss A/c	25,000
		25,000			25,000
2003			2003		
Mar 31	To Fixed Asset b/d	25,000	Mar 31	By Profit & Loss A/c	25,000
		25,000			25,000

Illustration : 3

A Company purchased Machinery for Rs.50,000 on 1st April 2002. It is depreciated at 10% per annum on Written Down Value method. The accounting year ends on 31st March of every year.

Pass necessary Journal entries, prepare Machinery account and Depreciation account for three years.

Solution:

Journal Entries

Date	Particulars		L.F	Debit Rs.	Credit Rs.
2002 Apr 1	Machinery A/c	Dr		50,000	
	To Bank A/c				50,000
	(Machinery purchased)				
2003 Mar 31	Depreciation A/c	Dr		5,000	
	To Machinery A/c				5,000
	(Depreciation provided)				
”	Profit & Loss A/c	Dr		5,000	
	To Depreciation A/c				5,000
	(Depreciation provided)				
2004 Mar 31	Depreciation A/c	Dr		4,500	
	To Machinery A/c				4,500
	(Depreciation provided)				
”	Profit & Loss A/c	Dr		4,500	
	To Depreciation A/c				4,500
	(Depreciation transferred to Profit & Loss account)				
2005 Mar 31	Depreciation A/c	Dr		4,050	
	To Machinery A/c				4,050
	(Depreciation provided)				
”	Profits & Loss A/c	Dr		4,050	
	To Depreciation A/c				4,050
	(Depreciation transferred to Profit & Loss A/c)				

Ledger Accounts

Machinery Account

Date	Particulars	Rs.	Date	Particulars	Rs.
2002			2003		
Apr 1	To Bank A/c	50,000	Mar 31	By Depreciation A/c	5,000
			”	By Balance c/d	45,000
		50,000			50,000
2003			2004		
Apr 1	To Balance b/d	45,000	Mar 31	By Depreciation A/c	4,500
			”	By Balance c/d	40,500
		45,000			45,000
2004			2003		
Apr 1	To Balance b/d	40,500	Mar 31	By Depreciation A/c	4,050
				By Balance c/d	36,450
		40,500			40,500
2005					
Apr 1	To Balance b/d	36,450			

Depreciation Account

Dr. **Cr.**

Date	Particulars	Rs.	Date	Particulars	Rs.
2003			2003		
Mar 31	To Machinery A/c	5,000	Mar 31	By Profit & Loss A/c	5,000
		5,000			5,000
2004			2004		
Mar 31	To Machinery b/d	4,500	Mar 31	By Profit & Loss A/c	4,500
		4,500			4,500
2005			2005		
Mar 31	To Machinery b/d	4,050	Mar 31	By Profit & Loss A/c	4,050
		4,050			4,050

3.8 CALCULATION OF PROFIT OR LOSS ON SALE OF ASSET

Some times, a business may dispose an asset when it is worn out. In that case, it is advisable to find the profit or loss on sale of asset. This is done by comparing the selling price with the book value of the asset.

Book value = Cost Price less Total Depreciation provided till the date of sale

If the book value is less than theselling price, then it is Profit on Sale.

If the book value is more than the selling price, it is Loss on Sale.

Illustration : 4

Ram manufacturing company purchased on 1st April 2002, Machinery for Rs.1,00,000. After having used it for three years it was sold for Rs. 85,000. Depreciation is to be provided every year at the rate of 10% per annum on the fixed instalment method. Books are closed on 31st March every year. Find out the profit or loss on sale of machinery.

Calculation of Profit or Loss on Sale of Machinery

		Rs.
	Cost Price	1,00,000
Less:	Depreciation for 2002-03	10,000
		90,000
Less:	Depreciation for 2003-04	10,000
		80,000
Less:	Depreciation for 2004-05	10,000
	Book value on the date of sale	70,000

Selling price is Rs.85,000.

Book value on the date of sale is Rs. 70,000

As book value is less than selling price the difference is Profit.

= 85,000 – 70,000

∴ Profit on sale of machinery = Rs. 15,000.

Illustration : 5

Robert & Co. purchased a Machinery on 1st April 2002 for Rs.75,000. After having used it for three years it was sold for Rs.35,000. Depreciation is to be provided every year at the rate of 10% per annum on Diminishing balance method. Accounts are closed on 31st March every year. Find out the profit or loss on sale of machinery.

Calculation of Profit or Loss on sale of Machinery

		Rs.
	Cost Price	75,000
Less:	Depreciation for 2002-03	7,500
		67,500
Less:	Depreciation for 2003-04	6,750
		60,750
Less:	Depreciation for 2004-05	6,070
	Book value on the date of sale	54,675

Selling price = Rs.35,000

Book value on the date of sale = Rs. 54,675.

As book value is greater than selling price the difference loss.

= 54,675 – 35,000

∴ Loss on sale of Machinery = Rs.19,675.

3.9 ENTRIES FOR SALE OF ASSET

When the following entries are made:

1. Entry for sale

Bank A/c….	Dr.	With the amount of sale proceeds
To Asset A/c.		

2. Entry for depreciation provided during the year of sale.

Depreciation A/c….	Dr.	With the amount of depreciation
To Asset A/c.		provided during the year

Note : Depreciation is calculated on the date of sale which may be during the year or end of the year.

3. Entry for the transfer of profit on sale of asset.

Asset A/c….	Dr.	With the amount of profit
To Profit & Loss A/c.		on sale of asset.

4. Entry for the transfer of Loss on sale of asset

Profit & Loss A/c….	Dr.	With the amount of Loss
To Asset A/c.		on sale of asset.

a) Format of Fixed Asset Account when it is profit on sales

Fixed Asset Account

Dr. **Cr.**

Date	Particulars	Rs.	Date	Particulars	Rs.
Date on which sale is made	To Balance b/d	xxx	Date on which Sale is made	By Depreciation A/c	xxx
	To Profit & Loss A/c (Profit on Sales)	xxx		By Bank A/c	xxx
		xxx			xxx

b) Format of Fixed Asset Account when it is loss on sales

Fixed Asset Account

Dr. **Cr.**

Date	Particulars	Rs.	Date	Particulars	Rs.
Year Beginning	To Balance b/d	xxx	Date on which Sale is made	By Depreciation A/c	xxx
			,,	By Bank A/c	xxx
				By Profit & Loss A/c (Loss on sale)	xxx
		xxx			xxx

Note: The above format relates only to the year in which sales are made.

Illustration : 6

Deepak Manufacturing Company purchased on 1st April 2002, Machinery for Rs.2,90,000 and spent Rs.10,000 on it's installation. After having used it for three years it was sold for Rs.2,00,000. Depreciation is to be provided every year at the rate of 15% per annum on the Fixed Instalment method.

Pass the necessary journal entries, prepare machinery account and depreciation account for three years ends on 31st March every year.

Solution:

Calculation of profit or loss on sale of machinery

		Rs.
	Cost Price (2,90,000 + 10,000)	3,00,000
Less:	Depreciation for 2002-03 @ 15%	45,000
		2,55,000

Less:	Depreciation for 2003-04 @ 15%	45,000
		2,10,000
Less:	Depreciation for 2004-05 @ 15%	45,000
	Book value on the date of sale	1,65,000

As book value is less than selling price the difference is Profit.

= Rs.2,00,000 - 1,65,000

∴ Profit is Rs.35,000.

Journal Entries in the books of Deepak Manufacturing Company

Date	Particulars	L.F.	Debt Rs.	Credit Rs.
2002				
Apr 1	Machinary A/c Dr		3,00,000	
	To Bank A/c			3,00,000
	(Machinary Purchased and installation charges paid			
2003				
Mar 31	Depreciation A/c Dr		45,000	
	To Machinery A/c			45,000
	(Depreciation Provided)			
"	Profit & Loss A/c Dr		45,000	
	To Depreciation A/c			45,000
	(Depreciation transferred to Profit & Loss account)			
2004				
Mar 31	Depreciation A/c Dr		45,000	
	To Machinery A/c			45,000
	(Depreciation provided)			
"	Profit & Loss A/c Dr		45,000	
	To Depreciation A/c			45,000
	(Depreciation transferred to Profit and Loss account)			

2005				
Mar 31	Depreciation A/c Dr		45,000	
	To Machinery A/c			45,000
	(Depreciation provided)			
”	Profit & Loss A/c Dr		45,000	
	To depreciation A/c			45,000
	(Depreciation transferred to Profit & Loss account)			
Mar 31	Bank A/c Dr		2,00,000	
	To Machinery A/c			2,00,000
	(Machinery Sold)			
”	Machinery A/c Dr		35,000	
	To Profit & Loss A/c			35,000
	(Profit on sale of machinery)			

Ledger Account

Dr. **Machinery Account** **Cr.**

Date	Particulars	Rs.	Date	Particulars	Rs.
2002			2003		
Apr 1	To Bank A/c	3,00,000	Mar 31	By Depreciation A/c	45,000
			”	By Balance c/d	2,55,000
		3,00,000			3,00,000
2003			2004		
Apr 1	To Balance b/d	2,55,000	Mar 31	By Depreciation A/c	45,000
			”	By Balance c/d	2,10,000
		2,55,000			2,55,000
2004			2003		
Apr 1	To Balance b/d	2,10,000	Mar 31	By Depreciation A/c	45,000
Mar 31	To Profit & Loss A/c (Profit on sale)	35,000		By Balance c/d	2,00,000
		2,45,000			2,45,000

Depreciation Account

Dr. **Cr.**

Date	Particulars	Rs.	Date	Particulars	Rs.
2003			2003		
Mar 31	To Machinery A/c	45,000	Mar 31	By Profit & Loss A/c	45,000
		45,000			45,000
2004			2004		
Mar 31	To Machinery A/c	45,000	Mar 31	By Profit & Loss A/c	45,000
		45,000			45,000
2005			2005		
Mar 31	To Machinery A/c	45,000	Mar 31	By Profit & Loss A/c	45,000
		45,000			45,000

Illustration : 7

Machinery account showed a balance of Rs.80,000 on 1st April 2001. On 1st October 2003, another machinery was purchased for Rs.48,000. On 30th September 2003, a machinery which has book value Rs.80,000 on 1.4.2001 was sold for the Rs.48,000. Depreciation is to be provided at 10% per annum on Written Down Value Method. The accounting year ends on 31st March.

Prepare Machinery account and Depreciation account for three years.

Solution:

Calculation of Profit or Loss on Sale of Machinery

		Rs.
	Cost of Machinery (1.4.2001)	80,000
Less:	Depreciation for 2001-02	8,000
		72,000
Less:	Depreciation for 2002-03	7,200
		64,800
Less:	Depreciation till the date of sale (30.9.2003)	3,240
	Book value on the date of sale	61,560

As book value is greater than selling price the difference is loss.

= 61,560 — 48,000

∴ Loss = Rs. 13,560

Ledger Accounts

Dr. **Machinery Account** **Cr.**

Date	Particulars	Rs.	Date	Particulars	Rs.
2001			2002		
Apr 1	To Balance b/d	80,000	Mar 31	By Depreciation A/c	8,000
			”	By Balance c/d	72,000
		80,000			80,000
2002			2003		
Apr 1	To Balance b/d	72,000	Mar 31	By Depreciation A/c	7,200
			”	By Balance c/d	64,800
		72,000			72,000
2003			2003		
Apr 1	To Balance b/d	64,800	Sep 30	By Depreciation A/c	3,240
Oct 1	To Bank A/c	48,000		(for 6 months)	
			”	By Bank A/c	48,000
			”	By Profit & Loss A/c	
				(Loss on sale)	13,560
			”	By Balance c/d	
			2004		
			Mar 31	By Depreciation A/c	2,400
				(on new machine for 6 months)	
			”	By Balance c/d	45,600
		1,12,800			1,12,800
2004					
Apr 1	To Balance b/d	45,600			

Depreciation Account

Dr. **Cr.**

Date	Particulars	Rs.	Date	Particulars	Rs.
2002			2002		
Mar 31	To Machinery A/c	8,000	Mar 31	By Profit & Loss A/c	8,000
		8,000			8,000

2003			2004		
Mar 31	To Machinery A/c	7,200	Mar 31	By Profit & Loss A/c	7,200
		7,200			7,200
2003			2004		
Sep 30	To Machinery A/c	3,240	Mar 31	By Profit & Loss A/c	5,640
2004					
Mar 31	To Machinery A/c	2,400			
		5,640			5,640

Illustration : 8

Vimal & Brothers purchased a Machinery for Rs.3,75,000 on 1st July 2002. It is depreciated at 20% per annum on Straight Line Method for three years. Having became obsolete it was sold for Rs.75,000 on 31.3.2005.

Pass the journal entries, prepare Machinery account and Depreciation account. Accounts are closed 31st March every year.

Solution:

Calculation of Profit or loss on sale of Machinery

		Rs.
	Cost of Machinery (1.7.2002)	3,75,000
Less:	Depreciation for 2002-03	56,250
	(for 9 months at the rate of 20%)	
		3,18,750
Less:	Depreciation for 2003-04	75,000
		2,43,750
Less:	Depreciation for 2004-05	75,000
	Book value on the date of sale	1,68,750

As book value is greater than selling price the difference is loss.

= Rs. 1,68,750 — 75,000

∴ Loss = Rs. 93,750

In the Books of Vimal & Brothers

Journal Entries

Date	Particulars		L.F	Debit Rs.	Credit Rs.
2002					
July 31	Machinery A/c	Dr		3,75,000	
	To Bank A/c				3,75,000
	(Machinery Purchased)				
2003					
Mar 31	Depreciation A/c	Dr		56,250	
	To Machinery A/c				56,250
	(Depreciation provided)				
”	Profit & Loss A/c	Dr		56,250	
	To Depreciation A/c				56,250
	(Depreciation transferred to Profit & Loss account)				
2004					
Mar 31	Depreciation A/c	Dr		75,000	
	To Machinery A/c				75,000
	(Depreciation provided)				
”	Profit & Loss A/c	Dr		75,000	
	To Depreciation A/c				75,000
	(Depreciation transferred to Profit & Loss account)				
2005 Mar 31	Depreciation A/c	Dr		75,000	
	To Machinery A/c				75,000
	(Depreciation provided)				
	Profits & Loss A/c			75,000	
”	To Depreciation A/c				75,000
	(Depreciation transferred to Profit & Loss A/c)				
”	Bank A/c	Dr		75,000	
	To Machinery A/c				75,000
	(Machinery Sold)				

Mar 31	Profit & Loss A/c	Dr		93,750	
	To Machinery A/c				93,750
	(Profit on sale of machinery)				

Ledger Account

Dr. **Plant Account** **Cr.**

Date	Particulars	Rs.	Date	Particulars	Rs.
2002			2003		
July 1	To Bank A/c	3,75,000	Mar 31	By Depreciation A/c	56,250
			”	By Balance c/d	3,18,750
		3,75,000			3,75,000
2003			2004		
Apr 1	To Balance b/d	3,18,750	Mar 31	By Depreciation A/c	75,000
			”	By Balance c/d	2,43,750
		3,18,750			3,18,750
2004			2005		
Apr 1	To Balance b/d	2,43,750	Mar 31	By Depreciation A/c	75,000
				By Bank A/c	75,000
			”	By Profit & Loss A/c	93,750
			”	(Loss on sale)	
		2,43,750			2,43,750

Depreciation Account

Dr. **Cr.**

Date	Particulars	Rs.	Date	Particulars	Rs.
2003			2003		
Mar 31	To Machinery A/c	56,250	Mar 31	By Profit & Loss A/c	56,250
		56,250			56,250
2004			2004		
Mar 31	To Machinery A/c	75,000	Mar 31	By Profit & Loss A/c	75,000
		75,000			75,000
2005			2005		
Mar 31	To Machinery A/c	75,000	Mar 31	By Profit & Loss A/c	75,000
		75,000			75,000

Illustration : 9

On April 1, 2001 Machinery was purchased for Rs.4,00,000. On 1st October 2002, a new machine costing Rs.2,40,000 was purchased. On 30th September 2003, the machinery purchased on 1st April 2001 having became obsolete was sold for Rs.2,40,000. The accounting year ends on 31st March and depreciation is to be provided at 10% p.a. on straight line method.

Pass journal entries and prepare important ledger accounts for three years.

Solution:

Calculation of Profit or Loss on Sale of Machinery

		Rs.
	Cost of Machinery (April, 2001)	4,00,000
Less:	Depreciation for 2001-02	40,000
		3,60,000
Less:	Depreciation for 2002-03	40,000
		3,20,000
Less:	Depreciation till the date of sale (30.9.2003)	20,000
	Book value on the date of sale	3,00,000

As book value is greater than selling price the difference is loss.

= Rs.3,00,000 - 2,40,000

$\therefore$ Loss = Rs.60,000

Journal Entries

Date	Particulars		L.F	Debit Rs.	Credit Rs.
2001					
Apr 1	Machinery A/c	Dr		4,00,000	
	To Bank A/c				4,00,000
	(Machinery Purchased)				
2002					
Mar 31	Depreciation A/c	Dr		40,000	
	To Machinery A/c				40,000
	(Depreciation provided)				
”	Profit & Loss A/c	Dr		40,000	
	To Depreciation A/c				40,000
	(Depreciation transferred to Profit & Loss account)				

2002 Oct 1	Machinery A/c Dr To Bank A/c (New machine purchased)		2,40,000	2,40,000
2003 Mar 31	Depreciation A/c Dr To Machinery A/c (Depreciation provided 40,000 + 12,000)		52,000	52,000
”	Profits & Loss A/c To Depreciation A/c (Depreciation transferred to Profit & Loss A/c)		52,000	52,000
2003 Sep 30	Depreciation A/c Dr To Machinery A/c (Depreciation provided on first machine till the date of sale)		20,000	20,000
”	Bank A/c Dr To Machinery A/c (First machinery sold)		2,40,000	2,40,000
Sep 30	Profit & Loss A/c Dr To Machinery A/c (Loss on Sale of Machinery)		60,000	60,000
2004 Mar 31	Depreciation A/c Dr To Machinery A/c (Depreciation provided on Second Machine)		24,000	24,000
”	Profit & Loss A/c Dr To Depreciation A/c (Depreciation transferred to profit & loss A/c) 20,000+24,000		44,000	44,000

Ledger Accounts

Machinery Account

Dr. **Cr.**

Date	Particulars	Rs.	Date	Particulars	Rs.
2001			2002		
Apr 1	To Bank A/c	4,00,000	Mar 31	By Depreciation A/c	40,000
			”	By Balance c/d	3,60,000
		4,00,000			4,00,000
2002			2003		
Apr 1	To Balance b/d	3,60,000	Mar 31	By Depreciation A/c	52,000
Oct 1	To Bank A/c	2,40,000	”	(40,000 + 12,000)	
			”	By Balance c/d	5,48,000
		6,00,000			6,00,000
2003			2003		
Apr 1	To Balance b/d	5,48,000	Sep 30	By Depreciation A/c	20,000
				By Bank A/c	2,40,000
			”	By Profit & Loss A/c	60,000
			”	(Loss on sale)	
			”		
			2004	By Depreciation A/c	24,000
			Mar 31	By Balance c/d	2,04,000
		5,48,000			5,48,000
2004					
Apr 1	To Balance b/d	2,04,000			

Depreciation Account

Dr. **Cr.**

Date	Particulars	Rs.	Date	Particulars	Rs.
2002			2002		
Mar 31	To Machinery A/c	40,000	Mar 31	By Profit & Loss A/c	40,000
		40,000			40,000
2003			2003		
Mar 31	To Machinery A/c	52,000	Mar 31	By Profit & Loss A/c	52,000

		52,000			52,000
2003			2004		
Sep 30	To Machinery A/c	20,000	Mar 31	By Profit & Loss A/c	44,000
2004					
Mar 31	To Machinery A/c	24,000			
		44,000			44,000

Illustration : 10

Aravinth & Brothers purchased a Machinery for Rs.90,000 on 1st April 2001. They spent Rs.10,000 for installation charges. But the machinery was brought into use from 1 October 2001. It further purchased a machinery costing Rs.20,000 on 1st January 2004. Accounts are closed 31st March every year. Depreciation is to be provided at the rate of 10% per annum on Written Down Value Method.

Prepare Machinery account & Depreciation account for three years.

In the Books of Aravinth & Brothers

Ledger Account

Dr. **Machinery Account** **Cr.**

Date	Particulars	Rs.	Date	Particulars	Rs.
2001			2002		
Apr 1	To Bank b/d	1,00,000	Mar 31	By Depreciation A/c	5,000
			,,	(10% on Rs.1,00,000 for 6 months)	
				By Balance c/d	
					95,000
		1,00,000			1,00,000
2002			2003		
Apr 1	To Balance b/d	95,000	Mar 31	By Depreciation A/c	9,500
			,,	By Balance c/d	85,500
		95,000			95,000
2003			2004		
Apr 1	To Balance b/d	85,500	Mar 31	By Depreciation A/c (8550+500 i.e., (10% on Rs.20,000 for 3 months)	
2004					
Jan 1	To Bank A/c	20,000	,,		9,050
				By Balance c/d	96,450

		1,05,500			1,05,500
2004					
Apr 1	To Balance b/d	96,450			

Depreciation Account

Dr. **Cr.**

Date	Particulars	Rs.	Date	Particulars	Rs.
2002			2002		
Mar 31	To Machinery A/c	5,000	Mar 31	By Profit & Loss A/c	5,000
		5,000			5,00
2003			2003		
Mar 31	To Machinery A/c	9,500	Mar 31	By Profit & Loss A/c	9,500
		9,500			9,500
2004			2004		
Mar 31	To Machinery A/c	9,050	Mar 31	By Profit & Loss A/c	9,050
		9,050			9,050

Illustration : 11

Machinery was purchased on 1.4.2000 for Rs.1,60,000. On 1.10.2000 another machinery was purchased for Rs.80,000. On 30.9.2001 the second machine was sold for Rs.80,000. Assuming that the books are closed on March 31 each year and the depreciation is 10% under diminishing balance method.

Prepare Machinery account for three years.

Solution:

Calculation of Profit or Loss on Sale of Machinery

		Rs.
	Cost of Machinery (1.10.2000)	80,000
Less:	Depreciation for 2000-01	4,000
		76,000
Less:	Depreciation till the date of sale (30.9.2001)	3,800
	Book value on the date of sale	72,200

As book value is less than selling price the difference is profit.

= 80,000 — 72,200

$\therefore$ Profit = Rs.7,800.

Ledger Account

Dr. **Machinery Account** **Cr.**

Date	Particulars	Rs.	Date	Particulars	Rs.
2000			2001		
Apr 1	To Bank A/c	1,60,000	Mar 31	By Depreciation A/c (16,000 + 4,000)	20,000
Oct 1	To Bank A/c	80,000	”	By Balance c/d	2,20,000
		2,40,000			2,40,000
2001			2001		
Apr 1	To Balance b/d	2,20,000	Sep 30	By Depreciation A/c (80,000 – 4,000 = 76,000 on Rs.76,000 @ 10% for 6 months)	3,800
Sep 30	To Profit & Loss A/c	7,800	Sep 30	By Bank A/c	80,000
			2002		
			Mar 31	By Depreciation A/c (1,60,000 – 16,000 = 1,44,000 on Rs.1,44,000 @ 10% for 1 year)	14,400
			Mar 31	By Balance c/d	1,29,600
		2,27,800			2,27,800
2002					
Apr 1	To Balance b/d	1,29,600			

QUESTIONS

I. Objective Type:

a) Fill in the blanks:

1. All assets whose benefit is derived for a ______ period of time are called as Fixed Assets.
2. The estimated sale value of the asset at the end of it’s economic life is called as ______ value.

3. ______ method of depreciation is calculated on the original cost of asets.

4. Under ______ method, depreciation is calculated on the book value of the asset each year.

5. ______ method of depreciation is used in the case of Lease.

6. Under insurance policy method, cash is paid by way of ______ every year.

7. ______ method of depreciation is suitable for special type of asset like Loose tools.

(**Answers:** 1. Long; 2. Residual / Scrap; 3. Straight line; 4. Written down value; 5. Annuity; 6. Premium; 7. Revaluation)

b) Choose the correct answer :

1. Depreciation arises due to

   a) wear and tear of the asset

   b) fall in the market value of asset

   c) fall in the value of money

2. Under straight line method, rate of depreciation is calculated on

   a) Original cost b) Written down value c) Cost less scrap value

3. Under diminishing balance method, depreciation

   a) decreases every year b) increases every year

   c) constant every year

4. The term depletion is used for

   a) Intangible assets b) Fixed assets c) Natural resources

5. If selling price is more than the book value of the asset on the date of sale, it is

   a) a loss b) an income c) a profit

6. If selling price is less than the book value of the asset it denotes

   a) loss b) capital profit c) expenditure

7. Profit made on sale of fixed asset is debited to

   a) Profit and Loss account b) Fixed Asset account

   c) Depreciation account

8. Loss on sale of fixed asset appear on the

   a) credit side of Depreciation account

   b) debit side of fixed asset account

   c) credit side of fixed asset acount

9. The amount of depreciation charged on a machinery will be debited to

a) Machinery account   b) Depreciation account   c) Cash account

10. Total amount of depreciation provided on the written down value method at the rate of 10% p.a. on Rs.10,000 for first three years will be

   a) Rs. 2,107   b) Rs. 2,710   c) Rs. 2,701

(***Answers :*** 1. (a); 2. (a); 3. (a); 4. (c); 5. (c); 6. (a); 7. (b); 8. (c); 9. (b); 10. (b))

II. Other Questions:

1. Define Depreciation.
2. What is Fixed Asset?
3. What is residual value?
4. What is obsolesence?
5. Write notes on ‘Effluxion of time’.
6. What is straight line method of depreciation?
7. Write notes on written down value method of depreciation.
8. What is Depreciation Fund Method of depreciation?
9. What is Annuity method of depreciation?
10. What is insurance policy method of depreciation?
11. Write notes on revaluation method of depreciation.
12. Write the formula to calculate rate of depreciation under straight line method.
13. What are different methods of providing depreciation?
14. What are the reasons for providing depreciation?
15. What are the causes of depreciation?
16. What are merits and demerits of straight line method of depreciation?
17. What are merits and demerits of written down value method?
18. What are the factors determining the amount of depreciation?

III. Problems :

1. A company purchased Furniture for Rs.28,000. Depreciation is to be provided annually according to the Straight Line Method. The useful life of the furniture is 5 years and the residual value is Rs.2,000.

   You are required to find out the amount of depreciation.

   (Answer : Rs.5,200)

2. From the following particulars, find out the rate of depreciation, under Straight Line Method.

Cost of Fixed Asset	Rs. 50,000
Residual Value	Rs. 5,000
Estimated Life	10 years

   (Answer : Rate of Dep. 9%)

3. A Plant has the original value of Rs.5,00,000. The scrap value in 10 years time is expected to be Rs.20,000. Determine the rate of depreciation when the management wants to depreciate it by Straight Line Method.

   (Answer : Rate of Dep. : 9.6%)

4. A machine costing Rs.3,00,000 is estimated to have a life of 10 years and estimated scrap value is Rs.20,000 at the end of its life. Calculate the rate of depreciation under the Straight Line Method.

   (Answer : Rate of dep : 9.3%)

5. A machine was purchased for Rs.2,40,000 on 1.1.2000. This is expected to last for five years. Estimated scrap at the end of five years is Rs.40,000. Find out the rate of depreciation under the Straight Line Method.

   (Answer : Rate of Dep : 16.7%)

6. Find out the rate of depreciation under straight line method:

Cost of the plant	Rs. 2,30,000
Installation charges	Rs. 20,000
Expected life in years	10 years
Scrap value	Rs. 50,000

   (Answer: Rate of Dep: 8%)

7. From the following particulars find out the rate of depreciation under the Straight Line Method.

Cost of assets:	Rs.10,000
Scrap value	Rs. 1,000.
Estimated life	10 years.

(June 2003)

(Answer : 9%)

8. A company purchased a Machinery for Rs.12,000. It's useful life is 10 years and the scrap value is Rs.1,200. Determine the rate of depreciation under the Straight Line Method.

(March 2003)

(Answer : 9%)

9. Sudha & Co., purchased a Machinery for Rs.64,000 on 1 April 1996. They spent Rs.28,000 on the repairs and installed the same. Depreciation is writtenoff at 10% p.a. on the Straight Line Method. On 30 June, 1998 the machinery was found to be unsuitable and sold for Rs.52,000. Assume that the accounts are closed on 31 December every year.

   Pass the journal entries and prepare Machinery account and Depreciation account for three years.

(October 2002)

(Answer: Loss on sale of machinery Rs. 19,300)

10. Sunil & Co. purchased a fixed asset on 1.4.2002 for Rs.5,00,000. Depreciation is to be provided at the rate of 15% annually according to the Straight Line Method. The books are closed on 31 March every year.

    Pass the necessary journal entries, prepare Fixed asset account and Depreciation account for the first three years.

(Answer: Balance at the end of third year Rs. 2,75,000)

11. M/s. Shankar & Co. purchased a Machinery on 1.1.2002 for Rs.10,00,000. The firm writes off depreciation at 10% on the original cost every year. The books are closed on 31 March every year.

    Pass the necessary journal entries, prepare Machinery account and Depreciation account for the first three years.

(Answer: Balance at the end of the third year : Rs. 7,75,000)

12. Ganesh & Co. purchased a Machinery worth Rs.3,00,000 on 1st October 2000. They spent Rs.20,000 on it's erection. The firm writes off depreciation at the rate of 10% on the original cost every year. The books are closed on 31st March of every year.

    Prepare Machinery account and Depreciation account for three years.

    (Answer: Balance at the end of the third year: Rs. 2,40,000)

13. On 1 April, 2001, Excel Company Limited purchased a machine for Rs.56,000. On the date of purchase it was estimated that the effective life of the machine will be 10 years and after 10 years it's scrap value will be Rs.6,000.

    Prepare Machine Account and Depreciation Account for three years, Depreciation is charged on Straight Line Method. Accounts are closed on 31st March of every year.

    (Answer: Depreciation amount: Rs.5,000.
    Balance at the end of third year: Rs.41,000).

14. Senthil purchased Machinery for Rs.4,00,000 on 1 st April 2000 On 1 April 2001, an additional machinery was purchased for Rs.40,000. Prepare the Asset account for three years. Depreciation is to be provided at 10% p.a. using Straight Line Method. The firm closes its book on 31 March of every year.

    (Answer: Balance at the end of third year Rs.3,12,000)

15. A garment company purchased a Plant on 1 April 2001 for Rs.1,00,000. After having used it for three years it was sold for Rs.80,000. Depreciation is to be provided at the rate of 10% per annum on Fixed Instalment Method. Accounts are closed on 31st March every year.

    Find out the Profit or Loss on sale of Plant.

    (Answer: Profit on sale of plant Rs.10,000)

16. Gayathri Garments purchased a Plant on 1.4.2000 for Rs.2,40,000. After three years the plant was sold for Rs.1,50,000. The firm charges depreciation at the rate of 10% per annum on straight line method. Accounts are closed on 31st March every year.

    Pass Journal entries, prepare Plant account and Depreciation account.

    (Answer: Loss on sale of Plant Rs.18,000)

17. Kumaran Brothers purchased a Machinery on 1.1.2000 for Rs.5,00,000. On 1.1.2002 the machinery was sold for Rs.4,00,000. The firm charges depreciation at the rate of 15% per annum on Straight Line Method. The books are closed on 31 March every year.

    Prepare Machinery account and Depreciation account.

    (Answer: Profit on sale of machinery Rs.50,000)

18. Michel & Co. purchased a second hand plant for Rs.4,70,000 on 1 July 2001. They spent Rs.30,000 on the repairs and installed the plant. Depreciation is written off at 10% p.a. on the Straight Line Method. On 30 September 2003, the plant was found to be unsuitable and sold for Rs.3,50,000.

    Prepare Plant account and Depreciation account for three years assuming that the accounts are closed on 31st March every year.

    (Answer: Loss on sale of plant Rs.37,500)

19. A company purchased a Machinery on 1.4.2001 for Rs.2,40,000. On 1 October 2002, it purchased another machinery for Rs.60,000. On 1 October 2003, it sold off the first machine purchased on 1.4.2001 for Rs.1,68,000. On the same date, it purchased another machinery for Rs.1,50,000.

    Accounts are closed every year on 31st March. Depreciation is written off at 10% p.a. on original cost.

    Prepare Machinery account and Depreciation account for three years.

    (Answer: Loss on sale of machinery Rs.12,000.
    Balance at the end of third year: Rs.1,93,500)

20. Akbar & Co. purchased a plant for Rs.80,000 on 1.4.2001. It is depreciated at 10% p.a. on reducing balance method for three years. Accounts are closed on 31st March every year.

    Pass the Journal entries, prepare Plant account and Depreciation account for three years. Pass the Journal entries, prepare Plant account and Depreciation account for three years.

    (Answer: Balance at the end of third year Rs.58,320)

21. Bhaskar & Brothers purchased a Machinery on 1.12.2002 for Rs.5,70,000. The firm writes off depreciation at 10% on reducing balance method. The books are closed on 31st March every year.

    Pass the necessary journal entries, prepare Machinery account and Depreciation account for the first three years.

    (Answer: Balance at the end of third year Rs,4,46,310)

22. On 1st October 2000, a company purchased a plant for Rs.6,00,000. They spent Rs.40,000 on its erection. The firm writes off depreciation at the rate of 20% on Reducing Balance Method. The books are closed on 31st March every year.

    Prepare Plant account and Depreciation account for three years.

    (Answer: Balance at the end of third year Rs.3,68,640)

23. Archana started business on 1 April 2001 and she purchased a on of charging 15% p.a. depreciation under Diminishing Balance Method. The accounts are closed every year on 31March. Prepare Machinery account and Depreciation account for the first three years.

(Answer: Balance at the end of third year Rs.1,09,884)

24. Abdul purchased a Machinery on 1st April 2001 for Rs.2,00,000. After having used it for three years it was sold for Rs.1,60,000. Depreciation is to be provided at the rate of 10% p.a. on Diminishing Balance Method. Accounts are closed on 31st March of every year.

    Find out the Profit or Loss on sale of machinery.

(Answer: Profit of sale of machinery Rs.14,200)

25. Sivam Printing Press purchased a printing machinery costing Rs.3,00,000 on 1.4.2001. After three years the machinery was sold for Rs.2,80,000. The firm charges depreciation @ 10% per annum on Diminishing Balance Method. Accounts are closed on 31st March every year.

    Pass journals, prepare Machinery account and Depreciation account.

(Answer: Profit on sale of machinery Rs.61,300)

26. A firm bought a machinery on 1.1.2002 for Rs.5,00,000. On 31.12.2003 the machinery was sold for Rs.3,90,000. The firm charges depreciation at the rate of 10% per annum on Diminishing Balance Method. The books are closed on 31st March every year. Pass journal entries. Prepare Machinery account and Depreciation account.

(Answer: Loss on sale of machinery Rs.15,844)

27. Chennai Printing House purchased a Machinery for Rs.4,60,000 on 1st July 2001. It spent Rs.40,000 on the repairs and isntalled the machinery. Deprecciation is written off at 10% p.a. on Diminishing Balance Method. On 31st October 2003, the machinery was found to be unsuitable and sold for Rs.4,10,000.

    Prepare Machinery account and Depreciation account for three years assuming that the accounts are closed on 31st March every year.

(Answer: Profit on sale of machinery Rs.18,031)

28. A Limited company purchased a Machinery on 1.6.2001 for Rs.2,10,000. On 1st October 2003, it purchased another machinery for Rs.1,00,000. On 1st October 2003, it sold off the first machinery purchase don 1.6.2001 for Rs.1,80,000. Accounts are closed every year on 31st March. Depreciation is written off at 10% per annum on Diminishing Balance Method.

Prepare Machinery account and Depreciation account for the first three years.

(Answer: Profit on sale of machine Rs.15,413,
Balance at the end of third year Rs.95,000)

29. A plant is purchased for Rs.90,000. It is depreciated as 10% p.a. on reducing balance for three years. When it becomes obsolete due to new method of production and is scrapped. The scrap produces Rs.66,000 at the end of the third year.

    Prepare plant and depreciation account for three years.

(Answer: Profit on sale of plant Rs.390

30. On 1st January 2003, Ramesh & Co., purchased plant worth Rs.1,00,000 was sold away on 31st December 2004 for Rs.50,000. Depreciation was provided at 20% p.a. on the written down value every year. Accounts are prepared on 31st March every year.

    Show the plant account and depreciation account for three years.

(Answer: Loss on sale of plant Rs.14,600)

31. Alexander Company Limited purchased a plant for Rs.1,80,000 on 1st January 2003. They spent Rs.20,000 for installation expenses. Depreciation is to be provided @ 10% p.a. on the diminishing value method.

    Prepare plant account and depreciation account for three years ending 31st March every year.

(Answer: Balance at the end of third year Rs.1,57,950)

CHAPTER – 4

FINANCIAL STATEMENT ANALYSIS - RATIO ANALYSIS

Learning Objectives

After studying this Chapter, you will be able to:

- *understand the meaning, significance and limitations of financial statement analysis.*
- *calculate liquidity, solvency, profitability and activity ratios.*

Financial statements are final result of accounting work done during the accounting period. Financial statements normally include Trading, Profit and Loss Account and Balance Sheet. The users of accounting information may not be able to get direct reply to certain questions from the above statements. However, by expressing the items in the financial statements, in relation to each other we can get meaningful information.

Analysis of financial statement has been defined as "a process of evaluating the relationship between the component parts of the financial statements to obtain a better understanding of a firm's position and performance".

Financial statement analysis is an important part of the overall financial assessment. The different users look at the business concern from their respective view point and are interested in knowing about its profitability and financial condition. A detailed cause and effect study of the profitability and financial condition is the overall objective of financial statement analysis.

4.1 Significance of Financial Statement Analysis

1. Judging the earning capacity or profitability of a business concern.
2. Analysing the short term and long term solvency of the business concern.
3. Helps in making comparative studies between various firms.
4. Assists in preparing budgets.

4.1.1 Limitations of Financial Statement Analysis:

Analysis of financial statements helps to ascertain the strength and weakness of the business concern, but at the same time it suffers from the following limitations.

1. It analyses what has happened till date and does not reflect the future.
2. It ignores price level changes.
3. Financial analysis takes into consideration only monetary matters, qualitative aspects are ignored.
4. The conclusions of the analysis is based on the correctness of the financial statements.
5. Analysis is a means to an end and not the end itself.
6. As there is variation in accounting practices followed by different firms a valid comparison of their financial analysis is not possible.

There are different ways by which financial statement analysis can be undertaken and one among them is **"Ratio Analysis"**. In this chapter we are discussing the Ratio Analysis.

4.2 Ratio Analysis:

Ratio is an expression of one number in relation to another. **Ratio analysis** is the process of determining and interpreting the numerical relationship between figures of financial statements. A ratio is a mathematical relationship between two items expressed in a quantitative form. An absolute figure does not convey much meaning. Generally, with the help of other related information the significance of the absolute figure could be understood better.

For example Nila earns Rs.50,000 profit in her business while Nivedita earns Rs.40,000 profit. Whose business is more profitable? Instantly we may say that as Nila earns more profit, her business is more profitable. But in order to answer this question we must know what was the sales made by both of them. Suppose Nila has made a sale of Rs.4,00,000 and Nivedita Rs.3,00,000. Now we can calculate the percentage of profit earned on the sales (Profit / Sales x 100) to know whose business is more profitable.

$$\text{Nila} = \frac{50,000}{4,00,000} \times 100 = 12.5\%$$

$$\text{Nivedita} = \frac{40,000}{3,00,000} \times 100 = 13.33\%$$

From the above calculations it is clear that the profitability of Nivedita is more than Nila, because, she is getting 13.33% return and Nila is getting only 12.5%.

Thus, the above example explains that absolute figures by themselves may not communicate meaningful information. Hence, business results are understood properly only when the relevant figures are considered together.

4.2.1 Definition:

In the words of **Kennedy** and **Mc Millan** "the relationship of an item to another expressed in simple mathematical form is known as a ratio"

Expression of Ratios:

Ratios are expressed in three ways:

1. **Time:** In this type of expression one number is divided by another number and the quotient is taken as number of times. For example, expressing the attendance of 40 students present in a class of 80 students would be:

$$\frac{40}{80} = 0.5 \text{ times}$$

2. **Percentage:** It is expressed in Percentage. When the above example is expressed as percentage, it would be as under

$$\frac{40}{80} \times 100 = 50\%$$

3. **Pure:** It is expressed as a proportion. In the above example, this would be as under

$$\frac{40}{80} = \frac{1}{2} = 0.5$$

This may also be expressed as 0.5:1.

The study of relationships between various items or groups of items in financial statements is known as 'Financial Ratio Analysis'.

4.2.2 Objectives:

The objectives of using ratios are to test the profitability, financial position (liquidity and solvency) and the operating efficiency of a concern.

4.2.3 Advantages of Ratio Analysis:

Ratio analysis is an important technique in financial analysis. It is a means for judging the financial soundness of the concern. The advantages of accounting ratios are as follows:

1. It is an useful device for analysing the financial statements.
2. It simplifies, summarizes the accounting figures to make it understandable.
3. It helps in financial forecasting.
4. It facilitates interfirm and intrafirm comparisons.

Ratio analysis is useful in finding the strength and weakness of a business concern. After identifying the weakness, the ratios are also helpful in determining the causes of the weakness.

4.2.4 Classification of Ratios:

The classification of ratios on the basis of purpose is as follows:

Ratios

Liquidity	**Solvency**	**Profitability**	**Activity (Turnover)**
1. Current Ratio	1. Debt-Equity Ratio	1. Gross Profit Ratio	1. Capital Turnover Ratio
2. Liquid Ratio	2. Proprietory Ratio	2. Net Profit Ratio	2. Fixed Asset Turnover Ratio
3. Absolute Liquid Ratio		3. Operating Profit Ratio	3. Stock Turnover Ratio
		4.. Operating Ratio	4. Debtors Turnover Ratio
			5. Creditors Turnover Ratio

I. Liquidity Ratios

Liquidity Ratios measure the firms' ability to pay off current dues i.e.,repayable within a year. Liquidity ratios are otherwise called as **Short Term Solvency Ratios.** The important liquidity ratios are

1. Current Ratio
2. Liquid Ratio
3. Absolute Liquid Ratio

1. Current Ratio :

This ratio is used to assess the firm's ability to meet its current liabilities. The relationship of current assets to current liabilities is known as **current ratio**. The ratio is calculated as:

$$\boxed{\text{Current Ratio} = \frac{\text{Current Assests}}{\text{Current Liabilities}}}$$

Current Assets are those assets, which are easily convertible into cash within one year. This includes cash in hand, cash at bank, sundry debtors, bills receivable, short term investment or marketable securities, stock and prepaid expenses.

Current Liabilities are those liabilities which are payable within one year. This includes bank overdraft, sundry creditors, bills payable and outstanding expenses.

Illustration : 1

From the following compute current ratio:

	Rs.		Rs.
Stock	36,500	Prepaid expenses	1,000
Sundry Debtors	63,500	Bank overdraft	20,000
Cash in hand & bank	10,000	Sundry creditors	25,000
Bills receivable	9,000	Bills payable	16,000
Short term investments	30,000	Outstanding expenses	14,000

Solution:

Current Ratio = $\frac{\text{Current Assests}}{\text{Current Liabilities}}$

Current Assets = Stock + Sundry debtors + Cash in hand and bank + Bills receivable + Short term investments + Prepaid expenses

= 36,500+ 63,500 + 10,000 + 9,000 + 30,000 + 1,000

= Rs.1,50,000

Current Liabilities = Bank overdraft + Sundry creditors + Bills payable + Outstanding expenses

= 20,000 + 25,000 + 16,000 + 14,000

= Rs.75,000

Current Ratio = $\frac{1,50,000}{75,000}$

= 2:1

2. Liquid Ratio

This ratio is used to assess the firm's short term liquidity. The relationship of liquid assets to current liabilities is known as **liquid ratio**. It is otherwise called as **Quick ratio** or **Acid Test ratio**. The ratio is calculated as:

$$\text{Liquid Ratio} = \frac{\text{Liquid Assets}}{\text{Current Liabilities}}$$

Liquid assets means current assets less stock and prepaid expenses.

Illustration : 2

Taking the figures from the above illustration liquid ratio is calculated as follows:

Solution:

$$\text{Liquid Ratio} = \frac{\text{Liquid Assets}}{\text{Current Liabilities}}$$

Liquid Assets = Current Assets – (Stock + Prepaid expenses)

= 1,50,000 – (36,500 + 1,000)

= 1,50,000 – 37,500

= Rs.1,12,500

$$\text{Liquid Ratio} = \frac{1,12,500}{75,000}$$

Liquid Ratio = 1. 5:1

3. Absolute Liquid Ratio

It is a modified form of liquid ratio. The relationship of absolute liquid assets to liquid liabilities is known as **absolute liquid ratio**. This ratio is also called as **'Super Quick Ratio'**. The ratio is calculated as:

$$\boxed{\text{Absolute Liquid Ratio} = \frac{\text{Absolute Liquid Assets}}{\text{Liquid Liabilities}}}$$

Absolute liquid assets means cash, bank and short term investments. **Liquid liabilities** means current liabilities less bank overdraft.

Illustration : 3

Taking the figures from Illustration : 1

Solution:

$$\text{Absolute Liquid Ratio} = \frac{\text{Absolute Liquid Assets}}{\text{Liquid Liabilities}}$$

Absolute Liquid Assets = Cash + Bank + Short term investments

= 10,000 + 30,000

= Rs.40,000

Liquid Liabilities = Current liabilities – Bank overdraft

75,000 – 20,000

Rs. 55,000

$$\text{Absolute Liquid Ratio} = \frac{40,000}{55,000} = 0.73:1$$

(**Note :** All liquidity ratios are expressed as a proportion)

II. Solvency Ratios

Solvency refers to the firms ability to meet its long term indebtedness. Solvency ratio studies the firms ability to meet its long term obligations. The following are the important solvency ratios:

1. Debt-Equity Ratio
2. Proprietory Ratio

1. Debt Equity Ratio

This ratio helps to ascertain the soundness of the long term financial position of the concern. It indicates the proportion between total long term debt and shareholders funds. This also indicates the extent to which the firm depends upon outsiders for its existence. The ratio is calculated as:

$$\boxed{\text{Debt-Equity Ratio} = \frac{\text{Total long term Dept}}{\text{Shareholders funds}}}$$

Total long term debt includes Debentures, long term loans from banks and financial institutions. **Shareholders funds** includes Equity share capital, Preference share capital, Reserves and surplus.

Illustration : 4

Calculate Debt Equity Ratio from the following information.

	Rs.
Debentures	2,00,000
Loan from Banks	1,00,000
Equity share capital	1,25,000
Reserves	25,000

Solution:

$$\text{Debt-Equity Ratio} = \frac{\text{Total long term Dept}}{\text{Shareholders funds}}$$

Total long term debt = Debentures + Loans from Bank

	=	2,00,000 + 1,00,000
	=	Rs.3,00,000
Shareholders funds	=	Equity Share Capital + Reserves
	=	1,25,000 + 25,000
	=	Rs.1,50,000

$$\text{Dept-Equity Ratio} = \frac{3,00,000}{1,50,000} = 2:1$$

2. Proprietory Ratio

This ratio shows the relationship between proprietors or shareholders funds and total tangible assets. The ratio is calculated as:

$$\boxed{\text{Proprietory Ratio} = \frac{\text{Shere holders funds (Propreitors funds)}}{\text{Total tangible assets}}}$$

Tangible assets will include all assets except goodwill, preliminary expenses etc.

Illustration : 5

From the following calculate Proprietory Ratio

	Rs.		Rs.
Equity share capital	1,00,000	Furniture	10,000
Preference share capital	75,000	Bank	20,000
Reserves & surplus	25,000	Cash	25,000
Machinery	30,000	Stock	15,000
Goodwill	5,000		

Solution :

$$\text{Proprietory Ratio} = \frac{\text{Shere holders funds}}{\text{Total tangible assets}}$$

Shareholders fund	=	Equity capital + Preference Share Capital + Reserve & Surplus
	=	1,00,000 + 75,000 + 25,000
	=	Rs. 2,00,000
Total tangible Assets	=	Machinery + Furniture + Bank + Cash + Stock
	=	30,000 + 10,000 + 20,000 + 25,000 + 15,000

$$= \text{Rs. } 1,00,000$$

$$= \frac{2,00,000}{1,00,000} = 2:1$$

(**Note :** All solvency ratios are expressed as a proportion.)

III. Profitability Ratios

Efficiency of a business is measured by profitability. Profitability ratio measures the profit earning capacity of the business concern. The important profitability ratios are discussed below:

1. Gross Profit Ratio
2. Net Profit Ratio
3. Operating Profit Ratio
4. Operating Ratio

1. Gross Profit Ratio

This ratio indicates the efficiency of trading activities. The relationship of Gross profit to Sales is known as **gross profit ratio**. The ratio is calculated as:

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

Gross profit is taken from the Trading Account of a business concern. Otherwise Gross profit can be calculated by deducting cost of goods sold from sales. Sales means Net sales.

Gross Profit = Sales — Cost of goods sold

Cost of goods sold = Opening Stock + Purchases — Closing Stock

(or)

Sales — Gross Profit

Illustration : 6

From the following particulars ascertain gross profit ratio

	Rs.		Rs.
Cash sales	40,000	Sales return	5,000
Credit sales	65,000	Gross profit	40,000

Solution:

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

$$\begin{aligned}\text{Sales} &= \text{Total Sales – Sales Returns}\\ &= 40{,}000 + 65{,}000 - 5{,}000\\ &= \text{Rs. } 1{,}00{,}000\\ &= \frac{40{,}000}{1{,}00{,}000} \times 100 = 40\%\end{aligned}$$

2. Net Profit Ratio:

This ratio determines the overall efficiency of the business. The relationship of Net profit to Sales is known as **net profit ratio**. The ratio is calculated as:

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

Net profit is taken from the Profit and Loss account of the business concern or the gross profit of the concern less administration expenses, selling and distribution expenses and financial expenses.

Illustration : 7

Calculate net profit ratio from the following:

	Rs.
Net Profit	60,000
Sales	3,00,000

Solution:

$$\begin{aligned}\text{Net Profit Ratio} &= \frac{\text{Net Profit}}{\text{Sales}} \times 100\\ &= \frac{60{,}000}{3{,}00{,}000} \times 100\\ &= 20\%\end{aligned}$$

3. Operating Profit Ratio

This ratio is an indicator of the operational efficiency of the management. It establishes the relationship between Operating profit and Sales. The ratio is calculated as:

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

Where operating profit is Net profit + Non-operating expenses – Non-operating income.

Where, Non-operating expenses are interest on loan and loss on sale of assets.

Non-operating income are dividend, interest received and profit on sale of asset. (or) Operating profit = Gross profit – Operating expenses.

Operating expenses include administration, selling and distribution expenses. Financial expenses like interest on loan are excluded for this purpose.

Illustration : 8

Calculate the operating profit ratio from the following:

	Rs.
Net Profit	3,00,000
Loss on Sale of Furniture	10,000
Profit on sale of investments	30,000
Interest paid on loan	30,000
Interest from investments	20,000
Sales	5,80,000

Solution:

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

Operating profit = Net profit + Non-operating expenses — Non-operating income.

Non-operating expenses = Interest on loan + Loss on sale of furniture.

= 30,000 + 10,000

= Rs. 40,000

Non-operating income = Interest received from investments + Profit on sale of investment

= 20,000 + 30,000

$$= \text{Rs.}50{,}000$$

$$\text{Operating profit} = 3{,}00{,}000 + 40{,}000 - 50{,}000$$

$$= \text{Rs. } 2{,}90{,}000$$

$$\text{Operating Profit Ratio} = \frac{2{,}90{,}000}{5{,}80{,}000} \times 100$$

$$= 50\%$$

4. Operating Ratio

This ratio determines the operating efficiency of the business concern. **Operating ratio** measures the amount of expenditure inurred in production, sales and distribution of output. The relationship between Operating cost to Sales is known as Operating Ratio. The ratio is calculated as:

$$\boxed{\text{Operating Ratio} = \frac{\text{Cost of goods sold+ Operating expenses}}{\text{sales}} \times 100}$$

Illustration : 9

From the following details, calculate the operating ratio.

	Rs.
Cost of goods sold	6,00,000
Operating expenses	40,000
Sales	8,20,000
Sales returns	20,000

Solution:

$$\text{Operating Ratio} = \frac{\text{Cost of goods sold + Operating expenses}}{\text{sales}} \times 100$$

$$= \frac{6{,}00{,}000 + 40{,}000}{8{,}20{,}000 - 20{,}000} \times 100$$

$$\text{Operating Ratio} = \frac{6{,}40{,}000}{8{,}00{,}000} \times 100 = 80\%$$

(**Note:** All profitability ratios will be expressed in terms of percentage.)

IV. Activity Ratios

Activity ratios indicate the performance of the business. The performance of a business is judged with its sales (turnover) or cost of goods sold. These ratios are thus referred to as **turnover ratios**. A few important activity ratios are discussed below:

1. Capital turnover ratio
2. Fixed assets turnover ratio
3. Stock turnover ratio
4. Debtors turnover ratio
5. Creditors turnover ratio

1. Capital Turnover Ratio

This shows the number of times the capital has been rotated in the process of carrying on business. Efficient utilisation of capital would lead to higher profitability. The relationship between Sales and Capital employed is known as **Capital Turnover Ratio**. The ratio is calculated as:

$$\text{Capital Turnover Ratio} = \frac{\text{Sales}}{\text{Capital Employed}}$$

Where Sales means Sales less sales returns and **Capital employed** refers to total long term funds of the business concern i.e., Equity share capital, Preference share capital, Reserves and surplus and Long term borrowed funds.

Illustration : 10

Calculate capital turnover ratio from the following information

	Rs.
Cash sales	2,00,000
Credit Sales	1,75,000
Sales return	25,000
Equity Share Capital	1,00,000
Long term loan	50,000
Reserves	25,000

Solution:

$$\text{Capital Turnover Ratio} = \frac{\text{Sales}}{\text{Capital Employed}}$$

Net Sales = Cash sales + Credit sales – Sales returns

= 2,00,000 + 1,75,000 - 25,000

	=	Rs. 3,50,000
Capital Employed	=	Share capital + Long term loan + Reserves
	=	1,00,000 + 50,000 + 25,000
	=	Rs. 1,75,000

$$\text{Capital Turnover Ratio} = \frac{3,50,000}{1,75,000} = 2 \text{ times}$$

2. Fixed Assets Turnover Ratio:

This shows how best the fixed assets are being utilised in the business concern. The relationship between Sales and Fixed assets is known as **Fixed assets turnover ratio**. The ratio is calculated as:

$$\boxed{\text{Fixed assets turnover Ratio} = \frac{\text{Sales}}{\text{Fixed Assets}}}$$

Fixed assets means Fixed assets less depreciation.

Illustration : 11

Calculate the fixed asset turnover ratio from the following figures.

	Rs.
Sales	6,15,000
Sales Return	15,000
Fixed assets	1,50,000

Solution:

$$\text{Fixed assets turnover Ratio} = \frac{\text{Sales}}{\text{Fixed Assets}}$$

Sales	=	Sales - Sales return
	=	6,15,000 - 15,000
	=	Rs. 6,00,000

$$\text{Fixed assets turnover ratio} = \frac{6,00,000}{1,50,000} = 4 \text{ times}$$

3. Stock Turnover Ratio

This ratio is otherwise called as **inventory turnover ratio**. It indicates whether stock has been efficiently used or not. It establishes a relationship between the cost of goods sold during a particular period and the average amount of stock in the concern. The ratio is calculated as:

$$\boxed{\text{Stock turnover Ratio} = \frac{\text{Cost of goods sold}}{\text{Average stock}}}$$

$$\text{Average stock} = \frac{\text{Opening stock + closing stock}}{2}$$

If information to calculate average stock is not given then closing stock may be taken as average stock.

Illustration : 12

Calculate stock turnover ratio from the following:

	Rs.
Cost of goods sold	6,75,000
Stock at the beginning of the year	1,00,000
Stock at the end of the year	1,25,000

Solution:

$$\text{Stock turnover Ratio} = \frac{\text{Cost of goods sold}}{\text{Average stock}}$$

$$\text{Average stock} = \frac{\text{Opening stock + closing stock}}{2}$$

$$= \frac{1,00,000 + 1,25,000}{2}$$

$$= \frac{2,25,000}{2}$$

$$= \text{Rs. } 1,12,500$$

$$\text{Stock turnover Ratio} = \frac{6,75,000}{1,12,500} = 6 \text{ Times}$$

Illustration : 13

Calculate stock turnover ratio from the following information.

	Rs.
Sales	2,00,000
Gross profit	50,000

Stock 30,000

Solution:

$$\text{Stock turnover ratio} = \frac{\text{cost of goods sold}}{\text{Average Stock}}$$

Cost of goods sold = Sales – Gross Profit

= 2,00,000 – 50,000

= Rs.1,50,000

$$\text{Stock turnover ratio} = \frac{1,50,000}{30,000} = 5 \text{ Times}$$

4. Debtors Turnover Ratio

This establishes the relationship between credit sales and average accounts receivable. Debtors turnover ratio indicates the efficiency of the business concern towards the collection of amount due from debtors. The ratio is calculated as:

$$\boxed{\text{Debtors turnover Ratio} = \frac{\text{Credit Sales}}{\text{Average Accounts Receivable}}}$$

Accounts receivable includes sundry debtors and bills receivable.

$$\text{Average Accounts Receivable} = \frac{\text{Opening (debtors + bills receivable)} + \text{Closing (debtors + bills receivable)}}{2}$$

In case credit sales is not given, total sales can be taken as credit sales.

Illustration : 14

Calculate Debtors turnover ratio from the following:

	Rs.		Rs.
Total sales	2,00,000	Cash sales	40,000
Opening debtors	35,000	Closing debtors	45,000

Solution:

$$\text{Debtors Turnover Ratio} = \frac{\text{Credit Sales}}{\text{Average debtors}}$$

Credit Sales = Total sales - Cash sales

= 2,00,000 - 40,000

$$= \text{Rs.}1{,}60{,}000$$

$$\text{Average Debtors} = \frac{\text{Opening Debtors + Closing Debtors}}{2}$$

$$= \frac{35{,}000 + 45{,}000}{2}$$

$$= \frac{80{,}000}{2}$$

$$= \text{Rs. } 40{,}000$$

$$\text{Debtors Turnover Ratio} = \frac{1{,}60{,}000}{40{,}000} = 4 \text{ Times}$$

5. Creditors Turnover Ratio:

This establishes the relationship between credit purchases and average accounts payable. Creditors turnover ratio indicates the period in which the payments are made to creditors. The ratio is calculated as:

$$\boxed{\text{Creditors turnover Ratio} = \frac{\text{Credit Purchases}}{\text{Average Accounts payable}}}$$

Accounts payable include sundry creditors and bills payable.

$$\text{Average Accounts Receivable} = \frac{\text{Opening (creditors + bills payable)} + \text{Closing (creditors + bills payable)}}{2}$$

In case credit purchases is not given total purchases can be taken as credit purchases.

Illustration : 15

Calculate creditors turnover ratio from the following:

	Rs.
Credit purchases	1,50,000
Opening creditors	36,000
Closing creditors	24,000

Solution:

$$\text{Creditors Turnover Ratio} = \frac{\text{Credit Purchases}}{\text{Average accounts payable}}$$

$$\text{Average Creditors} = \frac{36{,}000 + 24{,}000}{2}$$

$$= \frac{60{,}000}{2} = \text{Rs. } 30{,}000$$

$$= \frac{1{,}50{,}000}{30{,}000} = 5 \text{ Times}$$

(**Note:** All turnover ratios will be expressed in terms of times.)

Other Illustrations:

Illustration : 16

From the following calculate current ratio

Babu Co. Ltd.

Balance Sheet as on 31.3.04

Liabilities	Rs.	Assets	Rs.
Share capital	21,000	Fixed Assets	17,000
Reserves	4,000	Stock	6,000
Bank Overdraft	2,000	Debtors	3,200
Creditors	6,000	Cash	6,800
	33,000		33,000

Solution:

$$\text{Current Ratio} = \frac{\text{Current Assets}}{\text{Current Liabilities}}$$

Current Assets = Stock + Debtors + Cash

= 6,000 + 3,200 + 6,800

= Rs.16,000

Current Liabilities = Bank overdraft + Creditors

= 2,000 + 6,000

= Rs. 8,000

$$= \frac{16{,}000}{8{,}000} = 2{:}1$$

Illustration : 17

From the following Balance Sheet as on 31.3.2005, calculate current ratio and liquid ratio.

Pavithra Co. Ltd.

Balance Sheet as on 31.3.05

Liabilities	Rs.	Assets	Rs.
Equity share capital	40,000	Machinery	45,000
Profit & Loss A/c	4,000	Stock	22,000
Debentures	25,000	Debtors	19,000
Creditors	24,000	Cash	5,000
		Prepaid expenses	2,000
	93,000		93,000

Solution:

Current Ratio $= \dfrac{\text{Current Assets}}{\text{Current Liabilities}}$

Current Assets = Stock + Debtors + Cash + Prepaid expenses

= 22,000 + 19,000 + 5,000 + 2,000

= Rs. 48,000

Current Liabilities = Creditors

= Rs. 24,000

$= \dfrac{48{,}000}{24{,}000} = 2:1$

Liquid Ratio $= \dfrac{\text{Liquid Assets}}{\text{Current Liabilities}}$

Liquid Assets = Current Asset – (Stock + Prepaid expenses)

= 48,000 – (22,000 + 2,000)

= 48,000 – 24,000

= Rs. 24,000

Liquid Ration $= \dfrac{24{,}000}{24{,}000} = 1:1$

Illustration : 18

From the following, calculate Debt-Equity Ratio.

	Rs.		Rs.
Equity shares	1,00,000	General reserves	75,000
Debentures	75,000	Sundry creditors	40,000
Outstanding expenses	10,000		

Solution:

Debt Equity Ratio = $\frac{\text{Long term Debt}}{\text{Shareholders funds}}$

Long term Debt = Debentures

= Rs. 75,000

Shareholders funds = Equity shares + General Reserves

= 1,00,000 + 75,000

= Rs. 1,75,000

Debt Equity Ratio = $\frac{75,000}{1,75,000}$ = 0.42:1

Illustration : 19

Calculate Gross Profit Ratio from the following:

	Rs.
Purchases	2,65,000
Opening stock	10,000
Closing stock	20,000
Sales	3,00,000

Solution:

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

Gross Profit = Sales – Cost of Goods Sold

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

= 10,000 + 2,65,000 – 20,000

= Rs. 2,55,000

Gross Profit = 3,00,000 – 2,55,000

= Rs. 45,000

$$\text{Gross Profit Ratio} = \frac{45,000}{3,00,000} \times 100$$

= 15%

Illustration : 20

From the following data, calculate the fixed asset turnover ratio.

	Rs.
Cash sales	1,00,000
Credit sales	1,20,000
Sales Returns	20,000
Fixed assets	45,000
Depreciation	5,000

Solution:

$$\text{Fixed Asset Turnover Ratio} = \frac{\text{Sales}}{\text{Fixed Assets}}$$

Sales = Cash sales + Credit sales – Sales Returns

= 1,00,000 + 1,20,000 – 20,000

= 2,20,000 – 20,000

= Rs. 2,00,000

Fixed Assets = Fixed Assets – Depreciation

= 45,000 – 5,000

= Rs. 40,000

$$\text{Fixed Asset Turnover Ratio} = \frac{2,00,000}{40,000} = 5 \text{ Times}$$

Illustration : 21

From the following trading account, calculate stock turnover ratio and gross profit ratio.

Trading Account of Mohammed Ali & Co.

for the year ended 31.3.2004

Particulars	Rs.	Particulars	Rs.
To Opening stock	40,000	By Sales	2,00,000
To Purchases	1,20,000	By Closing stock	20,000
To Carriage	10,000		
To Gross profit	50,000		
	2,20,000		2,20,000

Solution:

$$\text{Stock Turnover Ratio} = \frac{\text{Cost of Goods sold}}{\text{Average Stock}}$$

$$\text{Cost of Goods Sold} = \text{Sales} - \text{Gross Profit}$$

$$= 2{,}00{,}000 - 50{,}000$$

$$= \text{Rs. } 1{,}50{,}000$$

$$\text{Average Stock} = \frac{\text{Opening Stock + Closing Stock}}{2}$$

$$= \frac{40{,}000 + 20{,}000}{2}$$

$$= \text{Rs.}30{,}000$$

$$\text{Stock Turnover Ratio} = \frac{1{,}50{,}000}{30{,}000} = 5 \text{ Times}$$

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

$$= \frac{50{,}000}{2{,}00{,}000} \times 100$$

$$= 25\%$$

Illustration : 22

From the following figures calculate creditors turnover ratio

	Rs.
Credit purchases	1,80,000
Bills payable	50,000
Creditors	40,000

Solution:

Creditors Turnover Ratio $= \dfrac{\text{Credit Purchases}}{\text{Average Accounts Payable}}$

Average accounts payable = Bills payable + Creditors

= 50,000 + 40,000

= Rs. 90,000

Creditors Turnover Ratio $= \dfrac{1,80,000}{90,000} = 2$ Times

Illustration : 23

The following is the Trading & Profit and Loss Account of a firm for the year ended 31.3.04.

Trading and Profit and Loss Account of Lilly & Co.

for the year ended 31.3.2003

Particulars	Rs.	Particulars	Rs.
To Opening stock	35,000	By Sales	4,00,000
To Purchases	2,25,000	By Closing stock	50,000
To Wages	10,000		
To Gross profit	1,80,000		
	4,50,000		4,50,000
To Administration expenses	10,000	By Gross profit	1,80,000
To Interest	5,000	By Dividend	2,000
To Loss on sale of machinery	2,000		
To Selling Expnes	10,000		
To Net Profit	1,55,000		
	1,82,000		1,82,000

Calculate profitability ratios.

Solution:

1. Goss Profit Ratio $= \dfrac{\text{Gross Profit}}{\text{Sales}} \times 100$

$= \dfrac{1,80,000}{4,00,000} \times 100$

= 45%

2. Nte Profit Ratio $= \dfrac{\text{Net Profit}}{\text{Sales}} \times 100$

$= \dfrac{1,55,000}{4,00,000} \times 100$

$=$ 38.75%

3. Operating Profit Ratio $= \dfrac{\text{Operating Profit}}{\text{Sales}} \times 100$

Operating profit = Net Profit + Non-operating expenses – Non-operating income

= Net Profit + Interest + Loss on sale of machinery – Dividend

= 1,55,000 + 2,000 + 5,000 – 2,000

= Rs. 1,60,000

Operating Profit Ratio $= \dfrac{1,60,000}{4,00,000} \times 100$

= 40 %

4. Operating Ratio $= \dfrac{\text{Cost of goods + Operating Expenses}}{\text{Sales}}$

Cost of goods sold = Sales – Gross Profit

= 4,00,000 - 1,80,000

= Rs. 2,20,000

Operating Expenses = Administration + Selling Expenses

= 10,000 + 10,000

= Rs. 20,000

Operating Ratio $= \dfrac{2,20,000 + 20,000}{4,00,000} \times 100$

= 60%*

* **Note** : Operating ratio = 100% – Operating profit ratio

= 100% – 40%

= 60%

Illustration : 24

From the given data, calculate

1. Gross Profit Ratio
2. Net Profit Ratio and
3. Current Ratio

	Rs.		Rs.
Sales	3,00,000	Cost of goods sold	2,00,000
Net Profit	30,000	Current Assets	60,000
Current LIabilities	30,000		

Solution:

i) Gross profit ratio $= \dfrac{\text{Gross Profit}}{\text{Sales}} \times 100$

Gross Profit = Sales – Cost of Goods sold

= 3,00,000 – 2,00,000

= Rs. 1,00,000

Gross Profit Ratio $= \dfrac{1,00,000}{3,00,000} \times 100 = 33.33\%$

ii) Net Profit Ratio $= \dfrac{\text{Net Profit}}{\text{Sales}} \times 100$

$= \dfrac{30,000}{3,00,000} \times 100$

= 10%

iii) Current Ratio $= \dfrac{\text{Current Assets}}{\text{Current Liabilities}}$

$= \dfrac{60,000}{30,000} = 2 : 1$

Illustration : 25

From the following details calculate

1. Gross Profit Ratio
2. Net Profit Ratio
3. Stock Turnover Ratio

4. Debtors Turnover Ratio

	Rs.
Sales	1,50,000
Cost of Goods Sold	1,20,000
Opening Stock	29,000
Closing Stock	31,000
Debtors	15,000
Administration Expenses	15,000

Solution:

1) Gross Profit Ratio $= \dfrac{\text{Gross Profit}}{\text{Sales}} \times 100$

Gross Profit = Sales – Cost of goods sold

= 1,50,000 – 1,20,000

= Rs. 30,000

Gross Profit Ratio $= \dfrac{30{,}000}{1{,}50{,}000} \times 100 = 20\%$

2) Net Profit Ratio $= \dfrac{\text{Net Profit}}{\text{Sales}} \times 100$

Net Profit = Gross Profit – Administration Expenses

= 30,000 – 15,000

= Rs. 15,000

$= \dfrac{15{,}000}{1{,}50{,}000} \times 100$

= 10%

3) Stock Turnover Ratio $= \dfrac{\text{Cost of Goods Sold}}{\text{Average Stock}}$

Average Stopck $= \dfrac{\text{Opening Stock + Closing Stock}}{2}$

$= \dfrac{29{,}000 + 31{,}000}{2}$

= Rs. 30,000

$= \dfrac{1{,}20{,}000}{30{,}000}$ = 4 Times

4) Debtors Turnover Ratio $= \dfrac{\text{Credit Sales}}{\text{Average Account Receivable}}$

$= \dfrac{1,50,000}{15,000} = 10 \text{ Times}$

Illustration : 26

From the Balance Sheet given below, calculate Current Ratio & Proprietory Ratio.

Balance Sheet of Ram & Co. Ltd. as on 31.3.2004

Liabilities	**Rs.**	**Assets**	**Rs.**
Share Capital	60,000	Fixed Assets	1,65,000
Reserves	45,000	Current Assets	75,000
Bank overdraft	70,000	Investments (long term)	35,000
Current liabilities	1,20,000	Preliminary expenses	10,000
		Goodwill	10,000
	2,95,000		2,95,000

Solution:

1. Current Ratio $= \dfrac{\text{Current Assets}}{\text{Current Liabilities}}$

$= \dfrac{75,000}{1,20,000}$

$= 0.625 : 1$

2. Proprietory Ratio $= \dfrac{\text{Shareholders funds}}{\text{Tangible Assets}}$

Shareholders funds = Share Capital + Reserves

= 60,000 + 45,000

= Rs.1,05,000

Tangible Assets = Fixed Assets + Current Assets + Investments

= 1,65,000 + 75,000 + 35,000

= Rs. 2,75,000

Proprietory Ratio $= \dfrac{1,05,000}{2,75,000} = 0.382 : 1$

Illustration : 27

Surya Ltd. provides the following information for the year ending 31.3.05. Calculate Gross Profit ratio, Net profit ratio, Operating profit ratio and Operating ratio.

	Rs.		Rs.
Sales	2,00,000	Gross Profit	80,000
Office Expenses	6,000	Selling Expenses	4,000
Finance expenses	3,000	Loss on sale of plant	400
Interest received	500	Net Profit	67,100

Solution:

1) Gross Profit Ratio $= \dfrac{\text{Gross Profit}}{\text{Sales}} = \times 100$

$= \dfrac{80,000}{2,00,000} \times 100$

$= 40\%$

2) Net Profit Ratio $= \dfrac{\text{Net Profit}}{\text{Sales}} \times 100$

$= \dfrac{67,000}{2,00,000} \times 100$

$= 33.55\%$

3) Operating Profit Ratio $= \dfrac{\text{Operating Profit}}{\text{Sales}}$

Operating Profit = Net Profit + Non-operating expenses − Non-operating Income

= Net Profit + Loss on sale of plant + Financial expenses - Interest received

= 67,100 + 400 + 3,000 – 500

= Rs.70,000

$= \dfrac{70,000}{2,00,000} \times 100$

$= 35\%$

4) Operating Ratio $= \dfrac{\text{Cost of goods sold + Operating expenses}}{\text{Sales}}$

Cost of goods sold	=	Sales - Gross Profit
	=	2,00,000 – 80000
	=	Rs.1,20,000
Operating expenses	=	Office expenses + Selling expenses
	=	6,000 + 4,000
	=	Rs.10,000
	=	$\frac{10{,}000 + 1{,}20{,}000}{2{,}00{,}000} \times 100$
	=	$\frac{1{,}30{,}000}{2{,}00{,}000} \times 100$
	=	65%

Illustration : 28

From the following Profit and Loss Account of a company, ascertain the following ratios.

1. Gross Profit Ratio
2. Net Profit Ratio
3. Operating Ratio
4. Operating Profit Ratio
5. Stock Turnover Ratio

Trading and Profit and Loss Account for

Dr. **the year ending 31.3.2005** **Cr.**

Particulars	Rs.	Particulars	Rs.
To Opening stock	10,000	By Sales	56,000
To Purchases	44,000	By Closing stock	10,000
To Gross profit	20,100		
	66,000		66,000
To Administration expenses	2,000	By Gross profit	20,100
To Selling expenses	8,900	By Dividend	1,000
To Interest	3,000	By Profit on sale of investments	800
To Net Profit	8,000		
	21,900		21,900

Solution:

1) Gross Profit Ratio $= \dfrac{\text{Gross Profit}}{\text{Sales}} = \times 100$

$= \dfrac{20{,}100}{56{,}000} \times 100 = 35.89\%$

2) Net Profit Ratio $= \dfrac{\text{Net Profit}}{\text{Sales}} \times 100$

$= \dfrac{8{,}100}{56{,}000} \times 100$

$= 14.29\%$

3) Operating Profit Ratio $= \dfrac{\text{Operating Profit}}{\text{Sales}} \times 100$

Operating Profit = Net Profit + Non-operating Expenses – Non Operating Income

= Net Profit + Interest – Profit on sale of investments

= 8,000 + 3,000 – (1000 + 800)

= 11,000 – 1,800

= Rs. 9,200

Operating Profit Ratio $= \dfrac{9{,}200}{56{,}000} \times 100$

$= 16.43\%$

4) Operating Ratio $= \dfrac{\text{Cost of goods sold + Operating Expenses}}{\text{Sales}} \times 100$

Gross Profit = Sales – Cost of goods sold

= 56,000 – 20,100

= Rs. 35,900

Operating expenses = Administration Expenses + Selling Expenses

= 2,000 + 8,900

= Rs. 10,900

$= \dfrac{35{,}000 + 10{,}900}{56{,}000} \times 100$

$$\text{Operating Ratio} = \frac{46,800}{56,000} \times 100 = 83.57\%$$

$$\text{5) Stock Turnover Ratio} = \frac{\text{Cost of Goods Sold}}{\text{Average Stock}}$$

$$\text{Average Stock} = \frac{\text{Opening stock + Closing Stock}}{2}$$

$$= \frac{10,000 + 10,000}{2}$$

$$= \text{Rs. } 10,000$$

$$\text{Stock Turnover Ratio} = \frac{35,900}{10,000} = 3.59 \text{ times}$$

Illustration : 29

Calculate Debtors turnover ratio from the following.

	Rs.		Rs.
Total Sales	10,000	Cash Sales	2,000
Opening Debtors	1,000	Closing Debtors	1,500
Opening Bills Receivable	750	Closing Bills Receivable	1,250

Solution:

$$\text{Debtor Turnover Ratio} = \frac{\text{Credit Sales}}{\text{Average Accounts Receivable}}$$

$$\text{Credit Sales} = \text{Total Sales – Cash Sales}$$

$$= 10,000 – 2,000$$

$$= \text{Rs. } 8,000$$

$$\text{Average Accounts Receivable} = \frac{\text{Opening (Debtors + Bills receivables) + Closing (Debtors + Bills receivables)}}{2}$$

$$= \frac{(1,000 + 750) + (1,500 + 1,250)}{2}$$

$$= \frac{1,750 + 2,750}{2}$$

$$= \frac{4,500}{2} = \text{Rs. } 2,250$$

$$= \text{Rs. } 2,250$$

$$\text{Debtors Turnover Ratio} = \frac{8,000}{2,250} = 3.56 \text{ times}$$

Table showing summary of Accounting Ratios

S.No	Description of the ratio	Formula	Notes
1.	Current ratio	$\frac{\text{Current assets}}{\text{Current liabilities}}$	Current assets include cash in hand, cash at bank, sundry debtors, bills receivable, marketable securities, stock and prepaid expenses. Current liabilities include Bank overdraft, sundry creditors, bills payable and outstanding expenses.
2.	Liquid Ratio	$\frac{\text{Liquid assets}}{\text{Current liabilities}}$	Liquid assets mean current assets less stock and prepaid expenses
3.	Absolute Liquid Ratio	$\frac{\text{Absolute Liquid assets}}{\text{Liquid liabilities}}$	Absolute Liquid assets means cash, bank and short term investment. Liquid liabilities means current liabilities less bank overdraft.
4.	Debt Equity Ratio	$\frac{\text{Long Term Debts}}{\text{Shareholders funds}}$	Long term debts include Debentures, long term loans from banks and financial institutions. Shareholders funds include Equity share capital, Preference share capital, Reserves and surplus.
5.	Proprietory Ratio	$\frac{\text{Shareholders funds}}{\text{Total tangible assets}}$	Tangible assets include all assets except goodwill, preliminary expenses etc.

6.	Gross Profit Ratio	$\frac{\text{Gross Profit}}{\text{Sales}} \times 100$	Gross profit = Sales – Cost of goods sold. Cost of goods sold = Opening stock + Purchases – Closing stock Net sales = Total sales (cash & credit) – Sales returns
7.	Net Profit Ratio	$\frac{\text{Net Profit}}{\text{Sales}} \times 100$	Net profit = Gross profit – (Administration, Selling and distribution and financial expenses expenses)
8.	Operating Profit Ratio	$\frac{\text{Operating Profit}}{\text{Sales}} \times 100$	Operating profit = Net profit + Non-operating expenses – Non-operating income [OR] Gross profit – Operating expenses
9.	Operating Ratio	$\frac{\text{Cost of goods sold + Operating expenses}}{\text{Sales}} \times 100$	
10.	Capital Turnover Ratio	$\frac{\text{Sales}}{\text{Capital Employed}}$	Capital employed = Equity share capital + Preference share capital + reserves and surplus + long term borrowed funds
11.	Fixed Assets Turnover Ratio	$\frac{\text{Sales}}{\text{Fixed Assets}}$	Fixed assets = Fixed assets – Depreciation
12.	Stock Turnover Ratio	$\frac{\text{Cost of goods sold}}{\text{Average stock}}$	Average stock = opening stock + closing stock divided by two.
13.	Debtors Turnover Ratio	$\frac{\text{Credit sales}}{\text{Average accounts receivable (Debtors + Bills receivable)}}$	Average accounts receivable is calculated by dividing the opening balance of debtors and bills receivable and closing balance of debtors and bills receivable by two.
14.	Creditors Turnover Ratio	$\frac{\text{Credit Purchases}}{\text{Average accounts payable (Creditors + Bills payable)}}$	Average accounts payable is calculated by dividing the opening balance of creditors and bills payable and closing balance of creditors and bills payable by two.

QUESTIONS

I. Objective Type:

a) Fill in the blanks:

1. ________ is a mathematical relationship between two items expressed in quantitative form.
2. Ratio helps in ________ forecasting.
3. ________ Ratio measures the firm ability to pay off its current dues.
4. ________are those assets which are easily convertible into cash.
5. Bank overdraft is an example of ________ liability.
6. Liquid ratio is used to assess the firm's ________ liquidity.
7. Liquid assets means current assets less ________ and ________.
8. ________ ratio is modified form of liquid ratio.
9. Liquid liabilities means current liabilities less ________.
10. Proprietory ratio shows the relathionship between ________ and total tangible assets.
11. Gross profit can be ascertained by deducting cost of goods sold from ____
12. Stock turnover ratio is otherwise called as ________.
13. 100% – Operating profit ratio is equal to ________ ratio.
14. When total sales is Rs.2,00,000, cash sales is Rs.65,000, then credit sales will be Rs. ________
15. Liquid ratio is otherwise known as ________.

(**Answers:** : 1. Ratio; 2. Financial; 3. Liquid; 4. Current Assets; 5. Current; 6. Short term; 7. Stock, prepaid expenses; 8. Absolute liquid; 9. Bank overdraft; 10. Shareholders fund / Proprietors fund; 11. Sales; 12. Inventory turnover ratio; 13. Operating ratio; 14. Rs.1,35,000; 15. Quick ratio (Acid test ratio))

b) Choose the correct answer :

1. All solvency ratios are expressed in terms of

   a) Proportion b) Times c) Percentage

2. All activity ratios are expressed in terms of

   a) Proportion b) Times c) Percentage

3. All profitability ratios are expressed in terms of

   a) Proportion b) Times c) Percentage

4. Liquid liabilities means

   a) Current liabilities b) Current liabilities – Bank overdraft

   c) Current liabilities + Bank overdraft

5. Shareholders funds includes

   a) Equity share capital, Preference share capital, Reserves & Surplus

   b) Loans from banks and financial institutions

   c) Equity share capital, Preference share capital, Reserves & Surplus and Loans from banks and financial institutions

6. Which of the following option is correct

   a) Tangible Assets = Land + Building + Furniture

   b) Tangible Assets = Land + Building + Goodwill

   c) Tabgible Assets = Land + Furniture + Goodwill + Copy right

7. Gross profit ratio establishes the relationship between

   a) Gross profit & Total sales b) Gross profit & Credit sales

   c) Gross profit & Cash sales

8. Opening stock is equal to Rs.10,000, Purchase Rs.2,00,000 and closing stock is Rs.5,000. Cost of goods sold is equal to

   a) Rs. 2,15,000 b) Rs. 2,10,000 c) Rs. 2,05,000

9. Operating ratio is equal to

   a) 100 – Operating profit ratio b) 100 + Operating profit ratio

   c) Operating profit ratio

10. Total sales is Rs,3,40,000 and the gross profit made is Rs.1,40,000. The cost of goods sold will be _________

    a) Rs.2,00,000 b) Rs. 4,80,000 c) Rs. 3,40,000

11. Total sales of a business concern is Rs.8,75,000. If cash sales is Rs.3,75,000, then credit sales will be

    a) Rs.12,50,000 b) Rs.5,00,000 c) 12,00,000

12. Cost of goods sold is Rs.4,00,000 and average stock is Rs.80,000. Stock turnover ratio will be

    a) 5 times   b) 4 times   c) 7 times

13. Current assets of a business concern is Rs.60,000 and current liabilities are Rs.30,000.Current ratio will be

    a) 1 : 2   b) 1 : 1   c) 2 : 1

14. Equity share capital is Rs.2,00,000, Reserves & surplus is Rs.30,000. Debenture Rs.40,000 and the shareholders funds will be

    a) Rs.2,00,000   b) Rs. 2,30,000   c) Rs. 1,90,000

(**Answers :** 1. (a); 2. (b); 3. (c); 4. (b); 5. (a); 6. (a); 7. (a); 8. (c); 9. (a); 10. (a); 11. (b); 12. (a); 13. (c); 14. (b))

II. Other Questions:

1. What are the siginificance of financial statement analysis?
2. What are the limitations of financial statement analysis?
3. Explain current ratio.
4. What is the need for calculating Debt – Equity ratio?
5. What are profitability ratios?
6. What are operating expenses?
7. Write notes on operating ratio.
8. What are activity ratios?
9. What is debtors turnover ratio?
10. What is accounts receivable?
11. What is account payable?
12. Explain solvency ratios.
13. Write notes on capital turnover ratio.
14. What are current assets?
15. Write notes on net profit ratio.

III. Problems :

1. From the following, calculate the current ratio.

	Rs.
Cash in hand	2,00,000
Sundry debtors	80,000
Stock	1,20,000
Sundry creditors	1,50,000
Bills payable	50,000

(Answer : 2 : 1)

2. Calculate liquid ratio.

	Rs.
Current assets	20,000
Stock	3,000
Prepaid expenses	1,000
Current liabilities	8,000

(Answer : 2 : 1)

3. From the following information, calculate current ratio and liquid ratio

	Rs.		Rs.
Cash	5,000	Debtors	29,000
Bills receivable	5,000	Short term investment	15,000
Stock	52,000	Prepaid expenses	2,000
Creditors	36,000	Bills payable	10,000
Outstanding expenses	8,000		

(Answer: Current ratio 2:1; Liquid ratio 1:1)

4. From the following, calculate Current ratio & Liquid ratio

Balance Sheet of Gopi Co.Ltd., as on 31.3.05.

Liabilities	Rs.	Assets	Rs.
Share Capital	6,300	Fixed Assets	5,100
Reserves	1,200	Stock	2,100
Bank overdraft	600	Debtors	960
Creditors	1,800	Cash	1,740
	9,900		9,900

(Answer: Current ratio 2:1; Liquid ratio 1.13:1)

5. From the following, you are required to calculate liquidity ratios.

	Rs.		Rs.
Debtors	5,000	Creditors	4,000
Cash in hand	4,000	Bills payable	3,000
Cash at Bank	6,000	Outstanding expenses	250
Short Term Investments	2,000	Bills receivable	3,000
Prepaid expenses	1,000	Closing stock	8,000

(Answer : Current Ratio 4:1; Liquid Ratio 2.76:1; Absolute Ratio 1.66:1)

6. From the following information, calculate current ratio, liquid ratio & Absolute liquid ratio.

	Rs.		Rs.
Cash	1,800	Creditors	5,000
Debtors	14,200	Outstanding expenses	1,500
Stock	18,000	Bank overdraft	7,500
Bills Payable	2,700		

(Answer: Current ratio 2.04:1; Liquid ratio 0.96:1; Absolute liquid ratio 0.196:1)

7. Calculate Debt - Equity ratio

	Rs.
Equity share capital	2,00,000
General Reserve	1,50,000
Long term loan	50,000
Debentures	1,00,000

(Answer: 0.43:1)

8. From the following, Calculate Gross Profit Ratio.

	Rs.
Gross Profit	50,000
Sales	5,50,000
Sales Return	50,000

(Answer: 10%)

9. Calculate Gross Profit ratio

	Rs.
Sales	6,50,000
Cost of Goods sold	4,80,000
Sales Return	50,000

(Answer: 20%)

10. Calculate Capital turnover ratio

	Rs.		Rs.
Sales	10,20,000	Sales Returns	20,000
Equity Share Capital	1,00,000	Loans	25,000
Preference Share Capital	50,000	Reserves	25,000

(Answer: 5 Times)

11. From the following data, calculate the Fixed Asset Turnover ratio

	Rs.
Fixed Assets	3,00,000
Depreciation	1,00,000
Total Sales	8,50,000
Sales Returns	50,000

(Answer: 4 times)

12. Calculate Net Profit Ratio

	Rs.
Net Profit	4,000
Sales	44,000
Sales Return	4,000

(Answer: 10%)

13. Calculate Operating profit ratio

	Rs.		Rs.
Gross profit	1,00,000	Operating expenses	40,000
Sales	6,02,000	Sales return	2,000

(Answer: 10%)

14. Calculate Fixed Assets Turnover Ratio

	Rs.
Fixed asset	1,00,000
Depreciation	25,000
Sales	3,00,000

(Answer: 4 times)

15. Calculate Fixed Assets Turnover Ratio

	Rs.
Fixed Assets	1,50,000
Sales	4,50,000

(Answer: 3 times)

16. From the following, determine the stock turnover ratio

	Rs.
Opening Stock	40,000
Closing stock	30,000
Purchases	95,000

(Answer: 3 times)

17. Calculate Stock turnover ratio

	Rs.
Opening Stock	15,000
Closing stock	25,000
Purchases	60,000

(Answer: 2.5 times)

18. Compute Debtors turnover ratio

	Rs.
Total Sales	7,50,000
Sales Return	50,000
Opening Debtors	1,17,000
Closing Debtors	83,000

(Answer: 7 times)

19. From the following, determine Debtors Turnover ratio

	Rs.		Rs.
Total Sales	1,75,000	Cash Sales	35,000
Sales Return	10,000	Opening Debtors	8,000
Closing Debtors	12,000		

(Answer: 13 times)

20. Calculate creditors turnover from the following information

	Rs.		Rs.
Total Purchases	85,000	Cash Purchases	20,000
Purchases Return	5,000	Opening Creditors	25,000
Closing Creditors	15,000		

(Answer: 3 times)

21. From the Trading & Profit & Loss Account of Fashion World Ltd., ascertain the profitability ratios.

Trading and Profit & Loss Account

Dr. **for the year ending 31.3.04** **Cr.**

Particulars	Rs.	Particulars	Rs.
To Opening stock	20,000	By Sales	1,60,000
To Purchases	1,20,000	By Closing stock	32,000
To Gross profit	52,000		
(transferred to profit & loss A/c)			
	1,92,000		1,92,000
To Administration expenses	12,000	By Gross profit	52,000
To Selling expenses	8,000	By Dividend	400
To Finance expenses	4,000		
To Loss on sale of furniture	500		
To Net Profit	27,900		
	52,400		52,400

(Answer: Gross Profit ratio 32.5.%; Net Profit ratio 17.44%; Operating Profit ratio 20%; Operating cost ratio 80%)

22. From the following, calculate Profitability ratios.

Trading & Profit and Loss of Ambika & Co.

Dr. **for the year ending 31.3.2004** **Cr.**

Particulars	Rs.	Particulars	Rs.
To Opening stock	1,99,000	By Sales	17,00,000
To Purchases	11,19,000	By Closing stock	2,98,000
To Gross profit	6,80,000		
	19,98,000		19,98,000
To Administration expenses	3,00,0000	By Gross profit	6,80,000
To Selling expenses	60,000	By Interest	18,000
To Finanicial expenses	30,000		
To Loss on sale of Plant	8,000		
To Net Profit	3,00,000		
	6,98,000		6,98,000

(Answer: Gross Profit ratio 40%; Net Profit ratio 17.65%; Operating Profit ratio 18.82%; Operating ratio 81.18%)

23. From the following Balance sheet, calculate Debtors turnover, creditors turnover, Capital turnover & Fixed asset turnover ratio.

Balance Sheet as on 31.3.04

Liabilities	**Rs.**	**Assets**	**Rs.**
Share Capital	4,00,000	Land & Building	3,00,000
Reserves	2,40,000	Plant & Machinery	1,60,000
Creditors	2,60,000	Stock	2,96,000
6% Debentures	60,000	Debtors	1,42,000
		Cash	62,000
	9,60,000		9,60,000

Additional Information:

Credit Purchases during the year Rs. 10,40,000

Credit Sales during the year Rs. 4,26,000

(Answer: Debtors turnover ratio - 3 times; Creditors turnover ratio - 4 times; Capital turnover ratio - 0.61 times, Fixed asset turnover ratio - 0.93 times)

24. From the following, calculate Operating profit ratio and Operating ratio, Gross profit ratio and Net profit ratio.

	Rs.		Rs.
Sales	1,00,000	Dividend received	400
Gross profit	30,000	Net profit	26,600
Administration expenses	1,000		
Selling expense	2,000		
Loss on sale of investments	800		

(Answer: Gross profit ratio - 30%: Net profit ratio - 26.6%; Operating profit ratio - 27%; Operating ratio - 73%)

25. From the following Balance sheet of Mumthaj Industries Ltd., you required to calculate Debt-Equity ratio, Proprietary ratio, Current ratio, Fixed assets turnover ratio.

Balance Sheet as on 31.03.05

Liabilities	Rs.	Assets	Rs.
Share Capital	1,00,000	Fixed Assets	1,20,000
General Reserve	20,000	Current Assets	80,000
Debentures	30,000		
Current liabilities	50,000		
	2,00,000		2,00,000

Additional information : Credit sales during the year was Rs.4,80,000.

(Answer: Debt-Equity ratio - 0.25:1; Proprietory ratio - 0.6:1; Current ratio - 1.6:1; Fixed asset turnover ratio - 4 times)

26. From the following Balance sheet calculate 1. Current ratio, 2. Liquid ratio, 3. Debt-Equity ratio & 4. Proprietory ratio

Balance Sheet of Jasmine Ltd. as on 31.03.2004

Liabilities	Rs.	Assets	Rs.
Share Capital	20,000	Goodwill	12,000
Reserves	10,000	Fixed Assets	28,000
Loans	16,000	Stock	8,000
Creditors	10,000	Debtors	4,000
Bank overdraft	4,000	Bills receivable	2,000

		Cash	6,000
	60,000		60,000

(Answer: Current ratio 1.43:1; Liquid ratio 0.86:1; Debt-Equity ratio 0.53:1; Proprietory ratio 0.625:1)

27. Calculate Current Ratio, Liquid ratio, Absolute liquid ratio, Debtors turnover and Creditors turnover ratio from the following Balance Sheet

Balance Sheet

Liabilities	**Rs.**	**Assets**	**Rs.**
Equity Share Capital	55,000	Land & Buildings	20,000
Preference share		Plant & Machinery	22,000
capital	15,000	Furniture & fixtures	3,000
General Reserve	25,000	Stock	47,000
Debentures	35,000	Bills Receivable	10,000
Bills payable	3,000	Debtors	23,000
Bank overdraft	3,000	Short term investments	5,000
Creditors	8,000	Prepaid expenses	1,000
Outstanding expenses	6,000	Cash	19,000
	1,50,000		1,50,000

Additional information:

Credit sales Rs. 1,65,000 Credit purchases Rs. 44,000

(Answer: Current ratio 5.25:1; Liquid ratio 2.85:1; Absolute liquid ratio 1.41:1; Debtors turnover ratio 5 times; Creditors turnover ratio 4 times)

28. The following is the summarised Trading and Profit and Loss A/c, for the year ending and the Balance Sheet as at that date:

Trading and Profit and Loss Account

Dr. **for the year ending 31.3.2005** **Cr.**

Particulars	Rs.	Particulars	Rs.
To Opening stock	10,000	By Sales	1,00,000
To Purchases	50,000	By Closing stock	15,000
To Direct expenses	5,000		

To Gross profit c/d	50,000		
	1,15,000		1,15,000
To Administration expenses	15,000	By Gross profit b/d	50,000
To Interest	3,000		
To Selling expenses	12,000		
To Net Profit	20,000		
	50,000		50,000

Balance Sheet as on 31.3.2005

Liabilities	Rs.	Assets	Rs.
Capital	1,00,000	Land and Building	50,000
Current liabilities	40,000	Plant and Machinery	30,000
Profit and Loss A/c	20,000	Furniture	20,000
		Stock	15,000
		Sundry debtors	15,000
		Bills receivable	12,500
		Cash in hand & at bank	17,500
	1,60,000		1,60,000

From the above, calculate –

(i) Gross Profit Ratio, (ii) Current Ratio, (iii) Acid Test Ratio,

(iv) Stock Turnover Ratio, (v) Fixed Assets Turnover Ratio.

(Answer: Gross Profit Ratio 50%; Current Ratio 1.5:1; Acid Test Ratio 1.125:1; Stock Turnover Ratio 4 times; Fixed Assets Turnover Ratio 1 time)

Chapter - 5
CASH BUDGET

Learning Objectives

After studying this Chapter, you will be able to:

- *understand the meaning, definition, characteristics and advantages of Cash budget.*
- *prepare cash budget using receipts and payments method.*

Cash Budget is a component of two words - cash and budget. The term "cash" here stands for cash and bank balance. "Budget" means, in simple words, an estimate relating to future activities of an organisation.

5.1 Budget

Budget is a blue print of future course of action and activities. Budget means expressing the future course of action of an organisation in quantitative terms.

Longman's Dictionary of Business English defines a budget as "an account of the probable future income and expenditure".

According to the **Institute of Cost and Management Accountants, London,** Budget is "a financial and/or quantitative statement, prepared and approved prior to a defined period of time, of the policy to be pursued during that period for the purpose of attaining a given objective".

5.1.1 Characteristics:

Budget has the following important characteristics

1. It is prepared in advance and relates to a future period.
2. It is expressed in terms of money and/or physical units.
3. It is a mean to achieve the planned objective.

In business, the different kinds of budgets are prepared to facilitate different aspects of the business concern. Such aspects relate to sales, purchases, production, overheads as well as financing of the business. One of the main budgets prepared by a business concern is **Cash Budget**.

5.2 Cash Budget

Cash budget is one of the most important budgets prepared by a business concern as every transaction directly or indirectly deals with cash. **Cash budget** shows the estimate of cash receipts and cash payments from all sources over a specific period. This is also called as 'Finance Budget'.

5.2.1 Advantages

1. It helps in maintaining an adequate cash balance.
2. It provides the following useful information to the management
   a. to determine the future cash needs of a business concern
   b. to plan for financing those needs and
   c. to have control over cash balance of the business concern.

Thus, in short cash budget is an useful tool for financial planning.

5.2.2 Preparation of cash budget – Methods

There are three methods by which a cash budget is prepared. They are

1. Receipts and Payments Method
2. Adjusted Profit and Loss Account Method or Cash Flow Method
3. Balance Sheet Method

However, among the three methods only "Receipts and Payments Method" alone is discussed in this chapter.

Receipts and Payments Method

Under this method Cash budget projects the concern's cash receipts and payments for a certain period (budget period). It has two basic components:

1. Estimate of cash receipts and
2. Estimate of cash payments

Cash Receipts include:

- Cash sales
- Cash receivable from customers
- Business receipts like interest, commission, dividend etc
- Sale of assets
- Proceeds from issue of shares/debentures Loans borrowed
- Loans borrowed

Cash Payments include:

- Cash purchases

- payable to suppliers
- Business expenses like wages, office expenses, selling expenses, etc.
- Payment of interest, income tax, dividend etc.
- Purchase of assets
- Redemption of shares/debentures
- Repayment of loans

Steps in the preparation of cash budget

Step 1 → Ascertain opening cash balance

Step 2 → Add the estimated total cash receipts for the month

Step 3 → Calculate the total cash available for the month

Step 4 → Less the estimated total cash payments during the month

Step 5 → Calculate the closing cash balance

Format:

Cash Budget for the period ——————

Particulars	Month 1 Rs.	Month 2 Rs.	Month 3 Rs.
Opening Cash Balance			
Add: Estimated cash receipts :			
Cash sales			
Cash receivable from customers			
Business receipts like Interest, commission, dividend etc			
Sale of assets Loans borrowed			
Proceeds from issue of shares / debentures			
Total cash available during the month			
Less: Estimated cash payments :			
Cash purchases			
Payable to suppliers			
Business expenses – wages, office expenses, selling expenses, etc			
Business Payments – Interest paid, income tax, dividend etc.			

Purchase of assets			
Repayment of loans			
Redemption of shares/debentures			
Total cash payments during the month			
Closing cash balance			

The closing cash balance of the current month will be the opening cash balance of the next month.

Illustration : 1

From the following information, prepare cash budget for June 2005.

Particulars	Rs.
Cash in hand 1.6.2005	10,000
Cash purchases for June, 2005	70,000
Cash sales for June, 2005	1,00,000
Interest payable in June, 2005	1,000
Purchase of Office furniture in June, 2005	2,500

Solution:

Cash Budget for the month June, 2005

Particulars	Rs.
Opening cash balance	10,000
Add: Estimated receipts:	
Cash Sales	1,00,000
Total cash available during the month	1,10,000
Less: Estimated cash payments:	
Cash purchases	70,000
Interest paid	1,000
Purchase of furniture	2,500
Total cash payments	73,500
Closing cash balance	36,500

Illustration : 2

Prepare a cash budget for the months of June, July, August 2004 from the following information:

1. Opening cash balance in June Rs.7,000.
2. Cash sales for June Rs.20,000; July Rs.30,000 and August Rs.40,000.
3. Wages payable Rs.6,000 every month.
4. Interest receivable Rs.500 in the month of August.
5. Purchase of furniture for Rs.16,000 in July.
6. Cash Purchases for June Rs.10,000; July Rs.9,000 and August Rs.14,000.

Solution:

Cash Budget for the period June to August 2004

Particulars	June Rs.	July Rs.	August Rs.
Opening cash balance	7,000	11,000	10,000
Add: Estimated cash receipts :			
Cash sales	20,000	30,000	40,000
Interest	—	—	500
Total cash available during the month	27,000	41,000	50,500
Less: Estimated cash payments :			
Cash purchases	10,000	9,000	14,000
Payment of wages	6,000	6,000	6,000
Purchase of furniture	—	16,000	—
Total cash payments during the month	16,000	31,000	20,000
Closing cash balance	11,000	10,000	30,500

Note : The closing cash balance in June will be the opening cash balance in July.

Illustration : 3

From the following information, prepare a budget for three months from October 2003.

1. Opening cash balance in October Rs.3000.
2. Cash Sales October: Rs.25,000; November : Rs.20,000;
   December : Rs.15,000

3. Credit purchases – September Rs.10,000; October Rs.12,000; November Rs.14,000; December Rs.16,000. The period of credit allowed by suppliers is one month.
4. Dividend to be received in December Rs.4,000.
5. Advance tax Rs.3,000 payable in October.
6. Sale of an old asset for Rs.12,000 during November.

Solution:

Cash Budget for the period October to December 2003

Particulars	October Rs.	November Rs.	December Rs.
Opening cash balance	3,000	15,000	35,000
Add: Estimated cash receipts :			
Cash sales	25,000	20,000	15,000
Interest	—	—	4,000
Sale of asset	—	12,000	—
Total cash available during the month	28,000	47,000	54,000
Less: Estimated cash payments :			
Payment to suppliers	10,000	12,000	14,000
Advance income tax payable	3,000	—	—
Total cash payments during the month	13,000	12,000	14,000
Closing cash balance	15,000	35,000	40,000

Note: The suppliers of goods have given one month credit, so the purchases made in September will be paid in October and those purchases in October will be paid in November, those purchases in November will be paid in December.

Illustration : 4

From the following information, prepare a cash budget for April, May and June 2005.

Month	Credit Sales Rs.	Credit Purchases Rs.	Office Expenses Rs.
February	45,000	30,000	8,000
March	55,000	25,000	7,000
April	60,000	20,000	7,000
May	60,000	40,000	9,000
June	65,000	40,000	9,000

1) Opening cash balance Rs.5000.

2) Credit allowed by suppliers is two months.

3) Credit allowed to customers is one month.

4) Office expenses are payable in the same month

5) Dividend Rs.1000 is receivable in April.

6) Interest payable in May Rs.1,800.

Solution:

Cash Budget for the period April to June, 2005

Particulars	April Rs.	May Rs.	June Rs.
Opening cash balance	5,000	24,000	48,200
Add: Estimated cash receipts :			
Cash receivable from customers	55,000	60,000	60,000
Dividend	1,000	—	—
Total cash available during the month	61,000	84,000	1,08,200
Less: Estimated cash payments :			
Payments to suppliers	30,000	25,000	20,000
Office expenses	7,000	9,000	9,000
Interest Payable	---	1,800	---
Total cash payments during the month	37,000	35,800	29,000
Closing cash balance	24,000	48,200	79,200

Illustration : 5

Prepare a cash budget for the months – March, April and May 2005 from the following informatio

Month	Credit Sales Rs.	Credit Purchase Rs.	Wages Rs.	Misc Expenses Rs.	Office Expenses Rs.
January	60,000	36,000	9,000	4,000	2,000
February	82,000	38,000	8,000	3,000	1,500
March	84,000	33,000	10,000	4,500	2,500
April	78,000	35,000	8,500	3,500	2,000
May	56,000	39,000	9,500	4,000	1,000

Additional information:

1) Opening cash balance Rs. 8,000.
2) Period of credit allowed to customers one month
3) Period of credit allowed by suppliers two months.
4) Wages and miscellaneous expenses are payable in the same month.
5) Lag in payment of office expenses in one month

Solution:

Cash Budget for the period March, April & May 2005

Particulars	March Rs.	April Rs.	May Rs.
Opening cash balance	8,000	38,000	69,500
Add: Estimated cash receipts :			
Cash receivable from customers	82,000	84,000	78,000
Total cash available during the month	90,000	1,22,000	1,47,500
Less: Estimated cash payments :			
Payments to supplier	36,000	38,000	33,000
Wages	10,000	8,500	9,500
Office expenses	1,500	2,500	2,000
Miscellaneous expenses	4,500	1,800	4,000
Total cash payments during the month	52,000	52,500	48,500
Closing cash balance	38,000	69,500	99,000

Notes:

1. The closing cash balance in March will be the opening balance in April and so on.
2. Since credit allowed to customers is one month, the amount of credit sales in February is collected in March and so on.
3. Since credit allowed by suppliers is two months credit purchases of January is paid in March and so on.
4. Office expenses are paid in the next month, so office expenses for February will be paid in March and so on.

QUESTIONS

I. Objective Type:

a) Fill in the blanks:

1. The term 'cash' in cash budget stands for ________ and ________.
2. Cash budget is also called as ________.
3. There are ________ methods by which a cash budget is prepared.
4. The opening balance of cash in April is Rs.1250. Total receipts for the month are Rs.4300 and total payments amounted to Rs.3750. Opening balance of cash in May will be ________
5. Cash budget is a useful tool for ________.
6. The closing balance of one month will be the ________ balance of the next month.

(**Answers:** 1. Cash balance, Bank balance; 2.Finance Budget; 3. Three; 4. Rs.1,800; 5. Financial Planning; 6. opening)

b) Choose the correct answer :

1. Budget is an estimate relating to_______ period.

   a) future b) current c) past

2. Budget is expressed in terms of

   a) Money b) Physical units c) Money & Physical units

3. Cash budget deals with

   a) Estimated cash receipts b) Estimated cash payments

   c) Estimated cash receipts & Estimated cash payments

4. Purchase of Furniture is an example for

   a) Cash receipts b) Cash payments c) None of the above

5. The opening balance of cash in January is Rs.9,000. The estimated receipts are Rs.14,000 and the estimated payments are Rs.10,000. The opening balance of cash in February will be

   a) Rs. 21,000 b) Rs. 11,000 c) Rs. 13,000

(**Answers :** 1. (a); 2. (c); 3. (c); 4. (b); 5. (c))

II. Other Questions:

1. Define Budget

2. What are the characteristics of a budget?

3. Write notes on Cash budget

4. What are the advantages of cash budget?

5. List the methods that can be used for the preparation of the cash budget.

6. Give few examples for cash receipts?

7. Give few examples for cash payments?

8. Enumerate the steps in the preparation of cash budget.

III. Problems :

1. Prepare cash budget for the month of January 2005 from the following information

    a) Cash in hand (estimated) Rs.250

    b) Cash sales for January, 2005 Rs.6,500

    c) Wages for the month January Rs.2,375

    d) Cash purchases Rs.2,745

    e) Interest receivable on investments Rs.175.

(Answer: Balance of cash Rs.1,805)

2. Prepare cash budget for the month of October from the following information

    a) Estimated cash balance on 1st October Rs.1,775

b) Credit sales :	August	Rs.14,000
	September	Rs.16,000
	October	Rs.17,000

    Period of credit allowed to customers is one month

c) Credit purchases	August	Rs. 8,000
	September	Rs.12,000
	October	Rs.10,000

    Period of credit allowed by suppliers is two months

    d) Purchase of plant Rs. 7,000

    e) Wages to be paid in October Rs. 2,000

(Answer: Rs. 775)

3. Prepare cash budget for the month of March from the following information
   a) Estimated cash balance on 1st March Rs.8,775
   b) Credit sales :

January	Rs.70,000
February	Rs.80,000
March	Rs.85,000

   Period of credit allowed to customers is one month
   c) Credit purchases

January	Rs. 40,000
February	Rs.60,000
March	Rs.50,000

   Period of credit allowed by suppliers is two months
   d) Purchase of plant Rs. 35,000
   e) Wages to be paid in March Rs. 10,000

(Answer: Rs. 3,775)

4. Prepare cash budget for the months of June and July 2004.
   a) Opening cash balance estimated in June Rs.4,025
   b) Cash purchases in June Rs.12,000 and July Rs.16,000
   c) Cash sales in June Rs.18,000 and July Rs.24,000
   d) Salaries payable in June Rs.5,000 and July Rs.5,000
   e) Repayment of a loan in July Rs.6,500

(Answer: Closing balance – June Rs.5,025; July Rs.1525)

5. Prepare a cash budget for the month of August and September 2004 from the following information

		Credit Sales Rs.	Credit Purchases Rs.	Wages Rs.	Selling Expenses Rs.
June	2004	1,87,000	1,24,800	12,000	8,600
July	2004	1,92,000	1,83,600	14,000	4,800

August	2004	1,94,000	1,46,000	11,000	6,600
September	2004	1,26,000	1,73,400	10,000	7,500

1. Suppliers allowed two months credit.
2. Customers were given one month credit.
3. Wages are payable in the same month.
4. Delay in payment of selling expenses was one month.
5. Commission receivable Rs.11,025 in August.
6. Estimated cash balance as on 1st August Rs.9,075

(Answer: August Rs. 71,500; September Rs.65,300)

6. Prepare a cash budget for the month of January, February and March 2005 from the following information

Month & Year		Credit purchases	Credit sales	Wages
		Rs.	Rs.	Rs.
November	2004	2,00,000	2,50,000	50,000
December	2004	3,00,000	3,50,000	60,000
January	2005	3,00,000	4,50,000	60,000
February	2005	4,00,000	2,00,000	80,000
March	2005	5,00,000	3,50,000	70,000

1. Expected Cash balance on 1.1.2005 is Rs.75,000
2. Suppliers allowed a credit period of two months
3. A credit period of two months is allowed to customers
4. Lag in payment of wages is one month

(Answer: January Rs.65,000; February Rs.55,000;

March Rs. 1,25,000)

7. From the following, prepare a cash budget for August & September 2004

	July Rs.	August Rs.	September Rs.
Cash purchases	1,00,000	2,00,000	3,00,000
Cash sales	2,75,000	3,25,000	4,75,000

Credit purchase	1,45,000	2,45,000	3,25,000
Credit sales	2,75,000	3,45,000	4,00,000
Expenses	50,000	60,000	70,000

1. Estimated Opening balance of cash on 1st August Rs.80,000
2. Credit allowed by suppliers and to customer is one month
3. Expenses are payable in the same month
4. Dividend receivable in August is Rs.16,000
5. Commission payable in September is Rs.2,70,000.

(Answer: August Rs. 2,91,000; September Rs.2,26,000)

8. Prepare a cash budget for January, February and March 2005 from the following information

Month		Sales Rs.	Purchases Rs.	Expenses Rs.
December	2004	5,00,000	4,00,000	55,000
January	2005	6,00,000	6,00,000	65,000
February	2005	7,00,000	4,00,000	75,000
March	2005	8,00,000	5,00,000	85,000

1. All sales are for cash.
2. The period of credit allowed by the suppliers is one month.
3. Lag in payment of expenses is one month.
4. Opening cash balance on 1.1.05 is Rs.45,000.
5. In March, an asset for Rs.2,00,000 is to be purchased

(Answer: January Rs.1,90,000; February Rs.2,25,000;

March Rs.3,50,000)

9. From the following, prepare a cash budget for June & July 2005

	May Rs.	June Rs.	July Rs.
Cash purchases	50,000	1,00,000	1,50,000
Cash sales	1,37,500	1,62,500	2,37,500
Credit purchase	72,500	1,22,500	1,62,500

Credit sales	1,37,500	1,72,500	2,00,000
Expenses	25,000	30,000	35,000

1. Estimated Opening balance of cash on 1st June Rs.40,000
2. Credit allowed by suppliers and to customer is one month
3. Expenses are payable in the same month
4. Dividend receivable in June is Rs.8,000
5. Commission payable in July is Rs.1,35,000.

(Answer: June Rs. 1,45,500; July Rs.1,13,000)

10. Prepare a cash budget for October, November and December 2004 from the following information

Month		Sales Rs.	Purchases Rs.	Expenses Rs.
September	2004	10,00,000	8,00,000	1,10,000
October	2004	12,00,000	12,00,000	1,30,000
November	2004	14,00,000	8,00,000	1,50,000
December	2004	16,00,000	10,00,000	1,70,000

1. All sales are for cash.
2. The period of credit allowed by the suppliers is one month.
3. Lag in payment of expenses is one month.
4. Opening balance of cash on 1.10.04 is Rs.90,000.
5. In December, an asset for Rs.4,00,000 is to be purchased.

(Answer: October Rs.3,80,000; November Rs.4,50,000;

December Rs.7,00,000)

11. Prepare a cash budget for the month of March, April and May 2005 from the following information

Month	Credit purchases	Credit sales Rs.	Administration & Selling expenses Rs.
January	75,000	1,50,000	1,20,000
February	1,00,000	1,35,000	1,35,000
March	85,000	1,75,000	65,000

April	1,25,000	1,20,000	70,000
May	90,000	1,40,000	80,000

1. Expected Cash balance on 1.3.2005 is Rs.80,000
2. Suppliers allowed a credit period of two months
3. A credit period of one month is allowed to customers
4. Expenses are paid in the same month.
5. Sale of fixed asset Rs. 25,000 in April.
6. Purchase of fixed asset in May Rs.25,000.

(Answer: March Rs.75,000; April Rs.1,05,000; May Rs. 35,000)

12. Prepare a Cash Budget of Rama Ltd., for the months of January to March 2004 from the following information:

2003	Credit purchases Rs.	Credit sales Rs.	Expenses Rs.
November	2,00,000	2,50,000	50,000
December	3,50,000	3,00,000	60,000
2004			
January	3,00,000	4,50,000	70,000
February	4,00,000	2,00,000	80,000
March	5,00,000	3,50,000	70,000

Additional Information:

i) Expected cash balance as on 1.1.2004 Rs.75,000

ii) Suppliers allowed credit of two months and a credit of two months is allowed to the customers

iii) Lag in payment of expenses one month.

iv) Sale of fixed assets in the month of February Rs. 95,000

(Answer: January Rs.65,000; February Rs.40,000; March Rs.1,10,000)

Chapter - 6
PARTNERSHIP ACCOUNTS
- BASIC CONCEPTS

Learning Objectives

After studying this Chapter, you will be able to

- *understand the meaning and the features of partnership.*
- *prepare the capital accounts of partners under fixed and fluctuating capital methods.*
- *understand the distribution of profits among the partners.*
- *prepare the Profit and Loss appropriation account.*
- *know the meaning, nature and methods of valuation of goodwill.*

A business may be organised in the form of a sole proprietorship, a partnership firm or a company. The sole proprietorship has its limitations such as limited capital, limited managerial ability and limited risk - bearing capacity. Hence, when a business expands, it needs more capital and involves more risk. Then two or more persons join hands to run it. They agree to share the capital, the management, the risk and the Profit or Loss of the business. Such mutual relationship based on agreement among these persons is termed as **"Partnership".** The persons who have entered into partnership are individually known as **'Partners'** and collectively as **'Firm'**.

6.1 Definition

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

6.1.1 Features:

Based on the above definition, the essential features of partnership are as follows.

1. **An association of two or more persons:** To form a partnership, there must be atleast two persons. Regarding the maximum number of persons, it is limited to 10 in banking business and 20 in other business.

2. **Agreement between the Partners:** The relationship among the partners is established by an agreement. Such agreement forms the basis of their mutual relationship.
3. **Profit sharing:** The agreement between the partners must be to share the profits or losses of the business.
4. **Lawful business:** The agreement should be for carrying on some legal business to make profit.
5. **Business carried on by all or any of them acting for all:** Partnership business must be carried on by all or any of them acting for all. Mutual and implied agency is the essence of partnership.

6.1.2 Accounting rules applicable in the absence of Partnership deed:

Normally, a partnership deed covers all matters relating to mutual relationship among the partners. But, in the absence of agreement, the following provisions of the Indian Partnership Act, 1932 shall apply for accounting purposes.

1. **Interest on Capital :** No interest is allowed on Capitals of the Partners. If as per the partnership deed, interest is allowed, it will be paid only when there is profit. If loss, no interest will be paid.
2. **Interest on Drawings :** No interest will be charged on drawings made by the partners.
3. **Salary/ Commission to partner :** No partner is entitled to salary/ commission from the firm, unless the partnership deed provides for it.
4. **Interest on loan :** If any partner, apart from his share capital, advances money to the firm as loan, he is entitled to interest on such amount at the rate of six percent per annum.
5. **Profit sharing ratio :** The partners shall share the profits of the firm equally irrespective of their capital contribution.

6.2 Partners' Capital Accounts

In partnership firm, the transactions relating to partners are recorded in their respective capital accounts. Normally, each partners capital account is prepared separately. There are two methods by which the capital accounts of partners can be maintained. These are

- Fluctuating Capital method
- Fixed Capital method.

6.2.1 Fluctuating Capital method:

Under the fluctuating capital method, only one account, viz., the capital account for each partner, is maintained. It records all adjustments relating to drawings, interest on capital, interest on drawings, salary and share of profit or loss in the capital account itself. As a result, the balance in the capital accounts keep on fluctuating. In the absence of any instruction, the capital accounts of the partners should be prepared under this method.

Format: *(Fluctuating Capital Method)*

Capital Accounts

Dr. Cr.

Particulars	X Rs.	Y Rs.	Z Rs.	Particulars	X Rs.	Y Rs.	Z Rs.
To Drawings				By Balance b/d			
To Interest on drawings				By Interest on capital			
				By Commission			
To Balance c/d				By Salary			
				By Share of Profit			
				By Balance b/d			

6.2.2 Fixed Capital Method:

Under this method, two accounts are maintained for each partner viz., (i) Capital account and (ii) Current account. The capital account will continue to show the same balance from year to year unless some amount of capital is introduced or withdrawn. In the current account, the transactions relating to drawings, interest on capital, interest on drawings, salary, share of profit or loss etc., are recorded. Hence, the balance in the current accounts change every year.

Format : *(Fixed Capital Method)*

Capital Accounts

Dr. Cr.

Particulars	X Rs.	Y Rs.	Z Rs.	Particulars	X Rs.	Y Rs.	Z Rs.
To Balance c/d				By Balance b/d			
				By Balance b/d			

Current Accounts

Dr. Cr.

Particulars	X Rs.	Y Rs.	Z Rs.	Particulars	X Rs.	Y Rs.	Z Rs.
To Drawings				By Balance b/d*			
To Interest on drawings				By Interest on capital			
To Balance c/d*				By Commission			
				By Salary			
				By Share of Profit			
				By Balance b/d*			

* The balance may be on the opposite side also.

6.2.3 Distinction between Fixed Capital Method and Fluctuating Capital Method

The main differences between the two methods of maintaining capital accounts are as follows:-

Basis of distinction	Fixed Capital Method	Fluctuating Capital Method
1. Change in capital	The capital normally remains unchanged except under special circumstances.	The capital is changing from period to period.
2. Number of Accounts	Each partner has two accounts, namely, Captial Account and Current Account.	Each partner has only one account i.e., Capital Account.
3. Balance	Capital Account shows always a credit balance. Current account may sometimes show debit or credit balance.	Capital Account shows always a credit balance.
4. Adjustments	All adjustments relating to partners are recorded in the Current Accounts.	All adjustments relating to partners are recorded directly in the Capital Accounts itself.

6.2.4 Preparation of Capital Accounts:

Illustration : 1

Show how the following items will appear in the capital accounts of the partners, Anbu and Balu.

	Anbu Rs.	Balu Rs.
Capital on 1.4.2004	90,000	70,000
Drawings during 2004 - 2005	12,000	9,000
Interest on drawings	360	270
Interest on capital	5,400	4,200
Partner's salary	12,000	---
Commission	---	6,000
Share of profit for 2004-05	6,000	4,000

Solution:

a) When capital accounts are fixed:

Capital Accounts

Dr. Cr.

Date	Particulars	Anbu Rs.	Balu Rs.	Date	Particulars	Anbu Rs.	Balu Rs.
2005				2004			
Mar 31	To Balance c/d	90,000	70,000	Apr 1	By Balance b/d	90,000	70,000
		90,000	70,000			90,000	70,000
				2005			
				Apr 1	By Balance b/d	90,000	70,000

Current Accounts

Dr. Cr.

Date	Particulars	Anbu Rs.	Balu Rs.	Date	Particulars	Anbu Rs.	Balu Rs.
2005				2005			
Mar 31	To Drawings	12,000	9,000	Mar 31	By Interest on Capital	5,400	4,200

"	To Interest on drawings	360	270	"	By Partners' salary	12,000	—
"	To Balance c/d	11,040	4,930	"	By Commission	—	6,000
				"	By Profit & Loss A/c	6,000	4,000
		23,400	14,200			23,400	14,200
				2005			
				Apr 1	By Balance b/d	11,050	4,930

b) When capital accounts are fluctuating:

Capital Accounts

Dr. Cr.

Date	Particulars	Anbu Rs.	Balu Rs.	Date	Particulars	Anbu Rs.	Balu Rs.
2005				2004			
Mar 31	To Drawings	12,000	9,000	Apr 1	By Balance b/d	90,000	70,000
"	To Interest on drawings	360	270	"	By Interest on capital	5,400	4,200
"	To Balance c/d	1,01,040	74,930	"	By Salary	12,000	—
				"	By Commission	—	6,000
					By Profit & Loss A/c	6,000	4,000
		1,13,400	84,200			1,13,400	84,200
				2005			
				Apr 1	By Balance b/d	1,01,400	74,930

Illustration : 2

Write up the capital and current accounts of the partners, Kala and Mala from the following and show how these will appear in the Balance Sheet.

	Kala	Mala
	Rs.	Rs.
Capital on 1.1.2004	1,50,000	1,00,000
Current accounts on 1.1.2004 (Cr.)	20,000	15,000
Drawings during 2004	30,000	40,000
Interest on drawings	900	1,000
Share of profit for 2004	10,000	8,000
Interest on capital	6%	6%

Solution:

Capital Accounts

Dr. Cr.

Date	Particulars	Kala Rs.	Mala Rs.	Date	Particulars	Kala Rs.	Mala Rs.
2004				2004			
Dec 31	To Balance c/d	1,50,000	1,00,000	Jan 1	By Balance b/d	1,50,000	1,00,000
		1,50,000	1,00,000			1,50,000	1,00,000
				2005			
				Jan 1	By Balance b/d	1,50,000	1,00,000

Current Accounts

Dr. Cr.

Date	Particulars	Kala Rs.	Mala Rs.	Date	Particulars	Kala Rs.	Mala Rs.
2004				2004			
Dec 31	To Drawings	30,000	40,000	Dec	By Balance		
”	To Interest			31	b/d	20,000	15,000
	on drawings	900	1,000	”	by Interest on		
”	To Balance				capital	9,000	6,000

	c/d	8,100		”	By Profit & Loss A/c	10,000	8,000
					By Balance c/d		12,000
		39,000	41,000			39,000	41,000
2005				2005			
Jan 1	To Balance b/d		12,000	Jan 1	By Balance b/d	8,100	

Balance Sheet of Kala and Mala as on 31.12.2004

Liabilities	Rs.	Assets	Rs.
Capital Accounts:		Current Account:	
Kala 1,50,000		Mala	12,000
Mala 1,00,000	2,50,000		
Current Account:			
Kala	8,100		

6.3 Distribution of Profits

In a sole trading concern, the net profit disclosed by the Profit and Loss Account belongs to the sole trader and is transferred to his capital account. However, in a partnership firm, the net profit as shown by the Profit and Loss Account need certain adjustments with regard to interest on capitals, interest on drawings, salary and commission to the partners. For this purpose, Profit and Loss Appropriation Account may be prepared. This is merely an extension of the Profit and Loss Account and is prepared to show how net profit has been distributed among the partners.

This account is credited with net profit and interest on drawings and debited with interest on capitals, salary or commission to partners. Net loss will be shown on the debit side. After these adjustments have been made, this account will show the amount of profit or loss which shall be distributed among the partners in the agreed profit sharing ratio.

The various adjustments made in the Profit and Loss Appropriation account are explained below:

6.3.1 Interest on capital:

Interest on capital is allowed to partners only, if the partnership deed specifically allows it. Interest is usually calculated on the opening capital and on the capital introduced during the year. If the date of additional capital introduced during the year is not given, the interest is to be calculated for six months.

Journal Entries:

(a) *To adjust interest on capital*

Interest on capital A/c   Dr.

To Partners' Capital A/c

(In case of fluctuating capital)

or

To Partners' Current A/c

(In case of fixed capital)

(b) *To close the interest on capital account*

Profit & Loss Appropriation A/c   Dr.

To Interest on capital A/c

Illustration : 3

Ravi and Raghu started business on April 1, 2003 with capitals of Rs.90,000 and Rs.70,000 respectively. Ravi introduced Rs.10,000 as additional capital on July 1, 2003. Interest on capital is to be allowed @ 10%. Calculate the interest payable to Ravi and Raghu for the year ending March 31,2004.

Solution:

a) Interest on Ravi's capital:

$$= \left[90{,}000 \times \frac{10}{100}\right] + \left[10{,}000 \times \frac{10}{100} \times \frac{9}{12}\right]$$

$$= \text{Rs.}9{,}000 + \text{Rs.}750$$

$$= \text{Rs.}9{,}750$$

That is

Interest on Rs.90,000 for one year	=	Rs.	9,000
Interest on Rs.10,000 for nine months	=	Rs.	750
Total Interest payable to Ravi	=	Rs.	9,750

b) Interest on Raghu's capital = $70{,}000 \times \frac{10}{100}$

That is

Interest on Rs. 70,000 for one year = <u>Rs. 7,000</u>

Interest payable to Raghu = Rs. 7,000

6.3.2 Interest on Drawings:

Drawings is the amount withdrawn in cash or in kind, for personal purposes. A Drawings Account is opened in the name of each partner and the drawings are debited to this account. At the end of every year, the Drawings Account is closed by a transfer to the respective partner's capital account or current account.

Interest on partners' drawings is charged only, if the Partnership Deed specifically allows it at a particular rate.

Journal Entries:

(a) *To charge interest on drawings*

Partners' Capital A/c *(In case of fluctuating capital)* Dr.

or

Partners' Current A/c *(In case of fixed capital)* Dr.

To Interest on drawings A/c

(b) *To close the interest on drawings account*

Interest on drawings A/c Dr.

To Profit & Loss Appropriation A/c

Interest on drawings can be calculated by applying the following two methods:

1) Product Method

2) Average Period Method

1) Product Method:

Under this method, the amount of drawings for each period is multiplied by the period for which the amount is going to be used. Then, the product is summed up and the following formula is used to find the interest on drawings.

$$\text{Interest on drawings} = \text{Product} \times \frac{\text{Rate of interest}}{100} \times \frac{1}{12}$$

If the amount is withdrawn at irregular period of months:

It is easier to calculate under Product Method.

2) Average Period Method:

Interest on drawings is to be calculated with reference to the average of the periods for which the money is withdrawn.

Interest on Drawings:

$$= \text{Total drawings} \times \frac{\text{Rate of interest}}{100} \times \frac{\text{Average period}}{12}$$

Calculation of Average Period :

The average period is calculated to take the period for the average of the periods applicable to the first instalment and the last instalment.

$$\text{Average Period} = \frac{\text{Beginning period of use + Ending period of use}}{2}$$

a) If the fixed amount is withdrawn in the beginning of every month:

Take the period at the average of the periods applicable to the first and last instalment.

The period of first instalment is 12 months. The period of last instalment is 1 month.

$$\text{Average Period} = \frac{12+1}{2} = 6\tfrac{1}{2}\text{months}$$

$$= \frac{6\tfrac{1}{2}}{12} \text{ (or) } \frac{13}{24}$$

b) If the fixed amount is withdrawn in the middle of every month:

Take the period at the average of the periods applicable to the first and last instalment.

The period of first instalment is 11½ months.

The period of last instalment is ½ month.

$$\text{Average Period} = \frac{11\tfrac{1}{2} + \tfrac{1}{2}}{2} = \frac{12}{2} = 6 \text{ months}$$

$$= \frac{6}{12} \text{ (or) } \frac{12}{24}$$

c) If the fixed amount is withdrawn at the end of every month:

Take the period at the average of the periods applicable to the first and last instalment.

The period of first instalment is 11 months.

The period of last instalment is 0 month.

$$\text{Average Period} = \frac{11+0}{2} = 5\tfrac{1}{2} \text{ months}$$

$$= \frac{5\tfrac{1}{2}}{12} \text{ (or) } \frac{11}{24}$$

d) When the dates of drawings are not given:

The average of the total period is to be taken

$$\text{Average Period} = \frac{\text{Total period}}{2}$$

1. If the drawings are for one year without dates, the average period is calculated as follows:

$$\text{Average Period} = \frac{12 \text{ months}}{2} = 6 \text{ months}$$

2. If the drawings are for 6 months without dates, then,

$$\text{Average Period} = \frac{6 \text{ months}}{2} = 3 \text{ months}$$

Illustration : 4

A partner draws Rs.1,000 p.m. Interest is to be charged at 10% p.a. Calculate interest on drawings, if the drawings are made

i) in the beginning of the month;

ii) in the middle of the month and

iii) at the end of the month during the year.

Solution:

The total amount of drawings is Rs.12,000 (Rs.1,000 x 12 months). The rate of interest is 10%. Take the period at the average of the periods applicable to the first and the last instalments.

i) When drawings are made in the beginning of the month:

$$\text{Average Period} = \frac{12+1}{2} = \frac{13}{2} = 6\tfrac{1}{2} \text{ months}$$

$$\text{Interest on Drawings} = \text{Total Drawings} \times \frac{\text{Rate of interest}}{100} \times \frac{\text{Average Period}}{12}$$

$$= 12{,}000 \times \frac{10}{100} \times \frac{13}{24}$$

$$= \text{Rs. } 650$$

ii) When drawings are made in the middle of the month:

$$\text{Average Period} = \frac{11\tfrac{1}{2} + \tfrac{1}{2}}{2} = \frac{12}{2} = 6 \text{ months}$$

$$\text{Interest on Drawings} = 12{,}000 \times \frac{10}{100} \times \frac{6}{12}$$

$$= \text{Rs. } 600$$

iii) When drawings are made at the end of the month:

$$\text{Average Period} = \frac{11+0}{2} = \frac{11}{2} = 5\tfrac{1}{2} \text{ months}$$

$$\text{Interest on Drawings} = 12{,}000 \times \frac{10}{100} \times \frac{11}{24}$$

$$= \text{Rs.} 550$$

i) When drawings are made in the beginning of the month - Calculation of Interest on Drawings under Product Method:

Date of drawings	Amount drawn Rs.	Period	Product Rs.
1.1.2004	1,000	12	12,000
1.2.2004	1,000	11	11,000
1.3.2004	1,000	10	10,000
1.4.2004	1,000	9	9,000
1.5.2004	1,000	8	8,000
1.6.2004	1,000	7	7,000
1.7.2004	1,000	6	6,000
1.8.2004	1,000	5	5,000
1.9.2004	1,000	4	4,000
1.10.2004	1,000	3	3,000

1.11.2004	1,000	2	2,000
1.12.2004	1,000	1	1,000
		Sum of products	78,000

Interest on drawings @ 10% p.a. on Rs.78,000.

$$= 78{,}000 \times \frac{10}{100} \times \frac{1}{12}$$
$$= \text{Rs.}650$$

Illustration : 5

P, Q and R were partners sharing profits in the ratio of 3:2:1. P draws Rs.5,000 at the end of each quarter. Q draws Rs.10,000 at the end of each half year. R draws Rs.2,000 on 1.5.2004 Rs.3,000 on 31.10.2004, Rs.5,000 on 30.11.2004. Calculate interest on their drawings at 10% p.a. for the year ending 31.3.2005.

Solution:

Calculation of Interest on Drawings under Product Method:

a) Interest on drawings of P :

Date of drawings	Amount drawn Rs.	Period	Product Rs.
30.6.2004	5,000	9	45,000
30.9.2004	5,000	6	30,000
31.12.2004	5,000	3	15,000
31.3.2005	5,000	0	0
		Sum of products	90,000

Interest on drawings at 10% p.a. on Rs.90,000

$$\text{Interest on Drawings} = 90{,}000 \times \frac{10}{100} \times \frac{1}{12}$$
$$= \text{Rs.}750$$

b) Interest on drawings of Q:

Date of drawings	Amount drawn Rs.	Period	Product Rs.
30.9.2004	10,000	6	60,000
31.3.2005	10,000	0	0
		Sum of products	60,000

Interest on drawings at 10% p.a. on Rs.60,000

$$\text{Interest on Drawings} = 60{,}000 \times \frac{10}{100} \times \frac{1}{12}$$
$$= \text{Rs.}500$$

c) Interest on drawings of R:

Date of drawings	Amount drawn Rs.	Period	Product Rs.
1.5.2004	2,000	11	22,000
31.10.2004	3,000	5	15,000
31.11.2004	5,000	4	20,000
		Sum of products	57,000

Interest on drawings at 10% p.a. on Rs.57,000

$$\text{Interest on Drawings} = 57{,}000 \times \frac{10}{100} \times \frac{1}{12}$$
$$= \text{Rs.}475$$

6.3.3 Salary or Commission to Partners:

Some partners may devote more time or possess better skills and experience in comparison with their fellow partners. As a result, they should be allowed a special compensation either in the form of salary or commission.

Commission may be allowed as a percentage of net profit before charging the commission or after charging the commission. Commission, under the two methods, is computed as under

i) Percentage of Net profit before charging such commission

$$\text{Net Profit before commission} \times \frac{\text{Rate of commission}}{100}$$

ii) Percentage of Net profit after charging such commission

$$\text{Net Profit before commission} \times \frac{\text{Rate of commission}}{100 + \text{Rate of commission}}$$

The accounting entries to be passed to adjust salary or commission:

a) To adjust salary or commission to a partner

Salary or Commission A/c... Dr.

To Partners' Capital A/c *(In case of fluctuating capital)* or

To Partners' Current A/c *(In case of fixed capital)*

b) To close the salary or commission account:

Profit & Loss Appropriation A/c... Dr.

To Salary or Commission A/c...

6.3.4 Preparation of Profit and loss appropriation account:

Illustration : 6

Mahesh and Ramesh are partners sharing profits in the ratio of 3:2 with capitals of Rs.50,000 and Rs.40,000 respectively. Interest on capital is agreed at 8% p.a. Interest on drawings is fixed at 10% p.a. The drawings of the partners were Rs.15,000 and Rs.10,000, the interest for Mahesh Rs.750 and for Ramesh Rs.500. Mahesh is entitled to a salary of Rs.12,000 p.a. and Ramesh is entitled to get a commission of 10% on the Net Profit before charging such commission. The Net Profit of the firm before making the above adjustments was Rs.60,000 for the year ended 31st March, 2005.

Prepare the profit and loss appropriation account.

Solution :

Dr In the Books of the Firm Profit and Loss Appropriation Account Cr

Date	Particulars	Rs.	Date	Particulars	Rs.
2005 Mar 31	To Interest on Capital		2004 Apr 1	By Net profit b/d	60,000
	Mahesh 4,000		2005 Mar 31	By Interest on Drawings	
	Ramesh 3,200	7,200		Mahesh 750	
”	To Partner's Salary			Ramesh 500	1,250
	Mahesh	12,000			
”	To Commission				
	Ramesh (10% on Rs.42,050)	4,205			
”	To Profit transferred to capital A/c				
	Mahesh 22,707				
	Ramesh 15,138	37,845			
		61,250			61,250

Note: Calculation of commission.

Step 1 → Total the credit side of the Profit and Loss Appropriation Account. i.e., Rs.61,250.

Step 2 → Total the debit side of the Profit and Loss Appropriation Account. i.e., Rs. 19,200.

Step 3 → Find the balance. i.e., Rs. 42,050.

Step 4 → Apply the formula.

$$\text{Commission} = \text{Net Profit before commission} \times \frac{\text{Rate of commission}}{100}$$

$$\text{Commission} = 42,050 \times \frac{10}{100}$$

$$= \text{Rs.}4,205$$

The Balance of Rs. 37,845 (Rs.42,050 – Rs.4,205) is transferred to Partners' Capital accounts in the ratio.

Illustration : 7

X and Y are partners in a firm, sharing profits and losses equally. X is entitled to a salary of Rs.5,000 p.m. Y is entitled to a commission of 10% of Net profit after charging such commission. Net profit before charging commission and salary was Rs.1,48,000. Show the Profit and loss appropriation account.

Solution:

a) Calculation of salary to X:

5,000 p.m. for 12 months = 12 x 5,000

= Rs.60,000

b) Calculation of commission to Y:

Percentage of Net profit after charging the commission =

$$\text{Net Profit before commission} \times \frac{\text{Rate of commission}}{100 + \text{Rate of commission}}$$

Net Profit before commission = 1,48,000 - 60,000

= Rs.88,000

$$\text{Commission} = 88,000 \times \frac{10}{100+10}$$

$$= 88,000 \times \frac{10}{110}$$

= Rs, 8.000

In the Books of the Firm

Dr **Profit and Loss Appropriation Account** **Cr**

Date	Particulars	Rs.	Date	Particulars	Rs.
	To X's Salary	60,000		By Net profit b/d	1,48,000
	To Y's Commission	8,000			
	To Net profit transferred to				
	X 40,000				
	Y 40,000	80,000			
		1,48,000			1,48,000

6.4 Goodwill

When a firm is reconstituted, goodwill is valued and shared by the existing partners. Goodwill is the present value of a firm's anticipated excess earnings in future and the efforts had already made in the past. Goodwill really arises only if firm is able to earn higher profit than normal.

6.4.1 Meaning and Nature

Goodwill is the value of the reputation of the firm which the business builds up due to its efficient service to its customers and quality of its products. It is a value of all favourable attributes relating to a business enterprise. It is not merely the past reputation but its continued existence in future that makes goodwill a valuable asset. It cannot be seen or touched. It is an intangible asset but not a fictitious asset.

6.4.2 Factors affecting the value of goodwill:

Goodwill relates to the profit earning capacity of the firm. Thus, the goodwill of a firm is affected by the following factors.

The factors are:

1. **Quality:** If the firm enjoys good reputation for the quality of its products, there will be a ready sale and the value of goodwill, therefore, will be high.
2. **Location:** If the business is located in a prominent place, its value will be more.
3. **Efficient management:** If the management is capable, the firm will earn more profits and that will raise the firm's value.
4. **Competition:** When there is no competition or competition is negligible , the value of those businesses will be high.

5. **Advantage of patents:** Possession of trade marks, patents or copyrights will increase the firm's value.

6. **Time:** A business establishes reputation in course of time which is running for long period on profitable line.

7. **Customers' attitude:** The type of customers which a firm has is important. If the firm has more customers, the value will be high.

8. **Nature of business:** A business having a stable demand is able to earn more profit and therefore has more goodwill.

6.4.3 Methods of valuation of goodwill:

There are three methods of valuation of goodwill. They are:

1) Average Profit method

2) Super Profit method

3) Capitalisation method

However, we are discussing only the first two methods in this chapter.

a) Average profit method:

In this method, past profits of a number of years are taken into account. Such profits are added and the average profit is found out. The average profit is multiplied by a certain number of years to arrive at the value of goodwill.

The steps involved under this method are:

Step 1 → Calculate total profits by adding each years profit and deducting loss, if any.

Step 2 → Calculate the average profit by applying the following formula.

$$\text{Average Profit} = \frac{\text{Total Profits}}{\text{No. of years}}$$

Step 3 → Calculate the Goodwill by applying the following formula.

Goodwill = Average Profit x No. of years' purchase

Illustration : 8

The Goodwill is to be valued at two years' purchase of last four years average profit. The profits were Rs.40,000, Rs.32,000, Rs.15,000 and Rs.13,000 respectively. Find out the value of goodwill.

Solution:

a) Calculation of average profit:

	Rs.
I year	40,000
II year	32,000
III year	15,000
IV year	13,000
Total Profit	1,00,000

$$\text{Average Profit} = \frac{\text{Total Profits}}{\text{No. of years}}$$

$$= \frac{1,00,000}{4}$$

$$= \text{Rs.}25,000$$

b) Calculation of Goodwill:

Goodwill $=$ Average Profit x two years' purchase

$= 25,000 \times 2$

$=$ Rs. 50,000.

Illustration : 9

Three years' purchase of the last four years average profits is agreed as the value of goodwill. The profits and losses for the last four years are: I year Rs.50,000, II year Rs.80,000; III year Rs.30,000(Loss); IV year Rs.60,000.

Calculate the amount of goodwill.

Solution:

a) Calculation of average profit:

	Rs.
I year	50,000
II year	80,000
IV year	60,000
Profit of 3 years	1,90,000
III year loss	30,000
Total profit	1,60,000

$$\text{Average Profit} = \frac{\text{Total Profits}}{\text{No. of years}}$$

$$= \frac{1,60,000}{4}$$

$$= \text{Rs.}40,000$$

b) Calculation of goodwill:

Goodwill = Average Profit x three years' purchase

= 40,000 x 3

= Rs. 1,20,000

b) Super Profit method:

The excess of average profit over normal profit is called super profit. The goodwill under the Super profits method is calculated by multiplying the super profits by certain number of years purchase.

The steps involved under this method are:

Step 1 $\rightarrow$ Calculate the average profit – it may be adjusted for partners remuneration.

Step 2 $\rightarrow$ Calculate the normal profit on capital employed by applying the following formula.

Normal Profit = Capital employed x Normal rate of return

Step 3 $\rightarrow$ Calculate the super profit.by applying the following formula.

Super profit = Average Profit - Normal profit

Step 4 $\rightarrow$ Calculate the value of goodwill by multiplying the amount of super profit by the given number of years' purchase

Goodwill = Super Profit x No. of years of purchase

Illustration : 10

A firm's net profits during the last three years were Rs.90,000 Rs.1,00,000 and Rs.1,10,000. The capital employed in the firm is Rs.3,00,000. A normal return on the capital is 10%. Calculate the value of goodwill on the basis of two years' purchase of super profit.

Solution:

a) Calculation of Average Profit:

	Rs.
I year	90,000
II year	1,00,000
III year	1,10,000
Total Profit	3,00,000

$$\text{Average Profit} = \frac{3,00,000}{3}$$

$$= \text{Rs. } 1,00,000$$

b) Calculation of Normal Profit:

Normal Profit = Capital employed x Normal rate of return

$$= \text{Rs. } 3,00,000 \times \frac{10}{100}$$

$$= \text{Rs. } 30,000$$

c) Calculation of Super Profit:

= Average Profit – Normal Profit

= 1,00,000 – 30,000

= Rs. 70,000.

d) Goodwill at two years' purchase of super profit:

Goodwill = Super Profit x No. of years of purchase

= 70,000 x 2

= Rs. 1,40,000

QUESTIONS

I. Objective Type:

a) Fill in the blanks:

1. A sole trader business is owned and managed by ________ person.
2. Indian Partnership Act was enacted in the year ________.
3. Mutual and ________ agency is the essence of a partnership.

4. The profits and losses of the business will be shared among the partners in the ________ ratio.

5. Under fluctuating capital method, profit or loss in a year, will be transferred to the respective ________ accounts.

6. The capital accounts of partners may be ________ or fluctuating.

7. Under ________ capital arrangement, current accounts will not be maintained.

8. The debit balance of the current account, will be shown in the ________ side of the balance sheet.

9. Interest on partners' capital is allowed, only when the ________ specifically provides for it.

10. Money lent to the business by a partner is credited to his ________ account and not his capital account.

11. Interest on partners' loan should be paid, even if there is no ________ in a year.

12. Goodwill is an ________ asset.

13. The excess of average profit over normal profit is ________.

14. In the absence of partnership deed, no interest is to be charged on ________.

15. A partnership can be formed only for a ________ business.

16. The persons who entered into partnership are collectively known as _____.

(**Answers:** 1. one; 2. 1932; 3. implied; 4. agreed; 5. capital; 6. fixed; 7. fluctuating; 8. assets; 9. partnership agreement; 10. loan; 11. profit; 12. intangible; 13. Super profit; 14. drawings; 15. legal; 16. firm)

b) Choose the correct answer :

1. The minimum number of persons in a partnership firm is

   a) one b) two c) seven

2. In a partnership business, agreement is

   a) compulsory b) optional c) not necessary

3. In a partnership, partners share their profits and losses in ______ ratio

   a) their capital b) equal c) agreed

4. Under fixed capital system, the profits and losses of partners will be transferred to their _______ account

   a) current b) drawings c) capital

5. Interest on capital is calculated on the

   a) Opening Capital b) Closing Capital c) Average Capital

6. Current accounts for partners will be opened under

   a) Fixed capital method

   b) Fluctuating capital method

   c) Either fixed capital method or fluctuating capital method

7. In the absence of an agreement profits and losses are divided

   a) in the ratio of capitals

   b) in the ratio of time devoted by each partner

   c) equally

8. X and Y are partners sharing the profits and losses in the ratio of 2:3 with capitals of Rs.1,20,000 and Rs.60,000 respectively. Profits for the year are Rs.9,000. If the partnership deed is silent as to interest on capital. Show how profit is shared among X and Y.

   a) Profit : X - Rs. 6,000; Y - Rs.3,000

   b) Profit : X - Rs. 3,600; Y - Rs.5,400

   c) Profit : X - Rs. 3,000; Y - Rs.6,000

9. Where a partner is entitled to interest on capital such interest will be payable,

   a) Only out of profits

   b) Only out of capital

   c) Out of profits or out of capital

10. In the absence of partnership deed, partners shall

    a) be paid salaries

    b) not to be paid salaries

    c) paid salaries to those who work for the firm

11. Under fixed capital method salary payable to a partner is recorded

    a) in Current Account

    b) in Capital Account

    c) either in Current Account or Capital Account.

12. If a firm is maintaining both 'Capital Accounts' and 'Current Accounts' of the partners A and B. Additional capital introduced by B will be recorded in

    a) B's Current Account b) B's Capital Account

    c) either B's Capital Account or Current Account

(**Answers :** 1. (b); 2. (b); 3. (c); 4. (a); 5.(a); 6.(a); 7. (c); 8. (b); 9. (a); 10. (b); 11. (a); 12. (b))

II. Other Questions:

1. Define Partnership.
2. What is Drawings?
3. What is Goodwill?
4. What is Average profit?
5. What is Super profit?
6. What is Partner's Current Account?
7. What is Profit and Loss Appropriation Account?
8. What are the features of a partnership?
9. Explain the methods by which the partners' capital accounts are maintained.
10. In the absence of Partnership Deed, how are the following items dealt in the books of accounts of a firm?
    a) Interest on Capital
    b) Interest on drawings
    c) Salaries to partners
    d) Commission to partners
    e) Interest on partners loan
    f) profit sharing ratio
11. What are the differences between fixed capital account and fluctuating capital account?
12. What are the factors affecting goodwill?
13. Explain the methods of valuation of Goodwill.

14. If the Partners' Capital Accounts are fixed, where will you record the following items:

    a) Salary payable to a Partner

    b) Drawings made by a Partner

15. If a firm is maitaining both Capital Accounts and Current Accounts of partners A and B where will the following be recorded

    a) Fresh Capital introduced by B

    b) Share of profits earned by A and B.

16. Mention the items that may appear on the credit side of the capital accounts of a partner when the capitals are fluctuating.

III. Problems :

Fixed and Fluctuating Capitals:

1. Show how the following items will appear in the Capital Accounts of the partners, Ramu and Somu, when their capitals are

   (a) Fluctuating and (b) Fixed.

	Ramu	Somu
	Rs.	Rs.
Capital on 1.4.2004	90,000	60,000
Drawings during 2004-05	18,000	15,000
Interest on Drawings	500	300
Share of Profit for 2004-05	12,000	8,000
Interest on Capital	5,400	3,600
Partner's Salary	6,000	---

(Answer: When Capitals are Fluctuating:

Ramu's Capital Account Rs. 94,900 Somu's Capital Account Rs. 56,300

When Capitals are Fixed:

Ramu's Current Account Rs. 4,900 Cr. Somu's Current Account Rs. 3,700 Dr.)

2. Prepare the Capital Accounts of the partners, Vani and Rani from the following details assuming that their capitals are fluctuating.

	Vani	Rani
	Rs.	Rs.
Capital as on 1.4.2003	2,10,000	1,20,000

Drawings during 2003-04	18,000	12,000
Interest on Capital at 6%	?	?
Interest on Drawings	450	300
Share of Profit 2003-04	24,000	18,000
Partner's Salary	---	6,000
Commission	4,800	3,600
Interest on Rani's Loan A/c	3,000	---

(Answer: Vani's Capital Account Rs. 2,32,950 Rani's Capital Account Rs. 1,42,500)

Note: Interest on Loan should be taken to Loan A/c

3. Write up the Capital and Current Accounts of the partners, Kannagi and Vasugi, from the following details:

	Kannagi		Vasugi	
	Rs.		Rs.	
Capital on 1.4.2003	1,00,000		60,000	
Current A/c on 1.4.2003	3,000	(Dr.)	2,000	(Cr.)
Drawings during 2003-04	8,000		5,000	
Interest on Capital	5,000		3,000	
Interest on Drawings	240		150	
Share of Profit 2003-04	12,000		10,000	
Partner's Salary	4,000		---	

(Answer: Kannagi's Current A/c Rs. 9,760 Cr.

Vasugi's Current A/c Rs. 9,850 Cr.)

4. Prepare the Capital Accounts of the partners Ravi and Raja from the following details assuming that their capitals are fluctuating:

Particulars	**Ravi Rs.**	**Raja Rs.**
Capital as on 1.1.2001	80,000	50,000
Drawings during 2001	6,000	4,000
Interest on Capital at 6%	?	?
Interest on Drawing at 5%	?	?
Profit Shares of 2001	8,000	6,000
Partners' Salary	---	2,000

Commission	1,600	1,200
Interest on Raja's Loan A/c	---	3,000

(October 2002) (Answer: Ravi's Capital Account Rs. 88,250
Raja's Capital Account Rs. 58,100)

Distribution of Profit:

5. Elavarasan and Amudharasan are partners with capitals of Rs.1,50,000 and Rs.1,00,000 respectively on 1st April 2004. The Trading Profit for the year ended 31st March, 2005 was Rs.60,000. Interest on capital is to be allowed at 6% per annum. Amudharasan entitled to a salary of Rs.15,000 per annum. The drawings of the partners were Elavarasan Rs.15,000 and Amudharasan Rs.10,000; The interest on drawings are Elavarasan Rs.500 and Amudharasan Rs.250. Assuming that Elavarasan and Amudharasan are equal partners. Prepare the Profit and Loss Appropriation Account and the Capital Accounts as on 31st March, 2005.

(Answer: Profit Rs. 30,750; Capital Accounts: Elavarasan Rs.1,58,875; Amudharasan Rs. 1,26,125)

6. Amuthan and Raman are partners in a firm showing Profits and Losses in the ratio 3:2. Their capitals on 1.4.2003 were Rs.1,60,000 and Rs.1,20,000 respectively. The Net Profit of the firm for the year ended 31st March 2004 before making adjustments for the above items was Rs.60,000. Drawings of the partners during the year were, Amuthan Rs.12,000 and Raman Rs.8,000. Their Partnership Deed provided for the following:

   1. Interest on Capital at 5% p.a.
   2. Interest on Drawings at 6% p.a.
   3. Amuthan and Raman to get a salary of Rs.10,000 each per annum.
   4. Amuthan to get a commission of 10% on the Net Profit before charging such commission.

   Show the Profit and Loss Appropriation Account and Capital Accounts of the partners

(Answer: a) Net Profit Rs. 23,940;
b) Capital Accounts: Amuthan : Rs. 1,82,664;
Raman : Rs. 1,37,336)

Note: In the absence of actual date of Drawings, Interest on them has to be calculated for an average period of 6 months.

7. Cheran, Pallavan are partners with capitals of Rs.60,000 and Rs.20,000 respectively on 1st January 2001. The Trading Profit (before taking into account the provision of the Deed) for the year ended 31st December, 2001 was Rs.12,000. Interest on capital is to be allowed at 6% per annum. Pallavan is entitled to a salary of Rs.3,000 per annum. The drawings of the partners were Cheran Rs.2,000 and Pallavan Rs.1,000; the interest on drawings for Cheran being Rs.100 and for Pallavan Rs.50.

   Assuming that Cheran, Pallavan are equal partners, prepare the Profit and Loss Appropriation Account and the partners' Capital Account (The capitals are fluctuating as at 31st December, 2001).

(June 2002) (Answer: a) Net Profit Rs. 4350;

b) Capital Accounts: Cheran : Rs. 66,625; Pallavan : Rs. 22,325)

Interest on Capital:

8. Manjula and Vennila started business on 1^{st} April 2004 with capitals of Rs.60,000 and Rs. 50,000 respectively. On 1^{st} July 2004 Manjula withdrew Rs.8,000 from his capital. Vennila introduced additional capital Rs.10,000 on 30.9.2004. Calculate interest on capital at 5% for the year ending 31st March 2005.

(Answer: Interest on capital; Manjula : Rs. 2,700; Vennila : Rs. 2,750)

9. Prince, Queen and King had capitals of Rs. 80,000, Rs.60,000 and Rs.40,000 respectively on 1.4.2004. Queen withdrew Rs.8,000 from his capital on 30.9.2004, King introduced additional capital Rs. 12,000 on 31.12.2004. Calculate interest on capital at 6% for the year ending 31st March 2005.

(Answer: Interest on capital; Prince : Rs. 4,800; Queen : Rs. 3,360; King : Rs.2,580)

10. X and Y had capitals of Rs.80,000 and Rs.40,000 respectively on 1.1.2000. X introduced additional capital of Rs.10,000, on 30.6.2000. Y withdrew Rs.5,000 from his capital on 1.10.2000. Calculate interest on capital at 5% for the year 2000.

(October 2002) (Answer: Interest on capital; X : Rs. 4,250; Y : Rs. 1,937.50)

Interest on Drawings:

11. Sundar and Shanmugam are two partners sharing profits and losses equally. Sundar drew regularly Rs.2,000 at the end of every month during the year. Shanmugam draws Rs.4,000 regularly at the beginning of every month during the year. Calculate interest on their drawings at 10% p.a.

(Answer: Interest on drawings; Sundar : Rs. 1,100; Shanmugam :Rs.2,600)

12. Pasupathi and Valayapathi are partners. Pasupathi draws Rs.900 regularly in the middle of each month during the year 2004. Valayapathi draws Rs.5,400 at the end of each half year. Calculate interest on their drawings at 5% p.a.

(Answer: Interest on drawings; Pasupathi : Rs.270; Valayapathi : Rs.135)

13. Matheswaran and Nagarajan are partners sharing profits in the ratio of 3:2. Matheswaran draws Rs.3,000 regularly at the end of every month during the year 2004. Nagarajan draws Rs.10,000 on 1.4.2004, Rs.6,000 on 30.6.2004, Rs.8,000 on 1.10.2004 and Rs.4,000 on 30.11.2004. Calculate interest on their Drawings at 6% p.a.

(Answer: Interest on drawings; Matheswaran : Rs. 990; Nagarajan : Rs. 770)

14. Hari and Karthi are two partners sharing profits and losses equally. Hari drew regularly Rs.400 at the end of every month during the year. Karthi drew Rs.800 regularly at the beginning of every month during the year. Calculate interest on their drawings at 10% p.a.

(March 2003)

(Answer: Interest on drawings; Hari : Rs. 220; Karthi : Rs. 520)

Valuation of Goodwill:

15. Goodwill is to be valued at three years purchase of five year's average profits. The profits for the last five years of the firm were:

2000 - Rs. 4,200; 2001 - Rs. 4,500; 2002 - Rs. 4,700;

2003 - Rs. 4,600 and 2004 - Rs. 5,000.

(Ans. : Goodwill Rs. 13,800)

16. Calculate the amount of goodwill on the basis of two year's purchase of the last four years average profits. The profits for the last four year's are:

I Year	Loss	Rs. 10,000
II Year	Profit	Rs. 26,000
III Year	Profit	Rs. 34,000
IV Year	Profit	Rs. 50,000

(Ans. : Goodwill Rs. 50,000)

17. Goodwill is to be valued at three years purchase of four years average profits.The profits for the last four years of the firm were:

2001 - Rs. 12,000; 2002 - Rs. 18,000; 2003 - Rs. 16,000;

2004 - Rs. 14,000.

Calculate the amount of goodwill.

(Ans. : Goodwill Rs. 45,000)

18. G, P, S were partners of a firm sharing profit and losses in the ratio 3:2:1. In view of G's retirement, goodwill was valued at two years' purchase of the average profits of last 4 years which are:

Ist year's Loss	Rs. 6,000
IInd year's Profit	Rs. 10,000
IIIrd year's Profit	Rs. 17,000
IVth year's Profit	Rs. 15,000

What entry would you pass to carry out their decision?

(October 2002)

(Ans. : Goodwill Rs. 18,000)

19. Calculate the amount of goodwill on the basis of two years' purchase of the last four years' average profits. The profits of the last four years are

1996 Profit Rs. 20,000

1997 Profit Rs. 30,000

1998 Loss Rs. 6,000

1999 Profit Rs. 16,000

(June 2003)

(Ans. : Goodwill Rs. 30,000)

20. A firm earned net profits during the last three years as follows:

I Year	Rs. 36,000
II Year	Rs. 40,000
III Year	Rs. 44,000

The Capital investment of the firm is Rs.1,20,000. A fair return on the capital having regard to the risk involved is 10%.

Calculate the value of goodwill on the basis of three years purchase of Super profits.

(Ans. : Goodwill Rs. 84,000)

21. From the following information, calculate the value of goodwill at three years' purchase of super profit.

   i) Average Capital employed in the business Rs.6,00,000.

   ii) Net trading profits of the firm for the past three years were Rs.1,07,600, Rs.90,700 and Rs.1,12,500.

iii) Rate of interest expected from capital having to the risk involved is 12%.

iv) Fair remuneration to the partners for their service Rs.12,000 p.a.

(Ans. : Goodwill Rs. 58,800)

22. The average net profits of the firm expected in the future are Rs.54,000 per year. The average capital employed in the business is Rs.3,00,000. The rate of interest expected from capital invested in the business is 10%. The remuneration of the partners is estimated to be Rs.9000 per annum.

    Find out the value of goodwill on the basis of two years purchase of Super Profits.

(Ans. : Goodwill Rs. 30,000)

Chapter - 7

PARTNERSHIP ACCOUNTS - ADMISSION

Learning Objectives

After studying this Chapter, you will be able to

- *understand the need for admission of a partner.*
- *calculate the new profit sharing ratio and the sacrificing ratio.*
- *understand how the revaluation of assets and liabilities is taken into account.*
- *understand the need for distribution of accumulated reserves, profits or losses.*
- *learn the accounting treatment of goodwill.*
- *prepare revaluation account, capital accounts and balance sheet of a new firm.*

A Partnership firm suffering from shortage of funds or administrative incapabilities may decide to admit a partner. Admission of a partner is one of the modes of reconstituting the firm. According to Section 31 (1) of the Indian Partnership Act 1932, a person can be admitted only with the consent of all the existing partners. A person who is admitted to the firm is known as an incoming or a new partner. On admission of a new partner, the existing partnership comes to an end and a new partnership comes into effect. In other words, a new firm is reconstituted under a fresh agreement.

Whenever a partner is admitted into the partnership firm, he acquires two rights.

a) Right to share the assets of the partnership firm.

b) Right to share the future profits of the partnership firm.

The amount that the new partner brings in for the right to share in the partnership assets is called his capital and is credited to his Capital account. Whereas the consideration which he pays to the old partners for the right to participate in the division of future profits is called Goodwill.

7.1 Adjustments:

While admitting a new partner, the following adjustments are necessary:

1. Recording the Capital of a new partner
2. Calculation of New Profit Sharing ratio and Sacrificing ratio
3. Revaluation of assets and liabilities
4. Transfer of Undistributed Profit or loss
5. Transfer of Accumulated reserves
6. Treatment of Goodwill

7.1.1 Recording of Capital of a New Partner

It is not compulsory that the new partner bring capital at the time of admission. He may be admitted in view of his talent, skill and reputation. However, in many cases, the incoming partner brings capital into the firm. With the consent of all the old partners, he may bring capital in cash or in kind or both.

The accounting treatment is

Cash A/c	Dr	.....	
Stock A/c	Dr	.....	
Furniture A/c	Dr	.....	
To New partners Capital A/c			.....

Illustration : 1

Anandan and Balaraman are partners in a firm with capitals of Rs.70,000 and Rs.50,000 respectively. They decided to admit Chandran into the firm with a capital of Rs.40,000. Give journal entry for Capital brought in by Chandran.

Solution:

Journal Entry

Date	Particulars	L.F	Debit Rs.	Credit Rs.
	Cash A/c Dr		40,000	
	To Chandran's Capital A/c			40,000
	(Cash brought in by Chandran as capital)			

7.2 Calculation of New Profit Sharing ratio and Sacrificing Ratio

When a new partner is admitted, he acquires his share in profits from the old partners. This reduces the old partners' shares in profit hence, new profit sharing ratio for old partners have to be calculated.

New Profit Sharing Ratio:

The ratio in which all partners (including incoming partner) share the future profits and losses is known as the new profit sharing ratio.

The determination of new profit sharing ratio depends upon the ratio in which the incoming partner acquires his share from the old partners.

New share = Old share – Sacrifice

Sacrificing Ratio:

The ratio in which the old partners have agreed to sacrifice their shares in profit in favour of a new partner is called the sacrificing ratio.

Sacrificing ratio = Old profit sharing ratio – New profit sharing ratio

Sacrifice = Old share – New share

The purpose of this ratio is to determine the amount of compensation (goodwill) to be paid by the new partner to the old partners for the share of profit surrendered.

From the calculation point of view of sacrificing ratio, the following are the different situations:

1. When the new share of the incoming partner is given.

a) Sacrifice of the old partners are not given (Sacrifice in the old ratio)

b) Unequal sacrifice of the old partners (Unequal sacrifice)

c) Equal sacrifice of the old partners (Equal sacrifice)

d) Entire sacrifice by one of the partners.

2. When the new share of the incoming partner is not given.

– Sacrifice of the old partners are given.

3. New profit sharing ratio is given.

1. When the new share of the incoming partner is given.

a) Sacrifice of the old partners are not given (Sacrifice in the old ratio)

Illustration : 2

A and B are partners sharing profits in the ratio of 3:2. They admit C for 1/5th share as new partner. Calculate new profit sharing ratio and sacrificing ratio of old partners.

Solution:

a) New Profit Sharing ratio:

Let the total profit be $= 1$

C's share $= \frac{1}{5}$

Remaining Share of A and B $= 1 - \frac{1}{5} = \frac{5-1}{5} = \frac{4}{5}$

		A	:	B	:	C
Old ratio	=	3	:	2		
Old share	=	$\frac{3}{5}$	:	$\frac{2}{5}$		
New Share	=	$\frac{4}{5} \times \frac{3}{5}$	:	$\frac{4}{5} \times \frac{2}{5}$	:	$\frac{1}{5}$
New Share	=	$\frac{12}{25}$	:	$\frac{8}{25}$	:	$\frac{5}{25}$
New Ratio	=	12	:	8	:	5

b) Sacrificing ratio:

Sacrifice = Old Share – New Share

A's sacrifice $= \frac{3}{5} - \frac{12}{25}$

$= \frac{15-12}{25} = \frac{3}{25}$

B's sacrifice $= \frac{2}{5} - \frac{8}{25}$

$= \frac{10-8}{25} = \frac{2}{25}$

Sacrificing ratio $= \frac{3}{25} : \frac{2}{25} = 3 : 2$

$= 3 : 2$

c) Unequal sacrifice of the old partners (Unequal sacrifice)

Illustration : 3

Rathai and Kothai are partners sharing profits in the ratio of 3:2. They admit Kanmani for 1/5th share of future profits which she acquires 3/20th from Rathai and 1/20th from Kothai. Calculate new Profit sharing ratio and sacrificing ratio of old partners.

Solution:

a) New ratio:

		Rathai	:	Kothai	:	Kannan
Old ratio	=	3	:	2		
Old share	=	$\frac{3}{5}$	:	$\frac{2}{5}$		
Sacrifice	=	$\frac{3}{20}$	:	$\frac{1}{20}$		
New Share (Old share – Sacrifice)	=	$\frac{3}{5} - \frac{3}{20}$	:	$\frac{2}{5} - \frac{1}{20}$	:	$\frac{1}{5}$
	=	$\frac{12-3}{20} = \frac{9}{20}$	:	$\frac{8-1}{20} = \frac{7}{20}$	:	$\frac{1}{5}$
	=	$\frac{9}{20}$	:	$\frac{7}{20}$	:	$\frac{4}{20}$
	=	$\frac{9:7:4}{20}$				
New ratio	=	9	:	7	:	4

b) Sacrificing ratio:

		Rathai	:	Kothai
Sacrifice	=	$\frac{3}{20}$	:	$\frac{1}{20}$
Sacrificing ratio	=	3 : 1		

c) Equal sacrifice of the old partners (Equal sacrifice)

Illustration : 4

P and Q are partners sharing profits in the ratio of 3:2. They admit R for 1/5th Share which acquires equally from P and Q. Calculate new profit sharing ratio and sacrificing ratio of old partners.

Solution:

a) New Profit sharing ratio

		P	:	Q	:	R
Old ratio	=	3	:	2		
Old share	=	$\frac{3}{5}$	:	$\frac{2}{5}$		
Sacrifice	=	$\frac{1}{5}\times\frac{1}{2}$	:	$\frac{1}{5}\times\frac{1}{2}$		
	=	$\frac{1}{10}$	:	$\frac{1}{10}$		
New Share (Old Share – Sacrifice)	=	$\frac{3}{5}-\frac{1}{10}$	:	$\frac{2}{5}-\frac{1}{10}$	:	$\frac{1}{5}$
	=	$\frac{6-1}{10}=\frac{5}{10}$	:	$\frac{4-1}{10}=\frac{3}{10}$	:	$\frac{1}{5}$
	=	$\frac{5}{10}$	:	$\frac{3}{10}$	:	$\frac{2}{10}$
New Profit sharing ratio	=	5	:	3	:	2

b. Sacrificing ratio:

		P	:	Q
Sacrifice	=	$\frac{1}{10}$	:	$\frac{1}{10}$
Sacrificing ratio	=	1	:	1

c) Entire Sacrifice by one partner only :

Illustration : 5

G and H are partners sharing profits in the ratio of 3:2. They admit I for 1/5th share which he acquires entirely from G. Calculate a) new ratio and b) Sacrificing ratio.

Solution:

a) New ratio:

		G	:	H	:	I
Old ratio	=	3	:	2		
Old share	=	$\frac{3}{5}$	:	$\frac{2}{5}$		
Sacrifice	=	$\frac{1}{5}$				
New Share	=	$\frac{3}{5}-\frac{1}{5}$	:	$\frac{2}{5}$	:	$\frac{1}{5}$
	=	$\frac{2}{5}$	:	$\frac{2}{5}$	:	$\frac{1}{5}$
New ratio	=	2	:	2	:	1

b. Sacrificing ratio:

G's Sacrifice $= \frac{1}{5}$

Since, only one partner sacrifice his share of profit, it implied that other partner not incurred any loss.

2. When the new share of the incoming partner is not given.

– *Sacrifice of the old partners are given.*

Illustration : 6

S and T are partners sharing profits in the ratio of 3:2. They admit U as new partner. which he acquires 1/5th of S's share and 2/5 of T's share. Calculate a) New ratio and b) Sacrificing ratio.

Solution:

a) New ratio :

		S	:	T	:	U
Old ratio	=	3	:	2		

Old share	=	$\frac{3}{5}$	:	$\frac{2}{5}$		
Sacrifice	=	$\frac{3}{5}\times\frac{1}{5}$	:	$\frac{2}{5}\times\frac{2}{5}$		
	=	$\frac{3}{25}$	:	$\frac{4}{25}$		
New Share (Old Share – Sacrifice)	=	$\frac{3}{5}-\frac{3}{25}$	:	$\frac{2}{5}-\frac{4}{25}$	:	$\frac{3}{25}+\frac{4}{25}$
	=	$\frac{15-3}{25}=\frac{12}{25}$	:	$\frac{10-4}{25}=\frac{6}{25}$	:	$\frac{7}{25}$
	=	$\frac{12}{25}$	:	$\frac{6}{25}$	:	$\frac{7}{25}$
New ratio	=	12	:	6	:	7

b. Sacrificing ratio:

		S	:	T
Sacrifice	=	$\frac{3}{25}$	:	$\frac{4}{25}$
Sacrificing ratio	=	3	:	4

3. New profit sharing ratio is given

Illustration : 7

X and Y are partners sharing profits in the ratio of 3:2. They admit Z as a new partner. The new profit sharing ratio among X, Y and Z is 4:3:2. Find out the sacrificing ratio.

Solution:

		X	:	Y	:	Z
Old ratio	=	3	:	2		
Old share	=	$\frac{3}{5}$	:	$\frac{2}{5}$		
New ratio	=	4	:	3	:	2
New Share	=	$\frac{4}{9}$	:	$\frac{3}{9}$	:	$\frac{2}{9}$

Sacrifice (Old Share – New Share)	=	$\frac{3}{5}-\frac{4}{9}$	:	$\frac{2}{5}-\frac{3}{9}$
	=	$\frac{27-20}{45}=\frac{7}{45}$	:	$\frac{18-15}{45}=\frac{3}{45}$
	=	$\frac{7}{45}$	:	$\frac{3}{45}$
Sacrificing ratio	=	7	:	3

7.3 REVALUATION OF ASSETS AND LIABILITIES

Revaluation is the valuation of assets and liabilities at the time of reconstitution of the partnership firm. At the time of admission of a partner, the assets and liabilities are revalued so that the profit and loss arising on account of such revaluation may be adjusted in the old partners' capital accounts in their old profit sharing ratio and the incoming partner may not be affected by the profit or loss on account of revaluation of assets and liabilities. For the purpose a **revaluation account** is opened.

Revaluation Account is credited with the following profit items:

1) Increase in the value of assets,
2) decrease in the amount of liabilities and
3) unrecorded assets now recorded.

Revaluation account is debited with the following loss items:

1) Decrease in the value of assets,
2) increase in the amount of liabilities,
3) unrecorded liabilities now recorded and
4) creation of a new liability.

The balance of Revaluation account shows the net effect on account of revaluation which is transferred to old partners' capital accounts in their old profit sharing ratio. The assets and liabilities appear in the Balance Sheet of the reconstituted firm at their revised values.

Accounting entries to record the revaluation of assets and liabilities:

a. For increase in the value of an asset

Concerned Asset A/c	Dr	......	
To Revaluation A/c			......

b. For decrease in the value of an asset

Revaluation A/c	Dr	......	
To Concerned Asset A/c			......

c. For increase in the amount of a liability

Revaluation A/c	Dr	......	
To Concerned Liability A/c			......

d. For decrease in the amount of liability

Concerned Liability A/c	Dr	......	
To Revaluation A/c			......

e. For recording an unrecorded asset

Unrecorded Asset A/c	Dr	......	
To Revaluation A/c			......

f. For recording an unrecorded liability

Revaluation A/c	Dr	......	
To Unrecorded Liability A/c			......

g. For recording a new liability

Revaluation A/c	Dr	......	
To New liability A/c			......

h. For transfer of balance in revaluation account

i) If credit side exceeds debit side (profit).

Revaluation A/c	Dr	......	
To Old Partners' capital A/cs			......

ii) If debit side exceeds credit side (loss)

Old Partners' Capital A/cs	Dr	......	
To Revaluation A/c			......

In short, only three entries are enough.

1. For profit items: i) Increase in the value of assets, ii) unrecorded assets recorded and iii) decrease in the amount of liabilities.

Concerned Assets A/c	Dr	......

Concerned Liabilities A/c Dr ......

To Revaluation A/c ......

2. For loss items: i) Decrease in the value of assets, ii) increase in the amount of liabilities, iii) unrecorded liabilities recorded and

iv) new liabilities created.

Revaluation A/c Dr ......

To Concerned Assets A/c ......

To Concerned Liabilities A/c ......

3. To transfer profit or loss on revaluation

a) If Profit:

Revaluation A/c Dr ......

To Partners' Capital A/cs ......

b) If Loss:

Partners' Capital A/cs Dr ......

To Revaluation A/c ......

Format:

Dr **Revaluation Account** **Cr**

Particulars	Rs.	Particulars	Rs.
To Assets (Individually) - (Decrease in the value)	....	By Assets (Individually) (Increase in the value and unrecorded)	....
To Liabilities (Increase in the amount, unrecorded and newly created)	....	By Liabilities (Decrease in the amount)	....
To Partners' capital A/c (Profit on revaluation)	....	By Partner's Capital A/c (Loss on revaluation)	....

Illustration : 8

Sankar and Saleem are partners in a firm sharing profits and losses in the ratio of 3:2 as on 31st March 2005. Their Balance Sheet was as under:

Liabilities	Rs.	Assets	Rs.
Creditors	90,000	Cash	5,000
Bills payable	25,000	Bank	40,000
Capital Accounts		Stock	60,000
Sankar : 1,50,000		Furniture	20,000
Saleem : 1,20,000	2,70,000	Land and Building	2,00,000
		Debtors 62,000	
		Less: Provision for Bad debts 2,000	60,000
	3,85,000		3,85,000

On 1st April 2005, they admit Solomon into partnership on the following condition:

1. Solomon has brought Rs.1,00,000 as capital.
2. The value of land and building was to be increased by Rs.20,000.
3. Stock and furniture were to be depreciated by Rs.10,000 and Rs.5,000 respectively.
4. Rs.15,000 to be written off from Sundry creditors as it is no longer liability.
5. Provision for doubtful debts is to be increased by Rs.1,000.

Give journal entries, prepare Revaluation Account and the Balance Sheet.

Solution:

Journal Entries

Date	Particulars		L.F	Debit Rs.	Credit Rs.
2005	Land and Building A/c	Dr		20,000	
April 1	Sundry Creditors A/c	Dr		15,000	
	To Revaluation A/c				35,000
	(Profit items credited to Revaluation A/c)				
	Revaluation A/c	Dr		15,000	
	To Stock A/c				10,000
	To Furniture A/c				4,000
	To Provision for doubtful debts A/c				1,000
	(Loss items debited to Revaluation A/c)				

Revaluation A/c Dr		20,000	
To Sankars Capital A/c			12,000
To Saleems Capital A/c			8,000
(Profit on revaluation transferred to old partner's capital accounts in the old ratio)			
Bank A/c Dr		1,00,000	
To Solomon's Capital A/c			1,00,000
(Capital brought in by Solomon)			

Revaluation Account

Dr. **Cr.**

Particulars	Rs.	Particulars	Rs.
To Stock	10,000	By Land and Building	20,000
To Furniture	4,000	By Sundry Creditors	15,000
To Provision for doubtful debts	1,000		
To Profit on revaluation transferred to Sankar's Capital A/c12,000 Saleem's Capital A/c 8,000	20,000		
	35,000		35,000

Capital Account

Dr. **Cr.**

Particulars	Sankar Rs.	Saleem Rs.	Solomon Rs.	Particulars	Sankar Rs.	Saleem Rs.	Solomon Rs.
To Balance c/d	1,62,000	1,28,000	1,00,000	By Balance b/d	1,50,000	1,20,000	
				By Bank A/c			1,00,000
				By Revaluation A/c	12,000	8,000	
	1,62,000	1,28,000	1,00,000		1,62,000	1,28,000	1,00,000

Bank Account

Dr. **Cr.**

Particulars	Rs.	Particulars	Rs.
To Balance b/d	40,000	By Balance c/d	1,40,000
To Solomon's Capital A/c	1,00,000		
	1,40,000		1,40,000

Balance Sheet of M/s. Sankar, Saleem & Solomon as on 1st April, 2005

Liabilities	Rs.	Assets	Rs.
Sundry Creditors	75,000	Cash	5,000
Bills payable	25,000	Bank	1,40,000
Capital Accounts		Stock	50,000
Sankar : 1,62,000		Furniture	16,000
Saleem : 1,28,000		Land and Building	2,20,000
Solomon : 1,00,000	3,90,000	Sundry Debtors 62,000	
		Less: Provision for doubtful debts 3,000	59,000
	4,90,000		4,90,000

Illustration : 9

Amar and Akbar are partners in a firm sharing profits and losses in the ratio of 2:1 as on 31st March 2005. Their Balance Sheet was as under:

Liabilities	Rs.	Assets	Rs.
Creditors	80,000	Cash	10,000
Bills payable	40,000	Bank	70,000
Capital Accounts		Stock	80,000
Amar : 2,70,000		Plant & Machinery	1,00,000
Akbar: 2,10,000	4,80,000	Land and Building	3,00,000
		Debtors	40,000
	6,00,000		6,00,000

On 1st April 2005, they admit Antony into partnership on the following conditions:

1. Antony has bring in a capital of Rs.1,50,000 for 1/5th share of the future profits.

2. Stock and machinery were to be depreciated by Rs.6,000 and Rs.15,000 respectively.

3. Investments of Rs.15,000 not recorded in the books brought into accounts.

4. Provision for doubtful debts is to be created at 5% on debtors.

5. A liability of Rs.4,000 for outstanding repairs has been omitted to be recorded in the books.

Give journal entries, prepare Revaluation Account, Capital Account, Bank Account and the Balance Sheet.

Solution:

Journal Entries

Date	Particulars		L.F	Debit Rs.	Credit Rs.
2005	Investments A/c	Dr		15,000	
April 1	To Revaluation A/c				15,000
	(Profit items transferred to Revaluation A/c)				
	Revaluation A/c	Dr		27,000	
	To Stock A/c				6,000
	To Machinery A/c				15,000
	To Provision for doubtful debts A/c				2,000
	To Outstanding repairs				4,000
	(Loss items transferred to Revaluation A/c)				
	Amar's Capital A/c	Dr		8,000	
	Akbar's Capital A/c	Dr		4,000	
	To Revaluation A/c				12,000
	(Loss on revaluation transferred to old partner's capital accounts in the old ratio)				
	Bank A/c	Dr		1,50,000	
	To Antony's Capital A/c				1,50,000
	(Capital brought in by Antony)				

Revaluation Account

Dr. **Cr.**

Particulars	Rs.	Particulars	Rs.
To Stock	6,000	By Investments	15,000
To Machinery	15,000	By Loss on revaluation transferred to	
To Provision for		Amar's Capital A/c 8,000	
doubtful debts	2,000	Akbar's Capital A/c 4,000	
To Provision for outstanding repairs	4,000		12,000
	27,000		27,000

Capital Account

Dr. **Cr.**

Particulars	Amar Rs.	Akbar Rs.	Antony Rs.	Particulars	Amar Rs.	Akbar Rs.	Antony Rs.
To Revaluation A/c	8,000	4,000		By Balance b/d	2,70,000	2,10,000	
				By Bank A/c			1,50,000
By Balance c/d	2,62,000	2,06,000	1,50,000				
	2,70,000	2,10,000	1,50,000		2,70,000	2,10,000	1,50,000

Bank Account

Dr. **Cr.**

Particulars	Rs.	Particulars	Rs.
To Balance b/d	70,000	By Balance c/d	2,20,000
To Antony's Capital A/c	1,50,000		
	2,20,000		2,20,000

Balance Sheet of M/s. Amar, Akbar & Antony as on 1st April, 2005

Liabilities	Rs.	Assets	Rs.
Sundry Creditors	80,000	Cash	10,000
Bills payable	40,000	Bank	2,20,000
Outstanding repairs	4,000	Stock	74,000

Capital Accounts		Plant & Machinery	85,000
Amar 2,62,000		Investments	15,000
Akbar 2,06,000		Land and Building	3,00,000
Antony 1,50,000		Sundry Debtors 40,000	
	6,18,000	Less: Provision for doubtful debts 2,000	38,000
	7,42,000		7,42,000

7.4 TRANSFER OF UNDISTRIBUTED PROFIT OR LOSS

Some times, the balance sheet of the partnership firm may show undistributed profits in the form of profit and loss account in the liabilities side. The undistributed loss in the business is generally shown at the assets side of the old Balance Sheet. The new partner is not entitled to have any share in the undistributed profit or loss. Therefore the undistributed profit or loss should be transferred to the old partners capital accounts in the old profit sharing ratio.

The accounting treatment would be as follows:

a. For transfer of undistributed profit :

Profit and Loss A/c	Dr	.....	
To Old Partners' Capital A/cs			.....

b. For transfer of undistributed loss:

Old Partners' Capital A/cs	Dr	....	
To Profit and Loss A/c			....

Illustration : 10

Sumathi and Sundari are partners of a firm sharing profit and loss in the ratio of 4:3. Their Balance Sheet shows Rs.14,000 as Profit and Loss A/c in the liabilities side. Pass entry.

Solution:

Journal Entry

Date	Particulars	L.F	Debit Rs.	Credit Rs.
	Profit and Loss A/c Dr		14,000	
	To Sumathi's Capital A/c			8,000
	To Sundari's Capital A/c			6,000

	(Undistributed profit transferred to Old Partners' Capital Accounts in the old ratio)			

Illustration : 11

Mahalakshmi and Dhanalakshmi are partners sharing profit and loss in the ratio of 3:2. They admit Deepalakshmi on 1st January 2005. On that date, their Balance Sheet showed an amount of Rs.25,000 as Profit and Loss A/c in the Asset side. Pass entry.

Solution:

Journal Entry

Date	Particulars	L.F	Debit Rs.	Credit Rs.
2005	Mahalakshmi's Capital A/c Dr		15,000	
Jan 1	Dhanalakshmi's Capital A/c Dr		10,000	
	To Profit and Loss A/c			25,000
	(Undistributed loss transferred to old partners Capital accounts in the old ratio)			

7.5 TRANSFER OF ACCUMULATED RESERVE

Sometimes, Partners of the firm, may set aside a portion or percentage of the profit earned to meet the unexpected or unforeseen losses arise in future in the name of Reserve, General Reserve, Reserve Fund, Contingency Reserve etc. At the time of admission of new partner, if there is any reserve, it should be transferred to the Capital accounts of the old partners in the old profit sharing ratio.

The accounting treatment would be as follows:

Reserve Fund A/c Dr .....

To Old Partners' Capital A/cs .....

Illustration : 12

Mahendran and Narasimhan are partners of a firm sharing profit and loss in the ratio of 5:4. On 31.3.2005 the firm's books showed a Reserve fund of Rs.36,000. They decided to admit Aparajitha on 1st April 2005 for 1/3rd share. Pass entry.

Solution:

Journal Entry

Date	Particulars	L.F	Debit Rs.	Credit Rs.
2005	Reserve Fund A/c Dr		36,000	
Apr 1	To Mahendran's Capital A/c			20,000
	To Narasimhan's Capital A/c			16,000
	(Reserve fund transferred to old partners' capital accounts in the old ratio)			

7.6 TREATMENT OF GOODWILL

The goodwill is the result of the old partners' efforts in the past. Therefore, at the time of admission of new partner the goodwill is to be adjusted in the old partners' capital account.

From the accounting point of view, the Goodwill can be adjusted in one of the following three methods:

1. Revaluation Method
2. Memorandum Revaluation Method
3. Premium Method

Among the above three methods, revaluation method alone discussed in this chapter.

1. Revaluation Method:

Under this method, the new partner does not bring in cash for his share of goodwill. The following accounting treatment is required to adjust goodwill in the books of the firm.

a) Goodwill is raised in the books of the firm:

Goodwill does not appear as an asset in the balance sheet though it exists in the firm. It means that it is not yet recorded in its books and remains a silent asset. At the time of admission of a partner, Goodwill is raised to its present value and shared by the old partners in the old ratio.

The entry is

Goodwill A/c Dr .....

To Old Partners' Capital A/cs .....

(Goodwill raised to its present value and credited in the old partners' capital accounts)

b) Goodwill appears in the books - understated

If goodwill appears in the balance sheet of the old partners at a value less than the present value then the difference between the present value and the recorded amount of goodwill is transferred to the old partners' capital accounts in the old ratio.

The entry is

Goodwill A/c	Dr	.....	
To Old partners' capital A/cs			.....

(Increase in the value of goodwill transferred to Partners' capital accounts in the old ratio)

c) Goodwill appears in the books - Over stated

If the goodwill appears in the balance sheet at a value more than the present value of goodwill, the reduction in the value of goodwill debited to the old partners capital accounts in the old profit sharing ratio.

The entry is

Old Partners' Capital A./c	Dr	.....	
To Goodwill A/c			.....

(Decrease in the value of goodwill transferred to old partners in the old ratio)

Illustration : 13

Damodaran and Jagadeesan are partners sharing profits in the ratio of 3:2. They decided to admit Vijayan for 1/5th share of future profit. Goodwill of the firm is to be valued at Rs.50,000.

Give journal entries, if

a) There is no goodwill in the books of the firm.

b) The goodwill appears at Rs.30,000

c) The goodwill appears at Rs.60,000.

Solution:

Journal Entries

Date	Particulars		L.F	Debit Rs.	Credit Rs.
	Case (a)				
	Goodwill A/c	Dr		50,000	
	To Damodran's Capital A/c				30,000
	To Jagadeesan's Capital A/c				20,000
	(Goodwill raised and credited)				
	Case (b)				
	Goodwill A/c	Dr		20,000	
	To Damodaran's Capital A/c				12,000
	To Jagadeesan's Capital A/c				8,000
	(Goodwill raised from Rs.30,000 to Rs.50,000, the difference of Rs.20,000 credited to the old partners)				
	Case (c)				
	Damodaran's Capital A/c	Dr		6,000	
	Jagadeesan's Capital A/c	Dr		4,000	
	To Goodwill A/c				10,000
	(Goodwill reduced from Rs.60,000 to Rs.50,000, the difference of Rs.10,000 debited to old partners)				

Note: Memorandum Revaluation Method and Premium method of Goodwill are beyond the scope of this book, they are not dealt.

7.7 Preparation of Revaluation Account, Capital Accounts and Balance Sheet after admission of Partner

Illustration : 14

Anitha and Vanitha are partners. They share profits and losses in the ratio of 3:1. Their Balance sheet as on 31st March 2005 is as follows:

Liabilities	Rs.	Assets	Rs.
Creditors	60,000	Cash	5,000
Bills payable	20,000	Debtors	70,000

General Reserve	40,000	Stock	30,000
Capitals:		Plant	25,000
Anitha 80,000		Buildings	1,00,000
Vanitha 40,000	1,20,000	Profit and Loss A/c	10,000
	2,40,000		2,40,000

On 1st April 2005, they agreed to admit Kavitha into the firm for 1/5th Share of future profits on the following terms:

a) Building is revalued at Rs.1,20,000

b) Stock is revalued at Rs.21,500

c) Goodwill is raised at Rs.40,000

d) Provision for bad debts is made at 5%

e) Kavitha to bring in a Capital of Rs.50,000

Give journal entries to give effect of above adjustments, prepare Revaluation account, Capital accounts, Cash account and the Balance Sheet of the reconstituted firm.

Solution:

Journal Entries

Date	Particulars	L.F	Debit Rs.	Credit Rs.
	Building A/c Dr		20,000	
	To Revaluation A/c			20,000
	(Building appreciated)			
	Revaluation A/c Dr		12,000	
	To Stock A/c			8,500
	To Provision for doubtful debts			3,500
	(Stock depreciated and provision for doubtful debts transferred)			
	Revaluation A/c Dr		8,000	
	To Anitha's Capital A/c			6,000
	To Vanitha's Capital A/c			2,000
	(Profit on revaluation transferred to old partners in the old ratio)			

Anitha's Capital A/c Vanitha's Capital A/c To Profit & Loss A/c (Undistributed loss transferred)	Dr Dr		7,500 2,500	 10,000
Goodwill A/c To Anitha's Capital A/c To Vanitha's Capital A/c (Goodwill raised and shared among old partners in the old ratio)	Dr		40,000	 30,000 10,000
Cash A/c To Kavitha's Capital A/c (Capital brought in by Kavitha)	Dr		50,000	 50,000
General Reserve A/c To Anitha's Capital A/c To Vanitha's Capital A/c (Accumulated reserve transferred to old partners in the old ratio)	Dr		40,000	 30,000 10,000

Revaluation Account

Dr. **Cr.**

Particulars	Rs.	Particulars	Rs.
To Stock	8,500	By Building A/c	20,000
To Provision for doubtful debts	3,500		
To Profit on revaluation transferred to Capital Accounts:			
Anitha 6,000			
Vanitha 2,000	8,000		
	20,000		20,000

Capital Accounts

Dr. **Cr.**

Particulars	Anitha Rs.	Vanitha Rs.	Kavitha Rs.	Particulars	Anitha Rs.	Vanitha Rs.	Kavitha Rs.
To Profit Loss A/c	7,500	2,500	----	By Balance b/d	80,000	40,000	---

				By Cash A/c			50,000
To Balance c/d	1,38,500	59,500	50,000	By General Reserve	30,000	10,000	---
				By Goodwill	30,000	10,000	---
				By Revaluation A/C	6,000	2,000	---
	1,46,000	62,000	50,000		1,46,000	62,000	50,000

Cash Account

Dr. **Cr.**

Particulars	Rs.	Particulars	Rs.
To Balance b/d	5,000	By Balance c/d	55,000
To Kavitha's Capital A/c	50,000		
	55,000		55,000

Balance Sheet of Anitha, Vanitha and Kavitha as on 1.4.2005

Liabilities		Rs.	Assets		Rs.
Creditors		60,00	Cash		55,000
Bills Payable		20,000	Debtors	70,000	
Capitals			Less: Provision		
Anitha	1,38,500		for Bad debts	3,500	66,500
Vanitha	59,500		Stock		21,500
Kavitha	50,000	2,48,000	Plant		25,000
			Building		1,20,000
			Goodwill		40,000
		3,28,000			3,28,000

Illustration: 15

Sankari and Sudha are partners sharing profit and loss in the ratio of 3:2. Their Balance Sheet as on 31st March 2005 is as under:

Liabilities		Rs.	Assets	Rs.
Capitals:			Land & Buildings	1,20,000
Sankari	90,000		Plant & Machinery	90,000
Sudha	75,000	1,65,000	Stock	33,000

Profit and Loss A/c	30,000	Sundry Debtors	15,000	
Sundry Creditors	48,000	Less: Provision for		
Bills Payable	50,000	doubtful debts	1,000	14,000
		Cash		6,000
		Goodwill		30,000
	2,93,000			2,93,000

They decided to admit Santhi into the partnership with effect from 1st April 2005 on the following terms:

a) Santhi to bring in Rs.60,000 as Capital for 1/3rd share of profits.

b) Goodwill was valued at Rs.45,000

c) Land was valued at Rs.1,50,000

d) Stock was to be written down by Rs.8,000

e) The provision for doubtful debts was to be increased to Rs.3,000

f) Creditors include Rs.5,000 no longer payable and this sum was to be written off.

g) Investments of Rs.10,000 be brought into books.

Prepare Revaluation A/c, Capital A/c and Balance Sheet of the new firm.

Solution:

Dr. **Revaluation Account** Cr.

Particulars		Rs.	Particulars	Rs.
To Stock		8,000	By Land	30,000
To Provision for doubtful			By Creditors	5,000
debts		2,000	By Investments	10,000
To Profit on revaluation:				
Sankari	21,000			
Sudha	14,000	35,000		
		45,000		45,000

capital Accounts

Dr. **Cr.**

Particulars	Sankari Rs.	Sudha Rs.	Santhi Rs.	Particulars	Sankari Rs.	Sudha Rs.	Santhi Rs.
To Balance c/d	1,38,000	1,07,000	60,000	By Balance b/d	90,000	75,000	
				By Cash A/c			60,000
				By Goodwill	9,000	6,000	
				By Profit and Loss A/c	18,000	12,000	
				By Revaluation A/c	21,000	14,000	
	1,38,000	1,07,000	60,000		1,38,000	1,07,000	60,000

Balance Sheet of Sankari, Sudha and Santhi as on 1st April 2005

Liabilities		Rs.	Assets		Rs.
Capitals:			Land & Buildings		1,50,000
Sankari	1,38,000		Plant & Machinery		90,000
Sudha	1,07,000		Stock		25,000
Santhi	60,000	3,05,000	Sundry Debtors	15,000	
Sundry Creditors		43,000	Less: Provision for		
Bills Payable		50,000	doubtful debts	3,000	12,000
			Goodwill		45,000
			Cash		66,000
			Investments		10,000
		3,98,000			3,98,000

QUESTIONS

I. Objective Type

a) Fill in the blanks:

1. In the event of admission of a new partner, legally there is _________ of old partnership.
2. At the time of admission of a new partner, _________ profit ratio should be found out.
3. At the time of admission of a new partner, _________ of assets and liabilities should be taken up.

4. When the value of an asset increases, it results in ________.

5. When an unrecorded liabilities is brought into books, it results in ________

6. The balance of revaluation account shows ________ on revaluation.

7. The revaluation profit or loss is transferred to the old partners' capital accounts, in their ________.

8. The difference between old profit sharing ratio and new profit sharing ratio at time of admission is ________ ratio.

9. Undistributed Profit will appear on the ________ side of the Balance sheet.

10. At the time of admission, when goodwill is raised, the old partners capital account will be credited in the ________ ratio.

11. The partner admitted into partnership firm acquires two rights i.e., right to share in the ________ of the partnership and right to share in the ________

12. The new profit sharing ratio will be determined by how the new partner acquires is from the old partners.

13. Under ________ goodwill account is raised by crediting the old partners capital accounts in the old profit sharing ratio.

(**Answers:** : 1. dissolution; 2. new; 3. revaluation; 4. profit; 5. loss; 6. profit or loss; 7. old ratio; 8. Sacrifice; 9. liabilities; 10.Old profit sharing; 11. assets, profits; 12. share of profit; 13. revaluation method)

b) Choose the correct answer :

1. When A and B sharing profits and losses in the ratio of 3:2, they admit C as a partner giving him 1/3 share of profits. This will be given by A and B.

   a) Equally b) In the ratio of their capitals

   c) In the ratio of their profits.

2. In admission, profit from revaluation of assets and liabilities will be transferred to the capital accounts of the old partners in the

   a) Old profit sharing ratio b) Sacrifice ratio

   c) New profit sharing ratio

3. If new share of the incoming partner is given without mentioning the details of the sacrifice made by the old partners then, the presumption is that old partners sacriffice in the

   a) Old profit sharing ratio b) Gaining ratio c) Capital ratio

4. In order to maintain fair dealings, at the time of admission, it is necessary to revalue assets and liabilities of the firm to their ________.

   a) cost price b) cost price less depreciation c) true value

5. On admission of a partner if goodwill account is to be raised this should be debited to

   a) Partners' capital account b) Goodwill account

   c) Revaluation account

6. When A and B sharing profits and losses in the ration 3:2, admit C as a partner giving him 1/5 share of profits. This will be given by A and B

   a) Equally b) in their capitals ratio

   c) in their profit sharing ratio

7. On admission of a new partner, increase in value of assets is debited to

   a) Asset account b) Proit & Loss adjustment account

   c) Old partners capital account

8. On admission of a new partner balance of General Reserve Account should be transferred to the capital account of

   a) all partners in their new profit sharing ratio

   b) old partners in their old profit sharing ratio

   c) old partners in their new profit sharing ratio

9. The old partners share all the accumulated profits and reserves in their

   a) new profit sharing ratio

   b) old profit sharing ratio

   c) capital ratio

10. The reconstitution of the partnership requires a revision of the of the existing partners

    a) Profit sharing ratio b) Capital ratio c) Sacrificing ratio

11. _________ ratio is computed at the time of admission of a new partner

    a) Gaining ratio b) Capital ratio c) Sacrificing ratio

(**Answers :** 1.(c); 2.(a); 3. (a); 4. (c); 5. (d); 6. (c); 7. (a); 8. (b); 9. (b); 10. (a); 11. (c))

II. Other Questions:

1. What is meant by admission of a partner?
2. Who is an incoming partner?
3. What are the adjustments to be made in connection with admission?
4. What is new profit ratio on admission of a partner?
5. What is Sacrifice Ratio?
6. What is revaluation account?
7. Why revaluation account is to be prepared?
8. What are the entries for Revaluation of Assets and Liabilities of a firm in the event of admission of a partner?
9. How will you treat the undistributed profits and losses at the time of admission of a partner?
10. What is accumulated reserve?
11. What is Revaluation Method of Goodwill?

III. Problems :

Calculation of New Profit Ratio and Sacrificing Ratio:

1. Sheela and Neela were sharing profits in the ratio of 4:3. Kamala was admitted with 1/5th share in profits of business. Calculated the New Profit Ratio and the sacrificing ratio.

   (Ans : New ratio 16:12:7; Sacrificing ratio = 4:3)

2. Kokila and Mala were sharing profits in the ratio of 4:3. Chandra was admitted in the business as a partner with 3/7th share in the profits of the firm which she takes 2/7th from Kokila and 1/7th from Mala. Find out New Profit Ratio and the sacrificing ratio.

   (Ans : New ratio 2:2:3; Sacrificing ratio = 2:1)

3. Anandan and Baskaran were partners in a firm sharing profit and loss in the ratio of 3:2. They admit Chandran into the partnership to 1/3rd share, the old partners sacrificing equally. Calculate the new profit - ratio and the sacrificing ratio.

   (Ans : New ratio 13:7:10; Sacrificing ratio = 1:1)

4. Kundran and Kumaran are partners sharing profit and losses in the ratio of 9:7. Kugan is admitted as partners; he acquires 3/16 of the profit entirely from Kundran. Calculate the new profit ratio and the sacrificing ratio.

   (Ans : New ratio 6:7:3; Sacrifice Kundran only 3/16)

5. Eswari and Ranikumari are partners sharing profits and losses in the ratio of 3/16. They agree to admit Chitra into partnership. Eswari surrenders 1/7th of her share and Ranikumari 1/5th of her share in favour of Chitra. Calculate the New Profit Ratio and the sacrificing ratio.

(Ans : New ratio 3:2:1; Sacrificing ratio = 1:1)

6. Ramesh and Suresh are sharing profits in the ratio of 4:3. Mahesh joins and the new ratio among Ramesh, Suresh and Mahesh is 7:4:3. Find out the sacrificing ratio.

(Ans.: Sacrificing ratio = 1:2)

7. Mani and Sundaram are partners in a firm sharing profits and losses in the ratio of 7:3. Muthian admitted as new partner. Mani surrenders 1/7th share of his profit in favour of Muthian and Sundaram surrenders 1/3rd of his share in favour of Muthian. Calculate New Profit Sharing Ratio and the sacrificing ratio.

(Ans : New ratio 3:1:1; Sacrificing ratio = 1:1)

8. Muthu and Siva were partners in a firm sharing profits in the ratio of 7:3. Bala was admitted on 1/5th shares in the profits. What would be their New Profit Ratio and their sacrificing ratio in each of the following cases:

   (a) If Bala acquired his shares equally, from the old partners.

   (b) If he acquired his profit - share in the original ratio of the old partners.

   (c) If he acquired it as 3/10th from Muthu and 1/10th from Siva.

   (d) If he acquires his share entirely from Muthu.

(Answer: New ratio (a) 17:3:15; (b) 14:6:15; (c) 29:11:30; (d) 19:21:30)

9. A and B are partners in a firm sharing profits and losses in the ratio of 6:4. C is admitted as a new partner. A surrenders 1/5th share of his profit in favour of C and B surrenders 2/5th of his share in favour of C. Calculate New Profit Sharing Ratio.

(March 2003)

(Answer: 12:6:7)

Revaluation of Assets and Liabilities:

10. Sridevi and Cynthia were partners sharing profit and loss in the ratio of 3:2. They decided to admit Fathima into the partnership and revalue their assets and liabilities as indicated here under:

    (a) To bring into record investment of Rs. 18,000 which had not so far been recorded in the books of the firm.

(b) To depreciate stock, furniture and machinery by Rs.18,000, Rs.6,000 and Rs.30,000 respectively.

(c) To provide for workmen's compensation of Rs.24,000.

Pass the necessary journal entries and show the revaluation account.

(Ans: Revaluation Loss Rs. 60,000)

11. Raman and Laxmanan were partners sharing profit and losses in the ratio of 4:3. In view of Velan's admission, they decided to revalue their assets and liabilities as indicated below:

(a) To increase the value of buildings by Rs. 60,000.

(b) Provision for doubtful debts to be decreased by Rs.800.

(c) To decrease machinery by Rs.16,000, furniture by Rs.4,000 and stock by Rs. 12,000.

(d) A provision for outstanding liabilities was to be created for Rs.800

Show the Revaluation Account.

(Ans.: Revaluation Profit Rs. 28,000)

12. M and G were partners sharing profit and loss in the ratio of 3:2.

They decided to admit L into the partnership and revalue their assets and liabilities as under:

a) To bring into record investment of Rs.12,000 which had not so far been recorded in the books of the firm.

b) To depreciate stock, furniture and machinery by Rs.3,000, Rs.1,000 and Rs.5,000 respectively.

c) A provision for Outstanding Liabilities was to be created for Rs.4,000.

Give journal entries and show the Revaluation Account.

(March 2003) (Answer: Revaluation Loss Rs.1,000)

13. Valluvan and Kamban were partners sharing profits and losses as 60% to Valluvan and 40% to Kamban. Their Balance Sheet as at 1st January, 2005 stood as under:

Liabilities	Rs.	Assets	Rs.
Sundry Creditors	96,000	Cash in Hand	4,000
Bills payable	34,000	Sundry debtors	56,000
Capital Accounts:		Stock	40,000

Valluvan : 90,000		Plant & Machinery	80,000
Kamban : 80,000	1,70,000	Land & Buildings	1,20,000
	3,00,000		3,00,000

The partners agreed to admit Elangovan into the firm subject to revaluation of the following items:

(i) Stock was to be reduced by Rs. 4.000

(ii) Land and Buildings were to be valued at Rs.1,60,000

(iii) A provision of 2 ½% was to be created for doubtful debtors.

(iv) A liability of Rs. 2,600 for outstanding expenses had been omitted to be recorded in the books.

Prepare the revaluation account, capital accounts and the balance sheet after the above adjustment.

(Ans. : Profit on Revaluation : Rs.32,000 ; Balance Sheet Total : Rs.3,34,600)

14. Set out below is the balance sheet of Narayanan and Perumal sharing profits and losses equally as at 1st April, 2005.

Liabilities	Rs.	Assets	Rs.
Sundry creditors	24,000	Cash in Hand	2,000
Capital Accounts:		Cash at Bank	19,000
Narayanan : 60,000		Sundry Debtors 12,000	
Perumal : 60,000	1,20,000	Less: Provision	
		for doubtful debts 1,000	11,000
		Furniture	8,000
		Buildings	80,000
		Stock	24,000
	1,44,000		1,44,000

On that date they admit Palani into the firm subject to the following terms of revaluation.

(a) Stock and furniture are to be reduced in value by 10%.

(b) Building are to be appreciated by Rs.15,000

(c) A Provision for doubtful debts to be increased to Rs.1,500.

Prepare the revaluation account, capital accounts and the Balance Sheet after the above adjustment.

(Ans. : Profit on Revaluation : Rs.11,300;
Balance Sheet Total : Rs.1,55,300)

15. Geetha and Seetha were partners sharing profits and losses in the ratio of 2:1. Their balance sheet as at 31st December, 2004 stood as under:

Liabilities	Rs.	Assets	Rs.
Sundry creditors	60,000	Bank	24,000
General Reserve	45,000	Land and Building	1,45,000
Profit and Loss A/c	60,000	Plant and Machinery	1,00,000
Capital Accounts:		Stock	60,000
Geetha : 1,40,000		Sundry debtors	56,000
Seetha : 80,000	2,20,000		
	3,85,000		3,85,000

On the above date, they decided to admit Latha subject to following items of revaluation.

(a) To appreciate land and buildings by 20%

(b) To depreciate plant and machinery by 5% and stock by 10%

(c) To create a provision for Rs.3,000 for a claim against the firm for damages.

Show revaluation account, capital accounts and balance sheet of the firm after the adjustments.

(Answer : Profit on Revaluation : Rs. 15,000
Balance Sheet Total : Rs.4,03,000)

Adjustment for Reserve and Undistributed Profit & Loss

16. Amala and Vimala were partners of a firm sharing profit and losses in the ratio of 5:3. On 1.4.2004, the firm's book showed a reserve fund of Rs.48,000. On the above date they decided to admit Komala into the partnership. Pass entry.

17. Gayathiri and Sumithra were partners of a firm sharing profit and loss is the ratio of 3:2. On 31st December 2002, the firm's books showed general reserve at Rs.50,000 and profit and loss A/c showing debit balance of Rs.30,000. On the above date they decided to admit Pavithra into the partnership. Pass entries to transfer the entire reserve and profit and loss to the capital accounts of the partners.

Treatment of Goodwill

18. Jabeen and Kathija were partners in a firm sharing profits and losses in the ratio of 2:1. They admitted Sultana as a partner and the new profit sharing ratio was 3:2:1. Goodwill did not appear on the date of the above admission in the partnership books and it was valued at Rs.36,000.

Show the journal entry for the treatment of goodwill under the revaluation method.

19. Ponmalar and Thenmozhi were partners in a firm sharing profits and losses in the ratio of 7:3. They decided to admit Kanimozhi into the firm to one sixth share of profits. Goodwill account stood in their books at Rs.60,000 and it was on that above date of the admission valued at Rs.40,000. What is the entry for the goodwill account to its agreed value?

20. Kalavathi and Malathi are two partners sharing profits in the ratio of 4:3. Leelavathi is admitted for 1/3rd share of profits. Goodwill of the firm is to be valued at 2 years' purchase of 3 years' profits which have been Rs.44,000 Rs. 56,000, Rs. 68,000. Give journal entries if:

    (a) There is no goodwill in the books of the firm.

    (b) The goodwill account appears at Rs. 28,000

    (c) The goodwill already existing in the books is Rs. 1,68,000

(Ans. Goodwill Rs.1,12,000)

Combining Some (or) All Adjustments:

21. The following is the Balance Sheet of Amutha and Rama sharing profits 3:2, as on 31.3.2005.

Liabilities	Rs.	Assets	Rs.
Sundry creditors	80,000	Bank	10,000
Bills payable	20,000	Sundry debtors	30,000
Capital accounts		Stock	20,000
Amutha : 40,000		Machinery	40,000
Rama : 30,000		Land and Buildings	70,000
	70,000		
	1,70,000		1,70,000

On 1.4.2005 they decided to admit Latha Baskar into the partnership on the following terms:

(a) Latha Baskar shall bring in a capital of Rs.30,000

(b) Goodwill of the firm being valued at Rs.20,000

(c) Land and buildings be appreciated by 10%

(d) Stock be depreciated by Rs.3,000 and provision for outstanding liability be created at Rs.2,000.

Prepare the Revaluation account, Capital accounts, Bank account and the Balance Sheet of the reconstituted partnership.

(Ans. : Revaluation Profit : Rs. 2,000; B/s : Rs.2,24,000)

22. The following is the Balance Sheet of Lion and Tiger sharing profits and losses as to Lion - 65% and Tiger - 35% as at 1st May 2004:

Liabilities		Rs.	Assets	Rs.
Sundry creditors		25,000	Cash	2,000
Bank overdraft		13,000	Debtors	30,000
Profit and Loss A/c		14,000	Stock	20,000
Capital :			Furniture	8,000
Lion :	40,000		Land and Buildings	50,000
Tiger :	30,000	70,000	Goodwill	12,000
		1,22,000		1,22,000

They agree to take Leopard into the partnership to 1/10th share on the following terms:

(a) Leopard shall bring in a capital of Rs. 30,000.

(b) The goodwill of the firm be increased to Rs.15,000

(c) A provision of Rs.1,000 be made for outstanding repairs bill.

(d) The value of land and buildings be brought upto Rs.60,000 being their present worth.

Prepare the Revaluation account, Capital accounts, Bank account and the Balance Sheet of the New Firm.

(Ans. : Revaluation Profit : Rs. 9,000; B/s. : Rs.1,65,000)

23. Prasanna and Nirmala were partners sharing profit and loss in the ratio of 7:5. Their Balance Sheet as on 31st December, 1994 is as under:

Liabilities		Rs.	Assets		Rs.
Capital:			Land & Buildings		80,000
Prasanna :	60,000		Plant & Machinery		20,000
Nirmala :	50,000	1,10,000	Investments		40,000
Reserve fund		20,000	Stock		22,000
Sundry creditors		32,000	Sundry debtors	10,000	
Bills payable		13,600	Less: Provision		

		for doubtful debts 400	9,600
		Cash	4,000
	1,75,600		1,75,600

They decided to admit Parimala into the partnership with effect from 1st January, 1994 on the following terms.

(a) Parimala shall bring in a capital of Rs.40,000 for 1/3rd share of profits.

(b) Goodwill of the firm was valued at Rs.72,000.

(c) Land was to be revalued at Rs.90,000 and investments Rs.50,000.

(d) Stock was to be written down by Rs.4,000

(e) Provision for doubtful debts was to be increased Rs.600.

(f) Creditors includes Rs.1,000 no longer payable and this sum was to be written off.

Show revaluation account, capital accounts of partners and the Balance Sheet of the reconstituted partnership.

(Ans. : Revaluation Profit : Rs. 16,800; B/s. : Rs.3,03,400)

24. Lakshmi and Saraswathi are partners of a firm sharing profits and losses in proportion to capital. Their Balance Sheet as on 31st March 2005 is as under:

Liabilities	**Rs.**	**Assets**	**Rs.**
Sundry creditors	60,000	Bank	12,000
Bills payable	40,000	Sundry debtors	40,000
Capital accounts:		Stock	40,000
Lakshmi : 60,000		Plant	90,000
Sarswathi : 40,000	1,00,000	Furniture	18,000
	2,00,000		2,00,000

They decided to admit Sulochana into the partnership with effect from 1st April, 2005 on the following terms.

(a) Sulochana shall bring in a capital of Rs.50,000 for 1/5th share of profits.

(b) Goodwill is to be valued at Rs.40,000.

(c) Plant and furniture was to be depreciated by 5%.

(d) Provision for doubtful debts be created at 1½% on sundry debtors.

Show revaluation account, capital accounts, bank account and balance sheet of the reconstituted partnership.

(Ans. : Revaluation Loss : Rs.6,000 B/s : Rs.2,84,000)

25. The following are the Balance Sheet of Pandian, Pallavan and Chozhan sharing profits and losses in the proportion of 1/2, 1/3 and 1/6 respectively as at 31.12.2004.

Liabilities	Rs.	Assets	Rs.
Sundry creditors	94,500	Cash	10,000
Bills payable	31,500	Bank	1,20,000
Reserve fund	1,20,000	Land and Building	2,50,000
Outstanding expenses	4,000	Furniture	35,000
Capital:		Stock	1,45,000
Pandian : 1,80,000		Debtors	1,30,000
Pallavan : 1,65,000			
Chozhan : 95,000	4,40,000		
	6,90,000		6,90,000

They decided to admit Cheran into the partnership with effect from 1st January, 2005 on the following terms.

(a) Cheran should bring in Rs.80,000 as his capital for ¼ share of profits.

(b) Furniture be depreciated by Rs.3,500.

(c) Stock be depreciated by 10%.

(d) The value of land and buildings having appreciated be brought upto Rs.3,25,000.

Show revaluation account, capital accounts, bank account and the balance sheet of the reconstituted partnership.

(Ans. : Revaluation Profit Rs.57,000; Balance Sheet Total : Rs. 8,27,000)

26. A and B sharing pofits in the ratio of 6:4, admit C as a partner with 1/3 share in profits on 1st January, 2000. The terms agreed upon were,

a) C has to contribute Rs.25,000 as capital.

b) Goodwill of the firm be valued at Rs.26,000.

c) Land & building be appreciated by 40%.

d) Depreciate Plant & Machinery by 10%.

e) The provision for doubtful debts was to be increased by Rs.800.

f) A liability of Rs.1,000 included in the Sundry Creditors is not likely to arise.

The Balance sheet of A, B as on 31.12.1999 before C's admission was as follows:

Liabilities		Rs.	Assets		Rs.
Sundry creditors		29,000	Cash		9,000
Bills payable		6,000	Land & Building		25,000
A	50,000		Plant & Machinery		30,000
B	35,000	85,000	Stock		15,000
General Reserve		16,000	Sundry debtors	20,000	
			Less: Provision for doubtful debts	1,000	19,000
			Goodwill		10,000
			Profit & Loss Account		28,000
		1,36,000			1,36,000

Pass necessary journal entries and prepare important Ledger Accounts and the new Balance Sheet as on 1.1.2000 after admission of C.

(June 2003)

(Answer: Revaluation Profit Rs.6,200; B/s Rs.1,55,200)

27. A and B were partners sharing profit and losses in the ratio of 3:2. Their Balance sheet as on 31st December, 2001 is as under:

Liabilities		Rs.	Assets		Rs.
Capital:			Land & Buildings		40,000
A	30,000		Plant & Machinery		10,000
B	25,000	55,000	Investment		10,000
Reserve fund		10,000	Stock		11,000
Sundry Creditors		16,000	Profit & Loss Account		10,000
Bills payable		6,800	Sundry Debtors	5,000	

		Less: Provision for doubtful debts	200	4,800
		Cash		2,000
	87,800			87,800

They decided to admit C into the partnership with effect from 1st January, 2002.

i) That C shall bring as a capital of Rs.20,000 for 1/3rd Profits.

ii) That goodwill of the firm was valued at Rs.36,000.

iii) Land was to be revalued at Rs.45,000 and investments at Rs.25,000.

iv) Stock was to be written down by Rs.2,000.

v) That provision for doubtful debts was to be increased to Rs.300.

vi) Creditors include Rs.500 no longer payable and this sum was to be written off.

Pass journal entries to carry out the above terms of admission. Also show Revaluation account, Capital accounts of partners and the Balance Sheet of the reconstituted partnership.

(October 2002)

(Answer: Revaluation Profit Rs.18,400; B/s Rs.1,51,700)

Chapter - 8

PARTNERSHIP ACCOUNTS - RETIREMENT

Learning Objectives

After studying this Chapter, you will be able to

- know the meaning and reasons for retirement.
- ascertain the new profit sharing ratio and the gaining ratio.
- prepare the revaluation account.
- understand the accounting treatment of goodwill.
- know the modalities of settlement of claim of the retiring partner.

According to section 32(1) of the Indian Partnership Act 1932, a partner may retire from the firm

1. with the consent of all the partners
2. in accordance with an express agreement by the partners
3. where the partnership at will by giving notice in writing to all the other partners of his intention to retire.

Sometimes, a partner may decide to retire from the firm because of old age, ill health etc. Technically, on retirement, the old partnership comes to an end and a new one comes into existence with the remaining partners. However, the firm as such continues. A person who is retired from the firm is known as an outgoing partner or a retiring partner. A retiring partner will be held liable for the debts incurred by the firm before his retirement. But, he will not be responsible for the firms' acts after his retirement.

When a partner retires, his share in the properties of the firm has to be ascertained and paid off. Certain adjustments have to be made in the books to ascertain the amount due to him from the firm. These adjustments are very similar to those which we saw in connection with the admission of a partner.

8.1 ADJUSTMENTS

When a partner retires, the following accounting adjustments are necessary

1. Calculation of New profit sharing ratio and Gaining ratio
2. Revaluation of assets and liabilities

3. Transfer of Undistributed Profit or loss
4. Transfer of Accumulated reserves
5. Treatment of Goodwill
6. Settlement of the retiring partner's claim.

8.1.1 Calculation of New Profit sharing ratio and Gaining ratio

At the time of retirement of a partner, the remaining partners acquire some portion of the retiring partner's share of profit. This necessitates the calculation of new profit sharing ratio of the remaining partners.

New Profit Sharing Ratio:

The ratio in which the continuing partners decide to share the future profits and losses is known as new profit sharing ratio.

New Profit sharing ratio = Old ratio + Gaining ratio

New share = Old share + Acquired share (gain)

Gaining Ratio:

The ratio in which the continuing partners acquire the outgoing partner's share is called as gaining ratio. This ratio is calculated by taking out the difference between new profit shareing ratio and old profit sharing ratio.

Gaining ratio = New ratio – Old ratio

Gain = New share – Old share

The purpose of this ratio is to determine the amount of compensation to be paid by each of the remaining partners as the firm to the retiring partner.

Distinction between Sacrificing Ratio and Gaining Ratio

Sacrificing Ratio and Gaining Ratio can be distinguished as follows:

Basis of Distinction	Sacrificing Ratio	Gaining Ratio
1. Meaning	It is the ratio in which the old partners have agreed to sacrifice their shares in profit in favour of new partner.	It is the ratio in which the continuing partners acquire the outgoing partner's share.
2. Purpose	It is calculated to determine the amount of compensation to be paid by the incoming partner to the sacrificing partners.	It is calculated to determine the amount of compensation to be paid by each of the continuing partners to the outgoing partner.

3. Calculation	It is calculated by taking out the difference between old ratio and new ratio.	It is calculated by taking out the difference between new ratio and old ratio.
4. Time	It is calculated at the time of admission of a new partner.	It is calculated at the time of retirement of a partner.

The following are the different situations while calculating the new profit sharing ratio and the gaining ratio.

1. Nothing is mentioned about the new ratio
2. Unequal gain
3. Equal gain
4. Entire gain by one partner
5. New profit sharing ratio is given

8.2 CALCULATION OF NEW PROFIT SHARING RATIO AND GAINING RATIO

1. Nothing is mentioned about the new ratio

If nothing is mentioned about the new ratio, old ratio of the continuing partners is equal to their new ratio. It is proved in the following illustration.

Illustration : 1

A,B and C sharing profits in the ratio of 5:3:2. C retires. Find out the new profit sharing ratio and gaining ratio.

Solution:

		A	:	B	:	C
Old ratio	=	5	:	3	:	2
Old share	=	$\frac{5}{10}$	:	$\frac{3}{10}$	:	$\frac{2}{10}$
New Ratio	=	5	:	3		
New share	=	$\frac{5}{8}$	:	$\frac{3}{8}$		
Gain	=	$\frac{5}{8}-\frac{5}{10}$	:	$\frac{3}{8}-\frac{3}{10}$		
	=	$\frac{25-20}{40}=\frac{5}{40}$	:	$\frac{15-12}{40}=\frac{3}{40}$		
∴ Gaining ratio	=	5 : 3				

2) Unequal gain

Illustration 2:

D, E and F are partners sharing profits in the ratio of 5 : 3 : 2. F retires and his share was taken up by D and E in the ratio of 2 : 1. Find out the new profit sharing ratio of D and E.

Solution:

		D	:	E	:	F
Old ratio	=	5	:	3	:	2
Old share	=	$\frac{5}{10}$	:	$\frac{3}{10}$	:	$\frac{2}{10}$
Gaining Ratio	=	2	:	1		
Gain	=	$\frac{2}{3} \times \frac{2}{10}$	:	$\frac{1}{3} \times \frac{2}{10}$		
	=	$\frac{4}{30}$	:	$\frac{2}{30}$		
New share	=	$\frac{5}{10} + \frac{4}{30}$	:	$\frac{3}{10} + \frac{2}{30}$		
	=	$\frac{15+4}{30} = \frac{19}{30}$	:	$\frac{9+2}{30} = \frac{11}{30}$		
New ratio	=	19	:	11		

3) Equal gain

Illustration 3:

G, H and I are partners sharing profits in the ratio of 5 : 3 : 2. I retires and his share was taken up by G and H equally. Find out the new Profit sharing ratio of G and H.

Solution:

		G	:	H	:	I
Old ratio	=	5	:	3	:	2
Old share	=	$\frac{5}{10}$	:	$\frac{3}{10}$	:	$\frac{2}{10}$
Gaining Ratio	=	1	:	1		

Gain share	=	$\frac{1}{2} \times \frac{2}{10}$	:	$\frac{1}{2} \times \frac{2}{10}$		
	=	$\frac{2}{20} = \frac{1}{10}$	:	$\frac{2}{20} = \frac{1}{10}$		
New share	=	$\frac{5}{10} + \frac{1}{10}$	:	$\frac{3}{10} + \frac{1}{10}$		
	=	$\frac{6}{10}$	:	$\frac{4}{10}$		
New ratio	=	6	:	4		
	=	3	:	2		

4) Entire gain by one partner

Illustration 4:

J, K and L are partners sharing profits in the ratio of 5 : 3 : 2. L retires and his share was taken up entirely by K. Find out the new Profit sharing ratio and gaining ratio of continuing partners.

Solution:

a) New ratio:

		J	:	K	:	L
Old ratio	=	5	:	3	:	2
Old share	=	$\frac{5}{10}$	:	$\frac{3}{10}$	:	$\frac{2}{10}$
Share of Gain	=			$\frac{2}{10}$		
New Share	=	$\frac{5}{10}$	:	$\frac{3}{10} + \frac{2}{10} = \frac{5}{10}$		
	=	5	:	5		
New ratio	=	1	:	1		i.e. equal

b) Gaining ratio:

Gaining ratio = New ratio – Old ratio

A's Gain = New share – Old share

A's Gain = $\frac{5}{10} - \frac{5}{10}$ = Nil

B's gain = $\frac{5}{10} - \frac{3}{10}$

B's gain = $\frac{2}{10}$ or $\frac{1}{5}$

5) New ratio is given

Illustration 5:

X,Y and Z are partners sharing profits in the ratio of 5 : 3 : 2. Z retires and the ratio between X and Y is 3 : 2. Find out the gaining ratio

Solution:

		X	:	Y	:	Z
Old ratio	=	5	:	3	:	2
Old share	=	$\frac{5}{10}$	:	$\frac{3}{10}$	:	$\frac{2}{10}$
New ratio	=	3	:	2		
New Share	=	$\frac{3}{5}$	:	$\frac{2}{5}$		
Share of gain	=	$\frac{3}{5} - \frac{5}{10}$	:	$\frac{2}{5} - \frac{3}{10}$		
	=	$\frac{1}{10}$	:	$\frac{1}{10}$		
Gaining ratio	=	1 : 1				

8.3 REVALUATION OF ASSETS AND LIABILITIES

At the time of retirement of a partner, it is necessary to revalue the assets and liabilities of the firm. It is necessary that the retiring partner is given a share of all profits that have arisen till his retirement. Further, he is made to bear his share of losses that had occurred till his retirement. A Revaluation account is opened and credited with all the profit items and debited with all the loss items. The profit or loss on revaluation will be transferred to partners' capital accounts including the retiring partner in the old profit sharing ratio.

Entries for revaluation here are similar to those in admission. They are:

1. For profit items: a) Increase in the value of assets b) Decrease in the amount of Liabilities & c) Unrecorded assets recorded

   Concerned Assets A/c Dr .....

   Concerned Liabilities A/c Dr .....

   To Revaluation A/c .....

2. For Loss items: a) Decrease in the Value of assets b) Increase in the amount of Liabilities c) Unrecorded liabilities recorded and d) New liability created.

   Revaluation A/c Dr ......

   To Concerned Assets A/c ......

   To Concerned Liabilities A/c ......

3. For transfer of profit or loss on revaluation

   a) If Profit

   Revaluation A/c Dr ......

   To All partners'capital A/c ......

   b) If Loss

   All partners'capital A/c Dr ......

   To Revaluation A/c ......

Illustration 6:

Prabha, Kavitha and Meena were partners of a firm sharing profit and loss in the ratio of 3 : 2 : 1. Meena wanted to retire. They decided to revalue the assets and liabilities of the firm as indicated below:

a) To write down Machinery by Rs.10,000 and Stock by Rs.4,000

b) To bring into books as unrecorded Investments Rs.5,000

c) To write off Rs.3,000 from sundry creditors as it was no longer liability.

Pass entries to give effect to the above adjustments. Show also Revaluation account.

Solution:

Journal Entries

Date	Particulars		L.F	Debit Rs.	Credit Rs.
	Investments A/c	Dr		5,000	
	Sundry creditors A/c	Dr		3,000	
	To Revaluation A/c				8,000
	(Profit items of revaluation)				
	Revaluation A/c	Dr		14,000	
	To Machinery A/c				10,000
	To Stock A/c				4,000
	(Loss items of revaluation)				
	Prabha's capital A/c	Dr		3,000	
	Kavitha's capital A/c	Dr		2,000	
	Meena's capital A/c	Dr		1,000	
	To Revaluation A/c				6,000
	(Loss on revaluation transferred to old partners in the old ratio)				

Revaluation Account

Dr. **Cr.**

Particulars	Rs.	Particulars		Rs.
To Machinery A/c	10,000	By Investments A/c		5,000
To Stock A/c	4,000	By Sundry creditors A/c		3,000
		By Loss transferred to capital account		
		Prabha	3,000	
		Kavitha	2,000	
		Meena	1,000	
				6,000
	14,000			14,000

8.4 TRANSFER OF UNDISTRIBUTED PROFIT OR LOSS

At the time of retirement of a partner, undistributed profit or loss of the old firm should be transferred to all partners' capital accounts in their old profit sharing ratio.

The accounting treatment would be as follows:

a. For transfer of undistributed profit :

Profit and Loss A/c Dr .....

To All Partners' Capital A/cs .....

b. For transfer of undistributed loss:

All Partners' Capital A/cs Dr ....

To Profit and Loss A/c ....

Illustration 7:

Bhanumathi, Bharathi and Shanthi are partners sharing. profits in the ratio of 5 : 3 : 2. On April 1, 2005 Shanthi decided to retire. On that date, there was a credit balance of Rs.60,000 in their profit and loss account. Pass entry.

Solution:

Journal Entry

Date	Particulars	L.F	Debit Rs.	Credit Rs.
2005				
Apr 1	Profit and Loss A/c Dr		60,000	
	To Bhanumathi's capital A/c			30,000
	To Bharathi's capital A/c			18,000
	To Shanthi's capital A/c			12,000
	(Undistributed profit transferred to capital accounts in the old ratio)			

8.5 TRANSFER OF ACCUMULATED RESERVE

Any amount kept aside as Reserve, General reserve, Reserve fund, contingency reserve etc., at the time of retirement of a partner, should be transferred to the capital accounts of all partners including retiring partner in the old profit sharing ratio.

The entry is

General Reserve A/c Dr ....

To All Partners' capital A/c ....

Illustration : 8

Thangamuthu, Anaimuthu and Vairamuthu are partners sharing profit and loss in the ratio of 3:3:2. Thangamuthu wanted to retire on 1st June 2005, the firms books showed a general reserve of Rs.40,000. Pass entry.

Solution:

Journal Entry

Date	Particulars	L.F	Debit Rs.	Credit Rs.
2005 Jan 1	General Reserve A/c Dr		40,000	
	To Thangamuthu's capital A/c			15,000
	To Anaimuthu's Capital A/c			15,000
	To Vairamuthu's capital A/c			10,000
	(General reserve transferred partners capital accounts)			

8.6 TREATMENT OF GOODWILL

At the time of retirement of a partner, adjustment for goodwill of the firm, if any, has to be made as in admission. In retirement too, we confine to the Revaluation Method only.

a) Goodwill is raised in the books of the firm:

At the time of retirement, Goodwill is raised to its present value and brought into record.

The entry is

Goodwill A/c Dr ....

To All partners' capital A/c ....

(Goodwill raised and adjusted to the all partners' capital account)

b) Goodwill appears in the books -understated:

If the goodwill appears in the balance sheet at a value less than the present value of goodwill, the difference in the goodwill account is transferred to all partners' capital accounts in the old ratio.

The entry is

Goodwill A/c Dr ....

To All Partners' capital A/c ....

(Increase in the value of goodwill transferred to all partners' capital accounts in the old ratio)

c) Goodwill appears in the books - overstated :

If the goodwill appears in the balance sheet at a value more than the present value of goodwill, the difference in the goodwill is transferred to all partners in the old ratio.

The entry is

All Partners' Capital A/c   Dr   ....

To Goodwill A/c   ....

(Decrease in the value of goodwill transferred to all partners' capital accounts in the old ratio)

Illustration : 9

Thamizhselvi, Kalaiselvi and Thenmozhi are partners sharing profits in the ratio of 5 : 3 : 2. Kalaiselvi decided to retire. Goodwill of the firm is to be valued at Rs.40,000. Give journal entries if

a) there is no goodwill in the books of the firm.

b) the goodwill appears at Rs.30,000

c) the goodwill appears at Rs.50,000

Solution:

Journal Entries

Date	Particulars		L.F	Debit Rs.	Credit Rs.
	(a)				
	Goodwill A/c	Dr		40,000	
	To Thamizhselvi Capital A/c				20,000
	To Kalaiselvi Capital A/c				12,000
	To Thenmozhi Capital A/c				8,000
	(Goodwill raised and transferred to old partners in the old ratio)				

(b)				
Goodwill A/c	Dr		10,000	
To Thamizhselvi Capital A/c				5,000
To Kalaiselvi Capital A/c				3,000
To Thenmozhi Capital A/c				2,000
(Increase in goodwill transferred)				
(c)				
Thamizh selvi Capital A/c	Dr		5,000	
Kalaiselvi Capital A/c	Dr		3,000	
Thenmozhi Capital A/c	Dr		2,000	
To Goodwill				10,000
(Decrease in goodwill transferred to the old partners in the old ratio)				

8.7 SETTLEMENT OF CLAIM OF THE RETIRING PARTNER

The retiring partner is entitled for the amount due to him from the firm. The amount due to the retiring partner is ascertained by preparing his capital account incorporating all the adjustments like the share of goodwill, undistributed profits or losses, accumulated reserves, profit or loss on revaluation of assets and liabilities etc.

The amount due is either paid off immediately or is paid in instalments. When it is not paid immediately, it will be transferred to his loan account.

a) When the amount due is paid off immediately

Retiring partner's capital A/c	Dr	....	
To Bank A/c			....

b) When the amount due is not paid immediately

Retiring partner's capital A/c	Dr	....	
To Retiring Partner's Loan A/c			....

c) When the amount is paid partly at once and the balance in instalments

Retiring partner's capital A/c	Dr	.....	
To Bank A/c			.....
To Retiring Partners loan A/c			.....

Illustration : 10

A, B and C are partners sharing profits and losses in the ratio of 5:3:2 respectively. A retires from the firm on 1st April 2005. After his retirement, his capital account shows a credit balance of Rs.1,35,000 after the necessary adjustments made. Give journal entries, if

a) the amount due is paid off immediately.

b) when the amount due is not paid immediately.

c) Rs. 45,000 is paid and the balance in future.

Date	Particulars		L.F	Debit Rs.	Credit Rs.
	(a)				
	C's capital A/c	Dr		1,35,000	
	To Bank A/c				1,35,000
	(The amount due Rs.1,35,000 is paid to C)				
	(b)				
	C's capital A/c	Dr		1,35,000	
	To C's Loan A/c				1,35,000
	(The amount due to C is transferred to C's loan account)				
	(c)				
	C's Capital A/c	Dr		1,35,000	
	To Bank A/c				45,000
	To C's Loan A/c				90,000
	(Rs.45,000 is paid and the balance transferred to C's loan A/c)				

8.8 Preparation of Revaluation Account, Capital Accounts, Bank Account and the Balance Sheet of the reconstituted partnership firm

Illustration : 11

Lalitha, Jothi and Kanaga were partners of a firm sharing profit and losses in the ratio of 3:2:3. Set out below was their balance sheet as on 31st March 2003.

Balance Sheet

Liabilities		Rs.	Assets	Rs.
Bills payable		32,000	Cash in Hand	750
Sundry Creditors		62,500	Cash at Bank	2,04,500
Capitals:			Book-debts	89,000
Lalitha	2,00,000		Stock	1,11,500
Jothi	1,25,000		Furniture	17,500
Kanaga	1,50,000	4,75,000	Plant & Machinery	48,750
Profit & Loss A/c		22,000	Building	1,20,000
Outstanding expenses		500		
		5,92,000		5,92,000

Lalitha retired from the partnership on 1st April 2004 on the following terms:

1. Goodwill of the firm was to be valued at Rs.30,000
2. The assets are to be valued as under: Stock Rs.1,00,000; Furniture Rs.15,000; Plant and Machinery Rs.45,000; Building Rs.1,00,000.
3. A provision for doubtful debts be created at Rs.4,250.
4. Lalitha was to be paid off immediately.

Show the journal entries, prepare revaluation account, capital accounts, Bank account and balance sheet of the reconstituted partnership.

Solution:

Journal Entries

Date	Particulars		L.F	Debit Rs.	Credit Rs.
	Revaluation A/c	Dr		42,000	
	To Stock A/c				11,500
	To Furniture A/c				2,500
	To Plant and machinery A/c				3,750
	To Building				20,000
	To Provision for doubtful debts A/c				4,250
	(Loss items transferred)				

Lalitha's Capital A/c Dr			15,750	
Jothi's Capital A/c Dr			10,500	
Kanaga's Capital A/c Dr			15,750	
To Revaluation A/c				42,000
(Loss on revaluation transferred to partners capital A/c)				
Goodwill A/c Dr Dr			30,000	
To Lalitha's Capital A/c				11,250
To Jothi's Capital A/c				7,500
To Kanaga's Capital A/c				11,250
(Goodwill raised & transferred to partners capital A/c)				
Profit and Loss A/c Dr			22,000	
To Lalitha's Capital A/c				8,250
To Jothi's Capital A/c				5,500
To Kanaga's Capital A/c				8,250
(Undistributed profit transferred to Partners capital A/c)				
Lalitha's Capital A/c Dr			2,03,750	
To Bank A/c				2,03,750
(The amount due to Lalitha is paid off immediately)				

Revaluation Account

Dr. **Cr.**

Particulars	Rs.	Particulars		Rs.
To Stock A/c	11,500	By Los transferred to		
To Furniture A/c	2,500	Lalitha's Capital A/c	15,750	
To Plant & Machinery A/c	3,750	Jothi's Capital A/c	10,500	
To Building A/c	20,000	Kanaga's Capital A/c	15,750	42,000

To Provision for doubtful debts A/c	4,250		
	42,000		42,000

Capital Accounts

Dr. **Cr.**

Particulars	Lalitha Rs.	Jothi Rs.	Kanaga Rs.	Particulars	Lalitha Rs.	Jothi Rs.	Kanaga Rs.
To Revaluation A/c	15,750	10,500	15,750	By Balance b/d	2,00,000	1,25,000	1,50,000
To Cash A/c	2,03,750	—	—	By Profit & Loss A/c	8,250	5,500	8,250
To Balance c/d	—	1,27,500	1,53,750	By Goodwill A/c	11,250	7,500	11,250
	2,19,500	1,38,000	1,69,500		2,19,500	1,38,000	1,69,500

Bank Account

Dr. **Cr.**

Particulars	Rs.	Particulars	Rs.
To Balance b/d	2,04,500	By L's Capital A/c	2,03,750
		By Balance c/d	750
	2,04,500		2,04,500

Balance Sheet of K and G as on 1.4.2004

Liabilities	Rs.	Assets	Rs.
Bills Payable	32,000	Cash in Hand	750
Sundry Creditors	62,500	Cash at Bank	750
Capital A/cs:		Book debts 89,000	
Jothi 1,27,500		Less: Provision for	
Kanaga 1,53,750	2,81,250	doubtful debts A/c 4,250	84,750
Outstanding Expenses	500	Stock	1,00,000
		Furniture	15,000
		Plant & Machinery	45,000
		Building	1,00,000
		Goodwill	30,000
	3,76,250		3,76,250

Illustration : 12

Pallavan, Pandian and Chozhan were carrying on partnership business sharing profits in the ratio of 3 : 2: 1. On March 31, 2005, the Balance Sheet of the firm stood as follows:

Balance Sheet

Liabilities	Rs.	Assets	Rs.
Creditors	30,000	Bank	65,000
Sundry Creditors	15,000	Debtors	40,000
Capitals:		Stock	80,000
Pallavan 2,00,000		Building	2,50,000
Pandian 1,20,000		Profit and Loss A/c	30,000
Chozhan 1,00,000	4,20,000		
	4,65,000		4,65,000

Chozhan retired on April 1, 2005 on the following terms:

1. Building to be appreciated by Rs. 15,000
2. Provision for doubtful debts to be made at 6% on debtors
3. Goodwill of the firm is valued at Rs.18,000.
4. Rs.50,000 to be paid to chozhan immediately and the balance transferred to his loan account.

Prepare Revaluation Account, Capital Accounts, Bank Account and the Balance Sheet after Chozhan's retirement.

Solution:

Revaluation Account

Dr. **Cr.**

Particulars	Rs.	Particulars	Rs.
To Provision for doubtful debts	2,400	By Building A/c	15,000
To Gain transferred to			
Pallavan 6,300			
Pandian 4,200			
Chozhan 2,100	12,600		
	15,000		15,000

Capital Accounts

Dr. **Cr.**

Particulars	Pallavan Rs.	Pandian Rs.	Chozhan Rs.	Particulars	Pallavan Rs.	Pandian Rs.	Chozhan Rs.
To Profit & Loss A/c	15,000	10,000	5,000	By Balance b/d	2,00,000	1,20,000	1,00,000
To Bank A/c			50,000	By Goodwill A/c	9,000	6,000	3,000
To Chozhan's loan A/c			52,600	By Revaluation A/c	6,300	4,200	2,100
To Balance c/d	2,07,800	1,25,200	—	By Reserve	7,500	5,000	2,500
	2,22,800	1,35,200	1,07,600		2,22,800	1,35,200	1,07,600

Bank Account

Dr. **Cr.**

Particulars	Rs.	Particulars	Rs.
To Balance b/d	65,000	By Chozhan's capital A/c	50,000
		By Balance c/d	15,000
	65,000		65,000

Balance Sheet of Pallavan and Pandian as on 1.4.2004

Liabilities		Rs.	Assets		Rs.
Creditors		30,000	Bank		15,000
Chozhan's Loan A/c		52,600	Debtors	40,000	
Capitals			Less: Provision for doubtful debts A/c	2,400	37,600
Pallavan	2,07,800				
Pandian	1,25,200	3,33,000			
			Stock		80,000
			Building		2,65,000
			Goodwill		18,000
		4,15,600			4,15,600

QUESTIONS

I. Objective Type

a) Fill in the blanks:

1. The retiring partner should be paid off or the amount due to him, will be treated as his _______ to the firm.
2. At the time of retirement of partners, the existing partners stand to ______.
3. If the value of liabilities decrease, it results in _______ item.
4. At the time of retirement, the increase in the value of goodwill will be transferred to the _______ side of the capital accounts of all the partners.
5. At the time of retirement, the profit on revaluation of assets and liabilities will be transferred to the _______ side of the capital accounts of all the partners.
6. At the time of retirement, the revaluation profits of business will be shared by _______ partners.

(Mar. '99)

7. In the absence of any specific agreement between the partners, partners loan to the firms will carry an interest at the rate of _______ percentage.

(Oct. '99)

8. The accumulated reserves will be transferred to the old partners Capital account in the _______ ratio at the time of his retirement

(Mar'2000)

9. The amount due to the retiring partner is either ________ or is paid in _______.
10. _______ is calculated to determine the amount of compensation to be paid by each of the continuing partners to the outgoing partners.
11. A, B and C shares profit as 1/2 to A, 1/3 to B and 1/6 to C. If B retires then, the new profit sharing ratio is _______.
12. Sacrificing ratio is the ratio in which the old partners (existing) have agreed to sacrifice their _______ in favour of ______________. .

(**Answers:** : 1. loan; 2. gain; 3.Profit; 4. credit; 5. credit; 6. all; 7. six; 8. old profit sharing; 9. paid off immediately, instalments; 10. Gaining ratio; 11. 3:1; 12. share of profit, incoming partner)

b) Choose the correct answer :

1. At the time of retirement of a partner, calculation of new profit ratio is

   a) not necessary b) necessary c) optional

2. Undistributed profits and losses transferred to all the partners account at the time of retirement of a partner.

   a) should be b) should not be c) may be

3. At the time of retirement Balance sheet items like Profit & Loss account and General Reserve must be transferred to

   a) Revaluation A/c b) Partner's Capital A/c

   c) None of the above

4. If the goodwill account is raised for Rs.30,000, the amount is debited to:

   a) The capital accounts of partners

   b) Goodwill Account

   c) Cash Account

5. _______ ratio is calculated by taking out the difference between new profit sharing ratio and old profit sharing ratio.

   a) Gaining b) Capital c) Sacrifice

6. On retirement of a partner goodwill amount is credited to the account of

   a) only retiring partner

   b) all partners including retiring partner

   c) only remaining partner

7. A, B and C are sharing profits in the ratio of 2/5 : 2/5 : 1/5. C retired from business and his share was purchased equally by A and B. Then new profit sharing ratio shall be

   a) A – 1/2 & B – 1/2 b) A – 3/5 & B – 2/5

   c) A – 2/5 & B – 3/5

8. When the amount due to an outgoing partner is not paid immediately, then it is transferred to

   a) Capital A/c b) Loan A/c c) Cash A/c

9. If the amount due to the outgoing partner is transferred to loan account then he is entitled to interest at _____untill it is paid out.

   a) 9% b) 5% c) 6%

(**Answers :** 1. (b); 2. (a); 3. (b); 4.(b); 5. (a); 6. (b); 7. (a); 8. (b); 9.(c))

II. Other Questions:

1. What do you mean by retirement of a partner?
2. Who is an outgoing partner?
3. How can a partner retire from the firm?
4. What is new profit ratio on retirement of a partner?
5. What is gaining ratio?
6. What are the adjustments to be made in connection with Retirement?
7. What are the entries for Revaluation of Assets and Liabilities of a firm in the event of retirement of a partner?
8. How will you deal with the amount due to an outgoing partner?
9. Distinguish between sacrificing ratio and gaining ratio.

III. Problems :

Determination of New Profit Ratio

1. The Old profit sharing ratio of A, B and C was 4:3:2. Calculate the new ratio and the ganing ratio when (i) A retires (ii) B retires (iii) C retires.

(Answer: New ratio (i)3:2; (ii) 2:1; (iii)4:3;
Gaining ratio (i)3:2; (ii) 2:1; (iii)4:3)

2. Mani, Nagappan and Ulaganathan are partners sharing profits in the ratio of 4:3:3. Ulaganathan retires and his share is taken up by Mani and Nagappan in the ratio of 3:2. Calculate the new ratio.

(Answer: 29:21)

3. Sabapathi, Thirumalai and Umapathi are partners sharing profits in the ratio of 3:2:1. Thirumalai retires and his share is taken up by Sabapathi and Umapathi equally. Calculate the new ratio.

(Answer : 2:1)

4. Roja, Meena and Shobana are partners sharing profits in the ratio of 5:4:3. Roja retires and her share is taken up entirely by Meena. Calculate the new ratio.

(Answer : 3:1)

5. P, Q and R sharing profits in the ratio of 2:2:1. Q retires and the new profit ratio agreed between the continuing partners P and R is 4:3. Calculate gaining ratio.

Answer: 3:4)

6. X, Y and Z were sharing profits and losses in the proportion of 1/2 , 1/5 and 3/10 respectively. Y retires. Calculate the new ratio of X and Z.

(Answer: 5:3)

7. A, B and C were partners in a firm sharing profits in the ratio 4:3:2. C retired. What would be their new ratio and gaining ratio in each of the following cases.

   a) If C's share was taken up by A and B equally.

   b) If C's share was taken up by A and B in the original ratio.

   c) If C's share was take up by A and B in the ratio of 2:1.

   d) If C's share was take up entirely by A.

(Answer: New ratio - a)5:4; b)4:3; c)16:11; d)2:1;
Gaining ratio - a)1:1; b)4:3; c) 2:1; d) A only 2/9)

Revaluation of Assets and Liabilities:

8. Sankar, Sekar and Sarathi were partners of a firm sharing profits and losses in the ratio of 3:2:1. As Sarathi wanted to retire, they decided to revalue their firms' assets and liabilities as indicated below:

   (a) To increase the value of buildings by Rs.33,000.

   (b) To bring into record at Rs.6,000 investments which have not so far been brought into account.

   (c) To decrease stock by Rs.3,000 and furniture by Rs.1,500.

   (d) To write off sundry creditors by Rs.1,500

Pass the necessary journal entries and show the revaluation account.

(Answer: Revaluation Profit Rs. 36,000)

9. Ramu, Somu and Gopu were partners of a firm sharing profit and losses in the ratio of 5:3:2. On 1st Jan 2005, Gopu wanted to retire, they decided to revalue their firms' assets and liabilities as indicated below:

   (a) Increase the value of premises by Rs.30,000.

   (b) Depreciate stock, furniture and machinery by Rs.10,000, Rs. 5,000 and Rs.23,000 respectively.

   (c) Provide for an outstanding liability of Rs.2,000.

   Pass journal entries and revaluation account in the books of the firm to carryout the above decision of its partners.

(Answer : Revaluation Loss Rs.10,000)

10. C, D and E were partners of a firm sharing profit and loss in the ratio of 5:3:2. As D wanted to retire, they decided to revalue their firm's assets and liabilities as indicated below:

a) To bring into books unrecorded investments Rs.3,000.

b) To write off Rs.4,000 from Sundry Creditors.

c) To write down machinery by Rs.1,000 and furniture by Rs.2,000.

d) Goodwill of the firm be raised in its books at Rs.15,000. Pass journal entries and prepare revaluation account.

(June 2003) (Answer: Revaluation Profit Rs.4,000)

11. Ganga and Yamuna were partners of a firm sharing profits in the ratio of 3/5 and 2/5. Their balance sheet as at 31st December, 2004 stood as under.

Liabilities	**Rs.**	**Assets**	**Rs.**
Capitals:		Machinery	58,500
Ganga : 60,000		Stock	48,000
Yamuna : 45,000	1,05,000	Debtors	45,000
Sundry creditors	15,000	Cash	1,500
Bills payable	33,000		
	1,53,000		1,53,000

Yamuna decides to retire from the business owing to illness and that Ganga will take over the business in order to admit Amaravathi on the following terms.

(a) Depreciate machinery by 10% and stock by 15%.

(b) A provision for doubtful debts be created at 5% on sundry debtors.

(c) Provide for discount on creditors at 2%.

Show revaluation account, capital accounts and the opening balance sheet of Ganga.

(Answer : Revaluation Loss Rs. 15,000 Balance Sheet Total : Rs. 1,37,700)

Transfer of Accumulated Reserves and Undistributed Profit and Loss

12. A, B and C were partners sharing profit and losses in the ratio of 4:3:2. On 31st March, 2005, the firm's books showed general reserve at Rs.45,000. 'B' wanted to retire from 1.4.2005. Pass entry to transfer the entire reserve to the capital accounts of the partners.

13. Mohanraj, Nagaraj and Packiaraj were partners of a firm sharing profits and losses in the ratio of 5:3:2. On 31.12.2004, the firm's books showed a reserve fund of Rs.30,000 and undistributed loss Rs.20,000. Packiaraj wanted to retire from 1.1.2005. Pass entries to transfer the entire reserve and undistributed losses to their capital accounts.

14. Kumutha, Kuzhali and Kothai were partners of a firm sharing profit and losses in the ratio of 6:2:2. Set out below was their balance sheet as on 30.6.1994.

Liabilities	Rs.	Assets	Rs.
Sundry creditors	8,000	Cash in hand	3,000
Reserve fund	30,000	Cash at Bank	5,000
Capital Accounts:		Sundry debtors	45,000
Kumutha : 70,000		Stock	35,000
Kuzhali : 50,000		Machinery	30,000
Kothai : 30,000	1,50,000	Factory building	70,000
	1,88,000		1,88,000

On that date, Kothai retires from business. It is agreed to adjust the values of the assets as follows:

(a) To provide a reserve of 5% on sundry debts.

(b) To depreciate stock by 5% and machinery by 10%.

(c) Factory building to be revalued at Rs.75,000.

Prepare revaluation account, capital accounts and the opening balance sheet of the reconstituted firm.

(Answer : Revaluation Loss Rs. 2,000 Balance Sheet Total : Rs. 1,86,000)

Treatment of Goodwill

15. O, P and Q were partners of a firm sharing profit and losses in the ratio of 7:5:3. In view of 'P' s' retirement, they valued their goodwill at Rs.45,000 and decided to raise the goodwill account which did not exist before. Pass entry.

16. A, B and C were partners of a firm sharing profit and losses in the ratio of 5:3:2. Goodwill account stood in their books at Rs.36,000. 'C' wanted to retire and in view of that the partners decided to update the value of goodwill to Rs.50,000. Pass entry.

17. G, P and S were partners of a firm sharing profit and losses in the ratio of 3:2:1. In view of G's retirement, goodwill was valued at two year's purchase of

the average profits of last three years which were Rs.16,000, Rs.30,000 and Rs.26,000. Pass entry.

(Answer : Goodwill Rs.48,000)

18. Venus, Mercury and Jupitar are partners in a firm sharing profits and losses in the proportion of ½, 3/10 and 1/5 respectively. Their balance sheet as on 31.3.2005 is as under:

Liabilities	Rs.	Assets	Rs.
Sundry Creditors	62,000	Cash at Bank	81,000
Reserve fund	40,000	Debtors 62,000	
Capital Accounts:		Less: Provision for	
Venus: 1,60,000		doubtful debts 1,000	61,000
Mercury : 1,20,000		Stock	40,000
Jubitar : 60,000	3,40,000	Plant and Machinery	1,00,000
		Buildings	1,60,000
	4,42,000		4,42,000

Jupitar retires on 1st April 2005 subject to the following terms.

(a) Buildings are to be appreciated by 10%.

(b) The provision for bad debts is to be raised to Rs.2,400.

(c) Goodwill is to be raised at Rs.40,000.

(d) The retiring partner is to be paid off immediately.

Pass journal entries to record the above transactions in the books of the firm and show the revaluation account, capital accounts and the balance sheet of the new firm after Jupitar's retirement.

(Answer : Revaluation Profit Rs.14,600; B/s : Rs. 4,17,680)

19. Selva kumar, Saravana kumar and Vinod kumar were partners of a firm sharing profits and losses in the ratio of 3:2:1. Set out below was their balance sheet as on 31st December 2004.

Liabilities	Rs.	Assets	Rs.
Bills payable	15,000	Cash in Hand	3,000
Sundry creditors	25,000	Cash at Bank	35,000
Capital Accounts:		Bill receivable	11,000
Selvakumar : 80,000		Book debts	18,000

Saravanakumar : 50,000		Stock	36,000
Vinod Kumar : 40,000	1,70,000	Furniture	7,000
Profit and Loss A/c	30,000	Plant & Machinery	50,000
		Buildings	80,000
	2,40,000		2,40,000

Selvakumar retired from the partnership on 1st January 2005 on the following terms:

(a) Goodwill of the firm was to be valued at Rs.30,000.

(b) Assets are to be valued as under: Stock Rs. 30,000: Plant and Machinery Rs. 40,000; Buildings Rs.1,00,000

(c) A provision for doubtful debts be created at Rs.1,000

(d) Rs.21,500 was to be paid to Selvakumar immediately and the balance was transferred to his loan account.

Show revaluation account, capital accounts, bank account and the balance sheet of the reconstituted partnership.

(Ans. : Profit on Revaluation : Rs.3,000;

Balance Sheet Total : Rs.2,51,500)

20. Priya, Sudha and Vidya were partners of a firm sharing profits and losses in proportion to their capitals. Their balance sheet as on 31st December 2004 stood as under:

Liabilities	Rs.	Assets	Rs.
Creditors	21,000	Cash at Bank	16,000
Reserve fund	48,000	Debtors 20,000	
Capital accounts		Less: Provision for	
Priya : 90,000		doubtful debts 1,000	19,000
Sudha : 60,000		Stock	18,000
Vidya : 30,000	1,80,000	Machinery	48,000
		Land and Building	1,00,000
		Goodwill	48,000
	2,49,000		2,49,000

On 1st January, 2005, Sudha retired from the firm on the following terms:

(a) Goodwill of the firm was estimated at Rs.36,000.

(b) The land and building was appreciated by 10%

(c) Provision for doubtful debts was reduced by Rs.600.

(d) Out of the amount of insurance which was debited entirely to profit and loss account, Rs.2,000 be carried forward for unexpired insurance.

(e) A provision of Rs.3,000 was made in respect of an outstanding bill for repairs.

Show revaluation account, Capital accounts and the balance sheet of the reconstituted partnership.

(Answer : Revaluation Profit Rs. 9,600; B/s : Rs. 2,49,600)

21. Malligai and Mullai were partners of a firm sharing profits and losses in the ratio of 7:5. Set out below was their balance sheet as on 31st December, 2004.

Liabilities	Rs.	Assets	Rs.
Sundry creditors	40,000	Bank	52,000
General Reserve	72,000	Sundry debtors	40,000
Workmen's Compensation Fund	60,000	Stock	72,000
Capital Accounts:		Machinery	1,60,000
Malligai : 1,20,000		Profit and Loss A/c	48,000
Mullai : 80,000	2,00,000		
	3,72,000		3,72,000

Mullai retired from the partnership from 1st January 2005 and that Malligai will take over the business on the following terms:

(a) Goodwill of the firm was to be valued at Rs.24,000.

(b) Machinery was depreciated at 10%.

(c) A provision for doubtful debts at created at 5% on sundry debtors.

(d) The liability on workmen's compensation fund is determined at Rs.36,000.

Show revaluation account, capital accounts and the balance sheet of Malligai after the adjustments have been made.

(Answer : Revaluation Loss Rs. 18,000 B/s. : Rs. 3,30,000)

22. Mathiazhagan, Govindarajan and Shanmugam were partners of a firm sharing profits and losses in the ratio of ½, 1/3 and 1/6 respectively. Set out below was their balance sheet as on 30th June, 2005.

Liabilities		Rs.	Assets	Rs.
Sundry creditors		1,20,000	Cash in Hand	18,000
Bills payable		40,000	Cash at Bank	1,70,000
Bank overdraft		80,000	Sundry debtors	52,000
General reserve		1,20,000	Stock	1,20,000
Capital Accounts:			Furniture	80,000
Mathiazhagan :	2,40,000		Plant	1,60,000
Govindarajan :	1,60,000		Land and Building	2,80,000
Shanmugam :	1,20,000	5,20,000		
		8,80,000		8,80,000

Shanmugam retired from the partnership from 1st July, 2005 on the following terms:

(a) Goodwill was to be raised at Rs.1,44,000.

(b) The value of land and building was to be increased by Rs.40,000.

(c) Furniture and plant were to be depreciated by Rs.4,000 and Rs.12,000 respectively.

(d) Shanmugam was to be paid off at once.

Show revaluation account, capital accounts, bank account and the opening balance sheet of the reconstituted firm.

(Answer : Revaluation Profit Rs. 24,000 B/s : Rs. 8,80,000)

23. X, Y and Z were partners of a firm sharing profit and losses in proportion of their capital. Their Balance Sheet as on 31.12.1994 stood as under:

Balance Sheet

Liabilities		Rs.	Assets		Rs.
Sundry creditors		10,500	Cash at Bank		8,000
Reserve fund		24,000	Sundry Debtors	10,000	
Capital Accounts:			Less: Provision for		
X	45,000		doubtful debts	500	9,500
Y	30,000		Stock		9,000
Z	15,000	90,000	Machinery		24,000
			Land & Buildings		38,000

		Goodwill	24,000
		Profit & Loss Account	12,000
	1,24,500		1,24,500

On 1st January, 1995, Z retired from the firm on the following terms:

a) That goodwill of the firm was estimated at Rs.18,000.

b) That the land and building be appreciated by 20%.

c) That provision for doubtful debts reduced by Rs.300.

d) That out of the amount of Insurance which was debited entirely to Profit and Loss Account, Rs.1,000 be carried forward for Unexpired Insurance.

e) That machinery be depreciated by 5%.

f) That a provision of Rs.1,100 be made in respect of an outstanding bill for repairs.

g) That Z be paid Rs.5,000 cash and the balance be transferred to his loan account.

Pass the journal entries to give effect to the terms of retirement. Show also Revaluation account, Capital account and the Balance Sheet of the reconstituted partnership.

(March 2003)

Answer: Revaluation Profit Rs.6,600, B/s. Rs. 1,09,200)

Chapter - 9

COMPANY ACCOUNTS

Learning Objectives

After studying this Chapter, you will be able to:

- understand the definition and characteristics of a company.
- understand the different types of share capital and shares.
- make accounting treatment for issue of shares at par, premium and discount.
- pass necessary entries for over-subscription and under- subscription of shares.
- understand the accounting treatment for forefeiture and reissue of shares.

Sole proprietorship is the most common type of business when the size of business is small. Partnership became popular as the size increased. As firms became very big requiring more amount of capital and involving more risks, it lead to the formation of Companies.

A company is an association of persons who contribute money or money's worth to a common stock (capital), for carrying on business for the purposes of profit. The capital is divided into shares, which are held by the members (shareholders) in any proportion and are transferable. It is a legal person, and in law exists like an individual, but with no physical existence.

Section 3(1)(i) of the Companies Act, 1956, defines a company as "a company formed and registered under this Act or an existing company". An existing company means a company formed and registered under any of the previous Companies Act.

9.1 Characteristics

A company has the following essential characteristics:

1) Voluntary Association

It is a voluntary association of persons. No law can compel persons to form a company. It is their own creation and voluntary act.

2) Limited Liability

The liability of shareholders is limited to the amount he has agreed to pay to the company, either by purchasing shares or by giving a guarantee.

3) Separate Legal Entity

Company can hold, buy and sell properties. It can open bank account in its name and can enter into contracts. It can sue and be sued.

4) Common Seal

Being an artificial person, it cannot sign the documents and can act only through natural persons, called Directors. Every company must, therefore have a common seal with its name engraved on it. The common seal of the company is regarded as the official signature of the company. Any documents prepared by the directors belongs to the company only when it contains the common seal.

5) Perpetual Succession

It is independent of members and its existence is not affected by the coming in and going out of its members. Its continuity is not affected by the changes in the membership.

6) Ownership and Management are separated

As the number of shareholders are large in number, it becomes difficult for them to carry on the day-to-day affairs of the business so the ownership and management are separated. The management of the company is in the hands of the Board of Directors.

7) Transferability of shares

Shares are freely transferable without restriction.

8) Compulsory Registration

All companies must be registered under the Companies Act, 1956.

9) Maintenance of Books

A company is required by law to keep a prescribed set of account books and it has to observe the regulations carefully.

10) Periodic Audit

Audit of company's accounts is compulsory by a practicing chartered accountant, who is appointed by the shareholders on the recommendation of Board of Directors, at the Annual General Meeting.

9.2 Sources of Finance

The company raises its finance through internal and external sources.

9.2.1 Internal Sources

It includes

a) Share capital

b) Undistributed profits of the companies.

9.2.2 External Sources

It includes

a) Issue of Debentures

b) Accepting Deposits from the public

c) Loans from Commercial Banks

d) Loans from Financial Institutions - such as, Industrial Finance Corporation, State Finance Corporation, Industrial Development Bank of India, Industrial Credit and Investment Corporation of India etc.

9.3 Share capital of a company

Part I Schedule VI of the Companies Act 1956 deals with this aspect. Every business is expected to have a capital. Generally 'capital' means a particular amount of money used in the business for the purpose of earning revenue. In the context of the Company Law, the capital may be:

Nominal or Authorised Capital

This is the maximum amount of capital which a company is authorised to raise and is stated in the Memorandum of Association. It can also be called as **'Registered Capital'.**

For example : A Ltd has been incorporated with an Authorised Capital of Rs.10,00,000 divided into 1,00,000 shares of Rs.10 each.

Issued Capital

This represents part of the authorised capital, which is issued to public for subscription, say 60,000 shares of Rs.10 each.

The difference between the authorised capital and the issued capital represents **unissued capital.** This can be offered to the public at a later date.

Subscribed capital

This refers to that part of the issued capital which has been subscribed by the public, say 50,000 shares of Rs.10/- each.

Unsubscribed Capital

The difference between the issued capital and subscribed capital represents unsubscribed capital, say 10,000 shares of Rs.10/- each in the above example.

Called-up Capital

This refers to that part of the subscribed capital which has been called up by the company for payment.

For example: If 50,000 shares of Rs.10/- each have been subscribed by the public of which Rs.5/- per share has been called up, then the subscribed capital of the company is Rs 5,00,000, of which the called up capital is Rs.2,50,000 (Rs.5 x 50,000).

Uncalled capital

The difference between subscribed and called up capital is called **uncalled capital**. Taking the previous example, uncalled capital would be Rs.2,50,000 (Rs.5 x 50000).

Paid up capital

This refers to that part of the called-up capital, which has been actually paid up by the shareholders. Some of the shareholders might have defaulted in paying a part of the called-up money. Such amount defaulted is known as calls-in-arrears.

In other words the difference between called-up capital and paid- up capital is known as **calls-in-arrears**.

For example, one shareholder holding 500 shares failed to pay the call @ Rs.2 per share, then paid up capital is Rs.2,49,000, and calls-in-arrears is Rs.1000.

Reserve Capital

A company can reserve part of its uncalled capital to be called up only at the time of winding up. A special resolution has to be passed for that purpose. This is called Reserve Capital. It is not disclosed in the companies balance sheet.

The different types of share capital can, for the sake of simplicity diagramatically presented as follows:

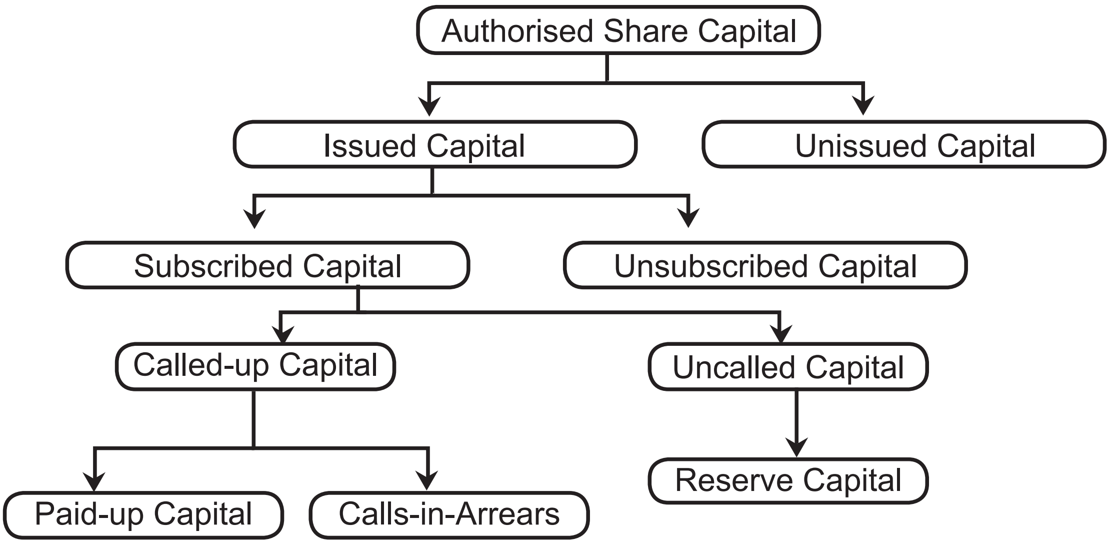


Illustration :1

A Company has been incorporated with an authorised capital of Rs.20,00,000 divided into 2,00,000 shares of Rs.10 each. It offered 1,90,000 shares to the public, but only 1,80,000 shares were subscribed for. The directors called for an amount of Rs.6 per share. All the amounts were received except the call money of Rs.2 on 1000 Shares. Calculate the amount of different categories of share capital.

Solution:

Categories of capital				**Amount Rs.**
Authorised	2,00,000	Shares of	Rs.10 each	20,00,000
Issued	1,90,000	Shares of	Rs.10 each	19,00,000
Subscribed	1,80,000	Shares of	Rs.10 each	18,00,000
Called up	1,80,000	Shares of	Rs. 6 each	10,80,000
Paid up (1,80,000 Shares x Rs.6) – (1000 shares @ Rs.2)				10,78,000
Calls in arrears	1,000	Shares of	Rs. 2 each	2,000

A specimen showing the extract of certain entries in the Balance Sheet is given below.

Extracts from Balance Sheet of .... Ltd. as on ....

Liabilities	Rs.	Rs.	Assets	Rs.	Rs.
Share Capital:			Current Assets:		
Authorised			Cash at Bank		xxx
...Shares of Rs...... each		xxx	Miscellaneous		
Issued			expenditure:		
...Shares of Rs..... each		xxx	Discount on issue of		
Subscribed:			shares		xxx
...Shares of Rs..... each		xxx			
Called-up					
...Shares of Rs..... each		xxx			
Paid up:					
Called up					
...Shares of Rs..... each	xxx				
Less: Calls-in-Arrears	xxx				

	xxx				
Add: Forfeited shares	xxx				
		xxx			
Reserves and Surplus :					
Securities Premium		xxx			
Capital Reserve		xxx			
		xxx			xxx

9.4 Shares:

The capital of the company is divided into units of small denomination. These units are called shares. Sec. 2(46) of the Companies Act explains the meaning of share as a share in the share capital of a company. Holders of shares are called shareholders.

For example : If the authorised capital Rs.10,00,000 is divided into 1,00,000 units of Rs.10 each, then each unit of Rs.10 is called a share of Rs.10 each. Thus, in the above case, the company is said to have 1,00,000 shares of Rs.10 each.

Shares must be numbered so that they may be identified. They are transferable in the manner provided by the Articles of Association.

9.4.1 Types of Shares

According to the Companies (Amendment) Act, 2000, the share capital of a company limited by share, shall be of two kinds only namely:

I) Preference Shares and

II) Equity Shares

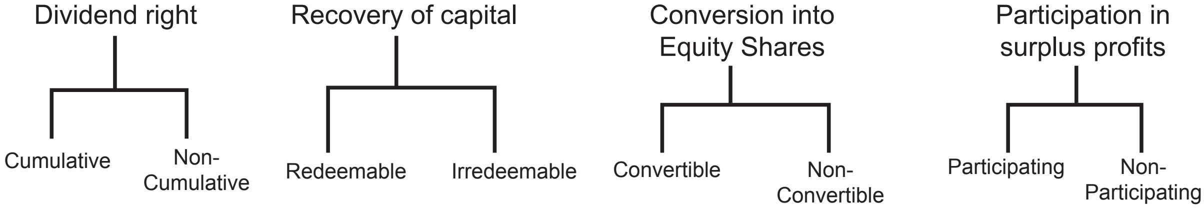
I. Preference Shares

The Companies Act, 1956, Sec. 85 deals with preference shares. Preference shares are those which satisfy the following two conditions.

1. The right to receive dividend at a specified rate before any dividend is paid.
2. Right to return of capital in case of winding up before the capital of equity share holders is returned.

Types of Preference Shares

Preference shares can be sub divided in different classes as follows:-



From the point of view of dividend payment

Cumulative Preference Shares: Holders of these shares have the right to receive arrears of dividend out of the subsequent years' profit.

Non cumulative Preference Shares: In this case, arrears of dividend are not paid.

From the point of view of redemption

Redeemable Preference Shares: These shares are redeemed or repaid in accordance with the terms of issue after a specified period. In India, companies can now issue only this category of preference shares.

Irredeemable Preference Shares: These are shares, which cannot be refunded before winding-up (Now all preference shares must be redeemable)

From the point of view of participating in profits

Participating Preference Shares: The holders of this class of preference shares have the right to share profits remaining after the payment of dividend to the equity shareholders. They also enjoy the right to participate in the surplus remaining after the repayment of capital of equity shareholders in case of winding-up of the company.

Non Participating Shares: It is as good as ordinary preference shares, which carry only fixed rate of dividend.

From the point of view of convertibility

Convertible Preference Shares: These are shares, which can be converted into an equity shares.

Non-Convertible Preference Shares: Shares which cannot be converted into equity shares, is called a non-convertible preference share. Unless the Articles or terms of issue provide preference shares are deemed to be non-convertible.

II. Equity Shares

Shares which are not preference shares are called **Equity Shares**. In other words, equity shares are those which are entitled to dividend and repayment of capital after the preference share holders are paid. The rate of dividend is decided by the Board of Directors. Normally, equity shareholders control the affairs of the business.

9.5 Issue of Shares

The shares of the company can be issued in two ways;

1) for consideration other than cash and

2) for cash

9.5.1 For consideration other than cash:

Some times the company agrees to pay the vendors from whom it has bought assets like land and building, etc., fully paid up shares of the company instead of giving cash for the same.

9.5.2 Issue of Shares for cash

The procedure of issuing shares for cash is given below:

1. Issue of Prospectus

When shares are issued to public for cash it should satisfy the provisions of the Companies Act and the Securities Exchange Board of India (SEBI) guidelines. Every public issue must be accompanied by an issue of prospectus. The terms and conditions of the issue of shares are stated in the prospectus. On reading the prospectus, the public will have to apply for the shares in the prescribed form.

2. Receipt of application money

Whenever a public company issues shares, advertisements appear in the leading newspapers about the issue. Those who are interested in purchasing the shares may get an application form along with a copy of the prospectus. If he is satisfied with the information available in the prospectus, he remits the application money along with the filled-in application form to any one of the banks (branches) mentioned in the application. The applicant is required to remit at least 5% of the nominal value of the share with the application as application money (Sec 69(3)). However, as per the SEBI guidelines, the minimum application should be 25% of its issue price. The accounting entry passed to record the same is

Bank (Cash) A/c Dr. [Total amount received on application]

To Share Application A/c

(Amount received on application on

——— shares @ Rs —— per share)

The banker will send the application money to the company along with a list of applicants. The public issue must be kept open for atleast three working days and not more than ten working days. The issue price of shares may be received in one instalment or in different instalments.

Note : Journal Entries

There are two types of journal entries connected with issue of shares. They are called **cash entries** and **transfer entries**. Cash entries involve the receipt of various instalments of the share. Transfer entries relate to transfer of these amounts to share capital. In case of share application, cash entry is made first followed by transfer entry. But in case of allotment and calls the transfer entry is passed first, then on receiving cash, cash entry is passed. This is because immediately allotment or call is made, money becomes due and therefore share capital is credited without waiting for the receipt of cash.

3. Allotment of Shares

While application is an offer to buy shares, allotment of shares by the company constitutes an acceptance of such offer. If the company does not receive the minimum subscription (is the least amount of shares which should be subscribed for by the public before the Directors can proceed to allotment) of 90% of the issued amount, the company has to refund the entire subscription. Once the shares are allotted, the applicants now get the status of shareholders or members of the company.

Transfer of Application money

On the date of allotment the company considers the application money on those shares which are allotted as a part of the share capital. Therefore the application money has to be transferred to share capital account. The accounting entry passed to record the same is:

Share Application A/c	Dr	[No. of shares allotted x Application money per share]
To Share Capital A/c		
(Application money on ____ shares transferred to Share capital)		

Amount Due on Allotment

As soon as shares are allotted, the shareholders are liable to pay the allotment money, which is due. The accounting entry passed to record the same is:

Share Allotment A/c	Dr	[No. of shares allotted x
To Share Capital A/c		Allotment amount per share]
(Amount due on the allotment of ____shares @ Rs.____ per share)		

Receipt of Allotment money

On receipt of allotment money, the following entry is made:

Bank A/c Dr
To Share Allotment A/c
(Allotment money received)

4. Call on Shares

If the shares are not fully called up after allotment the Directors have the right to call the remaining amount. Call is an instalment due on shares. A call letter will be generally issued to every shareholder. The maximum number of calls that a company can make is three. There should be at least one month gap between two calls unless otherwise provided by the Articles of Association of the company. The accounting entry passed to record the same is:

Amount due on Call

Share (First/ Second/ Third) Call A/c	Dr.	(No. of Shares x
To Share Capital A/c		Call amount per share)
(Call money due on — shares		
@ Rs – per share)		

On Receipt of Call money

Bank A/c Dr

To Share (First/ Second/ Third) Call A/c
(Call money received)

Summary of the above journal entries is given below:

1. Receipt of Application Money:

Bank (Cash) A/c	Dr.	[Total amount received on application]
To Share Application A/c		
(Amount received on application		
_____ shares @ Rs _____ per share)		

2. Transfer to share capital:

Share Application A/c	Dr	[No. of shares allotted x
To Share Capital A/c		Application money per share]
(Application money on _____ shares		
transferred to Share capital)		

3. Allotment money due:

Share Allotment A/c	Dr	[No. of shares allotted x
		Allotment amount per share]

To Share Capital A/c
(Amount due on allotment of
____shares @ Rs.____ per share)

4. ***Receipt of allotment money:***

Bank A/c Dr.
To Share Allotment A/c
(Allotment money received)

5. ***Call Money due:***

Share (First/ Second/ Third) Call A/c Dr. [No. of Shares x
To Share Capital A/c Call amount per share]
(Call money due on — shares
@ Rs – per share)

6. ***Receipt of call money:***

Bank A/c Dr
To Share (First/ Second/ Third) Call A/c
(Call money received)

Terms of Issue:

Shares of a company may be issued in any of the following three ways;

a) Issue of shares at par

b) Issue of shares at premium and

c) Issue of shares at discount

The accounting treatment of issue of shares in case of each of the above is different. We shall now discuss these three situations in detail.

a) Issue of shares at par

If the issue price is equal to the face value, it is said to be issued at par. For example when shares of Rs 10 each (face value) are issued at Rs 10 only.

Illustration : 2

Bharat Limited had an authorised capital of Rs.4,00,000 divided into shares of Rs.100 each.

It offered to the public 3000 shares payable as follows.

On Application	Rs. 30
On Allotment	Rs.20

On First Call Rs.25

On Second Call Rs.25

The shares were duly subscribed for by the public and all money was received. Pass journal entries to record the above transactions.

Solution:

Journal Entries in the Books of Bharat Limited

Date	Particulars	L.F	Debit Rs.	Credit Rs.
	Bank A/c Dr		90,000	
	To Share Application A/c			90,000
	(Money received on 3000 shares @ Rs,30 per share)			
	Share Application A/c Dr		90,000	
	To Share Capital A/c			90,000
	(Transfer of Application money on 3000 shares to Share capital)			
	Share Allotment A/c Dr		60,000	
	To Share Capital A/c			60,000
	(Amount due on the allotment of 3000 shares @ Rs.20/- per Share)			
	Bank A/c Dr		60,000	
	To Share Allotment A/c			60,000
	(Allotment Money received)			
	Share First call A/c Dr		75,000	
	To Share Capital A/c			75,000
	(First call money due on 3000 Share @ Rs.25/- per Share)			
	Bank A/c Dr		75,000	
	To Share First Call A/c			75,000
	(First call money received)			
	Share Second & Final call A/c Dr		75,000	
	To Share Capital A/c			75,000
	(Final call money due on 3000 share @ Rs.25/- per share)			

	Bank A/c Dr		75,000	
	To Share second & final call A/c (Final call money received)			75,000

Under-subscription

Due to poor response, all the shares offered may not be taken by the public. This is under-subscription. However the shares cannot be allotted if the minimum subscription is not received. Under-subscription does not require any special treatment. Journal entries are made on the basis of shares applied for.

Illustration : 3

Govindha Ltd., offered 10,000 shares of Rs.100 each to the public on the following terms:

Rs. 30 on application

Rs. 20 on allotment

Rs. 20 on first call and

Rs. 30 on final call

The public applied for 9,000 shares which were allotted. All money due was received. Pass journal entries.

Solution:

Journal in the Books of Govindha Limited

Date	Particulars	L.F	Debit Rs.	Credit Rs.
	Bank A/c Dr		2,70,000	
	To Share Application A/c			2,70,000
	(Money received 9000 shares @ Rs.30 per share)			
	Share Application A/c Dr		2,70,000	
	To Share Capital A/c			2,70,000
	(Transfer of Application money on 9000 shares to share capital)			
	Share Allotment A/c Dr		1,80,000	
	To Share Capital A/c			1,80,000
	(Amount due on the allotment on 9000 shares @ Rs.20/- per share)			

Bank A/c Dr To Share Allotment A/c (Allotment money received)		1,80,000	1,80,000
Share First call A/c Dr To Share Capital A/c (First call money due on 9000 shares @ Rs.20/- per share)		1,80,000	1,80,000
Bank A/c Dr To Share First Call A/c (First call money received)		1,80,000	1,80,000
Share Second & Final call A/c Dr To Share Capital A/c (Final call money due on 9000 shares @ Rs.30/- per share)		2,70,000	2,70,000
Bank A/c Dr To Share Second & Final call A/c (Final call money received)		2,70,000	2,70,000

Over-subscription

When the applications received are more than that has been issued to the public, it is called as over-subscription. A company cannot allot more shares than that were offered to public through the prospectus. When there is over subscription the allotment must follow SEBI guidelines to ensure proportional (Pro-rata) allotment.

When there is over - subscription the directors have three alternatives to deal with the situation.

1. Some applicants may not be allotted any shares **– rejection of shares.**
2. Some applicants may be allotted less number of shares than they applied for – **prorata allotment.**
3. Some applicants may be allotted full number of shares they applied for **– full allotment.**

We will be discussing the first two alternatives only in this chapter.

Rejection of shares:

Some applications may be rejected by the Directors due to over- subscription or certain other reasons. The company must refund the application money to those applicants to whom shares were not allotted. The accounting entry passed to record the same is:

Share Application A/c Dr. [No. of shares rejected x Application money per share]
To Bank A/c
(Application money returned on rejected applications for _____ shares)

Illustration : 4

Perumal Ltd. issued 1,00,000 shares of Rs.10 each payable:

Rs.3 on application and

Rs.2 on allotment and the balance when required.

1,20,000 shares were applied for.

The directors decided to reject the excess applications. All money due was received. Pass journal entries.

Solution:

Journal in the Books of Perumal Limited

Date	Particulars	L.F	Debit Rs.	Credit Rs.
	Bank A/c Dr		3,60,000	
	To Share Application A/c			3,60,000
	(Money received on 1,20,000 shares @ Rs.3 per share)			
	Share Application A/c Dr		3,00,000	
	To Share Capital A/c			3,00,000
	(Transfer of Application money on 1,00,000 shares to share capital)			
	Share Application A/c Dr		60,000	
	To Bank A/c			60,000
	(Refund of excess application money on 20,000 @ Rs.3 per share)			
	Share Allotment A/c Dr		2,00,000	
	To Share Capital A/c			2,00,000
	(Amount due on the allotment of 1,00,000 shares @ Rs.2/- per share)			

	Bank A/c Dr			2,00,000	
	To Share allotment A/c				2,00,000
	(Allotment money received)				

Pro-rata allotment:

Some of the applicants may be allotted a certain number of shares lesser than the number they applied for. Instead of returning the excess application money, the same will be adjusted on money due on allotment. The accounting entry passed to record the same is:

Share Application A/c To Share Allotment A/c (Excess application money received on —— shares @ Rs.— transferred to allotment)	Dr	[Application money received – (Application money transferred to share capital + Money refunded)]

Illustration : 5

Pradhiksha Ltd. issued 50,000 shares of Rs.10 each payable as

Rs.3 on application.

Rs.4 on allotment and

The balance on call.

Applications for 70,000 shares had been received.

Application for 8,000 shares were rejected and the remaining applicants were allotted the 50,000 shares on pro-rata basis. The excess amount on application was adjusted towards the amount due on allotment. All the shareholders paid the amount due. Journalise the transactions and prepare ledger accounts and show how the entries will appear in the balance sheet.

Solution:

I. Over subscription / Pro-rata Allotment:

Particulars	No.of Shares Rs.	Amount Rs.
Number of Applications received	70,000 x 3	2,10,000
Less : Transferred to share capital	50,000 x 3	1,50,000
Excess application money	20,000 x 3	60,000
Less : Refunded	8,000 x 3	24,000
Excess money to be adjusted towards allotment money	12,000 x 3	36,000

II. Calculation of allotment money to be received :

	Rs.
50,000 shares of Rs.4 each	2,00,000
Less : Excess Application money adjusted towards allotment money (12,000 x 3)	36,000
Money to be received	1,64,000

Pradhiksha Ltd.

Journal Entries

Date	Particulars	L.F	Debit Rs.	Credit Rs.
	Bank A/c Dr		2,10,000	
	To Share Application A/c			2,10,000
	(Application money received on 70,000 shares @ Rs.3 per share)			
	Share Application A/c Dr		1,50,000	
	To Share Capital A/c			1,50,000
	(Application money received on 50,000 shares @ Rs.3 per share transferred to share capital)			
	Share Application A/c Dr		24,000	
	To Bank A/c			24,000
	(Application money on 8,000 shares @ Rs.3 per share refunded)			
	Share Application A/c Dr		36,000	
	To Share Allotment A/c			36,000
	(Surplus application money on 12,000 shares @ Rs.3 per share adjusted towards allotment)			
	Share Allotment A/c Dr		2,00,000	
	To Share Capital A/c			2,00,000
	(Allotment money due on 50,000 shares @ Rs.4 per share)			

Bank A/c Dr To Share Allotment A/c (Allotment money received)		1,64,000	1,64,000
Share First and Final Call A/c Dr Dr To Share Capital A/c (Call money due on 50,000 shares @ Rs.3 per share due)		1,50,000	1,50,000
Bank A/c Dr To Share First and Final Call A/c (Being call money received)		1,50,000	1,50,000

Ledger Accounts in the books of Pradhiksha Ltd.

Dr. Bank Account Cr.

Particulars	Rs.	Particulars	Rs.
To Share Application A/c	2,10,000	By Share Application A/c	24,000
To Share Allotment A/c	1,64,000	By Balance c/d	5,00,000
To Share Call A/c	1,50,000		
	5,24,000		5,24,000
To Balance b/d	5,00,000		

Dr. Share Application Account Cr.

Particulars	Rs.	Particulars	Rs.
To Share Capital A/c	1,50,000	By Bank A/c	2,10,000
To Bank A/c	24,000		
To Share Allotment A/c	36,000		
	2,10,000		2,10,000

Dr. Share Allotment Account Cr.

Particulars	Rs.	Particulars	Rs.
To Share Capital A/c	2,00,000	By Share Application A/c	36,000
		By Bank A/c	1,64,000
	2,00,000		2,00,000

Dr. **Share First and Final Call Account** **Cr.**

Particulars	Rs.	Particulars	Rs.
To Share Capital A/c	1,50,000	By Bank A/c	1,50,000
	1,50,000		1,50,000

Dr. **Share Capital Account** **Cr.**

Particulars	Rs.	Particulars	Rs.
		By Share Application A/c	1,50,000
		By Share Allotment A/c	2,00,000
		By Share First & Final	
To Balance c/d	5,00,000	Call A/c	1,50,000
	5,00,000		5,00,000
		By Balance b/d	5,00,000

Extracts from Balance Sheet of Pradhiksha Ltd.

Liabilities	Rs.	Assets	Rs.
Share Capital:		Current Assets:	
Authorised:	....	Cash at Bank	5,00,000
Issued:			
50,000 shares of Rs.10 each	5,00,000		
Subscribed :			
50,000 shares of Rs.10 each	5,00,000		
Called-up :			
50,000 shares of Rs.10 each	5,00,000		
Paid up :			
50,000 shares of Rs. 10 each	5,00,000		
	5,00,000		5,00,000

Calls- in- Arrears

Sometimes shareholders may fail to pay the amount due on calls. The total amount not received on the calls by the company are called as **Calls-in-Arrears.** This amount is shown as a deduction from the called- up capital to arrive the paid up share capital in the Balance Sheet. The accounting entry passed to record the same is:

Calls-in-Arrears A/c Dr (Amount on unpaid calls)

To Share Call A/c

(Call money on .... shares @ Rs...... not received)

According to Table A, normally an interest of 5 % is charged on calls-in-arrears till such amount is actually paid. However the Directors can waive this interest or charge a higher rate at their discretion.

Illustration : 6

Robert & Co Ltd. issues 20,000 shares of Rs.10/- each payable Rs.3 on application, Rs. 2 on allotment, Rs. 2.50 on First call and the balance on final call.

All shares were subscribed and allotted. Calls were made in due course but the first call money on 1000 shares and final call money on 1500 shares were not yet received. Pass journal entries.

Solution:

Robert & Co. Ltd

Journal

Date	Particulars	L.F	Debit Rs.	Credit Rs.
	Bank A/c Dr		60,000	
	To Share Application A/c			60,000
	(Application money received on 20000 shares @ Rs.3 per share)			
	Share Application A/c Dr		60,000	
	To Share Capital a/c			60,000
	(Transfer of application money to share capital a/c)			
	Share Allotment A/c Dr		40,000	
	To Share Capital A/c			40,000
	(Allotment money due on 20000 shares @ Rs.2 per share)			
	Bank A/c Dr		40,000	
	To Share allotment A/c			40,000
	(Allotment money received)			

Share First call A/c Dr			50,000	
To Share Capital A/c				50,000
(First call amount due on 20000 shares @ Rs.2.50 per share)				
Bank A/c Dr			47,500	
Calls-in-arrears a/c Dr			2,500	
To Share First Call A/c				50,000
(First call money received on 19000 shares)				
Share Second Call A/c Dr			50,000	
To Share Capital A/c				50,000
(Final call money on 20000 shares @ 2.50 per share due)				
Bank A/c Dr			46,250	
Calls in arrears A/c Dr			3,750	
To Share Second call a/c				50,000
(Final call money received on 18,500 shares)				

Calls-in-Advance

When an applicant sends more money than what is called by the company, the excess money is called **Calls-in-Advance**. The accounting entry passed to record the same is:

Bank A/c Dr

To Calls – in- Advance

(Call amount for .... shares @ Rs..... received in advance)

According to Section 92 calls-in-advance can be accepted only when a company is so authorised by its Articles. If a company has adopted Table A normally an interest at 6 % is to be paid on such calls- in-advance from the date of receipt till due date. When calls become actually due, calls-in-advance account is adjusted towards the call. The accounting entry passed to record the same is:

Transfer of Calls-in-Advance to particular call

Calls-in-Advance A/c Dr

To Particular Call A/c

(Calls-in-advance transferred to particular call account)

Illustration : 7

Somu Ltd. issued to the public 8000 equity shares of Rs.10 each payable as follows.

On Application	Rs. 2.50
On Allotment	Rs. 4.00
On First Call & Final Call	Rs. 3.50

All the shares were subscribed for and all money due were received. Akbar a shareholder who subscribed for 500 shares paid the call money along with the allotment money. Pass journal entries to record the same.

Solution:

Somu Ltd.

Journal Entries

Date	Particulars	L.F	Debit Rs.	Credit Rs.
	Bank A/c Dr		20,000	
	To Share Capital A/c			20,000
	(Application money received on 8,000 shares@Rs.2.50 per share)			
	Share Application A/c Dr		20,000	
	To Share Capital A/c			20,000
	(Application money transferred to share capital A/c)			
	Share Allotment A/c Dr		32,000	
	To Share Capital A/c			32,000
	(Allotment money due on 8,000 share @ Rs.4 per share)			
	Bank A/c Dr		33,750	
	To Share Allotment A/c			32,000
	To Calls-in-advance A/c			1,750
	(Allotment money received with calls in advance)			

	Share First & Final call A/c Dr To Share Capital A/c (Call amount due on 8,000 shares @ Rs.3.50 per share)		28,000	 28,000
	Bank A/c Dr Calls-in-advance A/c Dr To Share First & Final call A/c (Call money received and calls-in- advance account transferred to call account)		26,250 1,750	 28,000

Issue of shares at premium

When a company issues its shares at a price more than the face value, it is said to be issued at premium. Premium is the excess money collected over and above the face value of the share. When share of Rs.10 (face value) are issued at Rs.12, it is said to be issued at a premium of Rs.2.

When shares are issued at premium, the amount of premium shall be credited to a separate account called as **'Securities Premium Account'**1. It is not a part of the share capital. It is shown separately in the Balance sheet under the heading **'Reserves and Surplus'.** Under Sec. 78 the amount to the credit of the securities premium account may be used for the following purposes:

1) issue of fully paid bonus shares
2) writing off the preliminary expenses
3) writing off expenses like commission paid or discount allowed on shares / debentures and
4) for the premium payable on redemption of preference shares / debentures.

The amount of premium can be collected with the application money or with the allotment money. **But normally it is collected with the allotment money only.** The accounting entry passed to record the same is:

a) Share Allotment A/c Dr [No. of shares allotted x allotment and premium money per share]

To Share Capital A/c [No. of shares allotted x allotment money per share]

\ The term 'securities premium' has been used instead of 'share premium' in accordance with the provisions of the Companies (Amendment) Act, 1999.

To Securities Premium A/c [No. of shares allotted x premium money per share]

(amount due on allotment of shares @Rs—per share including premium)

b) Bank A/c Dr

To Share Allotment A/c

(money received on allotment including premium)

Illustration : 8

Raja & Rani Ltd. issued 10,000 shares of Rs.10 each at a premium of Rs.2 per share payable as follows.

On application	Rs.3
On allotment	Rs.5 (including premium)
On first call	Rs.2
On second & final call	Rs.2

All these shares were duly subscribed and money due were fully received. Pass journal entries prepare ledger accounts and also show the entries in the Balance sheet.

Solution:

Raja & Rani Ltd.

Journal Entries

Date	Particulars	L.F	Debit Rs.	Credit Rs.
	Bank A/c Dr		30,000	
	To Share Application A/c			30,000
	(Application money on 10,000 shares received @ Rs.3 per share)			
	Share Application A/c Dr		30,000	30,000
	To Share Capital A/c			
	(Application money transferred to share capital)			

Share Allotment A/c Dr		50,000	
To Share Capital A/c			30,000
To Securities Premium A/c			20,000
(Allotment money and share premium due on 10,000 shares)			
Bank A/c Dr		50,000	
To Share Allotment A/c			50,000
(Allotment money and premium amount received)			
Share First Call A/c Dr		20,000	
To Share Capital A/c			20,000
(First Call amount due on 10,000 shares @ Rs.2/- per share)			
Bank A/c Dr		20,000	
To Share First call A/c			20,000
(First call amount received)			
Share Second & Final Call A/c		20,000	
Dr To Share Capital A/c			20,000
(Final Call amount due on 10,000 shares @ Rs.2/- per share)			
Bank A/c Dr		20,000	
To Share Second & Final Call A/c			20,000
(Being final call amount received)			

Raja & Rani Ltd.

Ledger Accounts

Dr. **Bank Account** **Cr.**

Particulars	Rs.	Particulars	Rs.
To Share Application A/c	30,000	By Balance c/d	1,20,000
To Share Allotment A/c	50,000		
To Share First call A/c	20,000		
To Share Second & Final call A/c	20,000		
	1,20,000		1,20,000
To Balance b/d	1,20,000		

Dr. **Share Application Account** **Cr.**

Particulars	Rs.	Particulars	Rs.
To Share Application A/c	30,000	By Bank A/c	30,000
	30,000		30,000

Dr. **Share Allotment Account** **Cr.**

Particulars	Rs.	Particulars	Rs.
To Share Capital A/c	30,000	By Bank A/c	50,000
To Securities Premium A/c	20,000		
	50,000		50,000

Dr. **Securities Premium Account** **Cr.**

Particulars	Rs.	Particulars	Rs.
To Balance c/d	20,000	By Share Allotment A/c	20,000
	20,000		20,000
		By Balance b/d	20,000

Dr. **Share First Call Account** **Cr.**

Particulars	Rs.	Particulars	Rs.
To Share Capital A/c	20,000	By Bank A/c	20,000
	20,000		20,000

Dr. **Share Second and Final Call Account** **Cr.**

Particulars	Rs.	Particulars	Rs.
To Share Capital A/c	20,000	By Bank A/c	20,000
	20,000		20,000

Dr. **Share Capital Account** **Cr.**

Particulars	Rs.	Particulars	Rs.
To Balance c/d	1,00,000	By Share Application A/c	30,000
		By Share Allotment A/c	30,000
		By First Call A/c	20,000
		By Second & Final Call A/c	20,000
	1,00,000		1,00,000
		By Balance b/d	1,00,000

Extracts from Balance Sheet of Raja & Rani Ltd.

Liabilities	Rs.	Assets	Rs.
Share Capital		Current Assets:	
Authorised Capital	----	Bank	1,20,000
Issued Capital			
10,000 shares @ Rs.10 each	1,00,000		
Subscribed Capital			
10,000 shares @ Rs.10 each	1,00,000		
Called up Capital			
10,000 shares @ Rs.10 each	1,00,000		
Paid up Capital			
10,000 shares @ Rs.10 each	1,00,000		
Reserves & surplus:			
Securities Premium	20,000		
	1,20,000		1,20,000

Issue of Shares at Discount

When a company issues its shares at a price less than the face value, it is said to be issued at discount. Discount is the difference between the face value and the issue price. For example a share of Rs.10 (face value) is issued at Rs 9, it is said that shares are issued at discount of Re.1.

A company can issue shares at a discount only when the following conditions are satisfied (Sec. 79).

a. Issue of shares at discount is authorised by an ordinary resolution passed by the company in its general body meeting and sanctioned by Company Law Board.

b. The shares must belong to a class already issued.

c. The maximum amount of discount can not exceed 10%, however, if the Company Law Board is convinced the shares can be issued at a higher discount rate.

d. The company has to be in existence at least for one year.

Whenever shares are issued at a discount the amount of discount is brought into account with the instalment due on allotment. The accounting entry passed to record the same is:

Share Allotment A/c	Dr.
Discount on issue of shares A/c	Dr.
To Share Capital A/c	
(Amount due on allotment of — shares @ Rs – per share and discount on issue brought into account)	

The shares will appear at the full face value on the liability side of the Balance Sheet. The amount of discount on issue of shares being loss of capital nature shown on the asset side and written off against the Profit and Loss account over a period of time. The amount of discount not yet written off will appear in the asset side of the Balance Sheet under the heading **'Miscellaneous Expenditure'.**

Illustration : 9

Senthil Ltd. issued 1,70,000 shares of Rs.10 each at discount of 10%. The shares were payable as under

on application	Rs.3
on allotment	Rs.4 (with adjustment of discount)
on first and final call	Rs.2

Public applied for 1,60,000 shares and the shares have been duly allotted. All money were duly received. Pass journal entries and prepare ledger accounts and also show the balance sheet.

Senthil Ltd.

Journal Entries

Date	Particulars		L.F	Debit Rs.	Credit Rs.
	Bank A/c	Dr		4,80,000	
	To Share Application A/c				4,80,000
	(Application money received on 1,60,000 shares @ Rs.3 per share)				
	Share Application A/c	Dr		4,80,000	
	To Share Capital A/c				4,80,000
	(Application money transferred to share capital)				

Share Allotment A/c Dr		6,40,000	
Discount on issue of shares A/c Dr		1,60,000	
To Share Capital A/c			8,00,000
(Allotment money due on 1,60,000 shares with adjustment of discount)			
Bank A/c Dr		6,40,000	
To Share Allotment A/c			6,40,000
(Allotment money received)			
Share First & Final Call A/c Dr		3,20,000	
To Share Capital A/c 3,20,000			3,20,000
(Call money due on 1,60,000 shares @ Rs.2 per share)			
Bank A/c Dr		3,20,000	
To Share First & Final Call A/c			3,20,000
(Call money received)			

Senthil Ltd.

Ledger Accounts

Dr. **Bank Account** Cr.

Particulars	Rs.	Particulars	Rs.
To Share Application A/c	4,80,000	By Balance c/d	14,40,000
To Share Allotment A/c	6,40,000		
To Share First and Final Call A/c	3,20,000		
	14,40,000		14,40,000
To Balance b/d	14,40,000		

Dr. **Share Application Account** Cr.

Particulars	Rs.	Particulars	Rs.
To Share Application A/c	4,80,000	By Bank A/c	4,80,000
	4,80,000		4,80,000

Dr. **Share Allotment Account** Cr.

Particulars	**Rs.**	**Particulars**	**Rs.**
To Share Capital A/c	6,40,000	By Bank A/c	6,40,000
	6,40,000		6,40,000

Dr. **Discount on issue of shares Account** Cr.

Particulars	**Rs.**	**Particulars**	**Rs.**
To Share Capital A/c	1,60,000	By Balance c/d	1,60,000
	1,60,000		1,60,000
To Balance b/d	1,60,000		

Dr. **Share First and Final Call Account** Cr.

Particulars	Rs.	Particulars	Rs.
To Share Capital A/c	3,20,000	By Bank A/c	3,20,000
	3,20,000		3,20,000

Dr. **Share Capital Account** **Cr.**

Particulars	Rs.	Particulars	Rs.
		By Share Application A/c	4,80,000
		By Share Allotment A/c	6,40,000
		By Discount on Shares A/c	1,60,000
		By Shares First and	
		Final Call A/c	3,20,000
To Balance c/d	16,00,000		16,00,000
	16,00,000	By Balance b/d	16,00,000

Extracts from Balance Sheet of Senthil Ltd.

Liabilities	**Rs.**	**Assets**	**Rs.**
Share Capital		Current Assets:	
Authorised Capital	----	Bank	14,40,000
Issued Capital		Miscellaneous	
1,70,000 shares @		Expenditure:	
Rs.10 each	17,00,000	Discount on issue	
Subscribed Capital		of shares	1,60,000

1,60,000 shares @			
Rs.10 each	16,00,000		
Called-up Capital			
1,60,000 shares @			
Rs.10 each	16,00,000		
Paid up Capital			
1,60,000 shares @			
Rs.10 each	16,00,000		
	16,00,000		16,00,000

Illustration : 10

Cholan Ltd., issued 1000 shares of Rs.100 each. Pass journal entry in the following cases.

a) Shares are issued at par

b) Shares are issued at a premium of Rs. 20.

c) Shares are issued at a discount of Rs.10.

Solution:

Journal Entries

Date	Particulars	L.F	Debit Rs.	Credit Rs.
	Case a:			
	Bank A/c Dr		1,00,000	
	To Share capital A/c			1,00,000
	(1000 shares issued @ Rs.100 per share)			
	Case b:			
	Bank A/c Dr		1,20,000	
	To Share capital A/c			1,00,000
	To Securities premium A/c			20,000
	(1000 shares issued @ Rs.100 per share with premium of Rs.20)			

Case c:				
Bank A/c Dr			90,000	
Discount on issue of shares A/c Dr			10,000	
To Share capital A/c				1,00,000
(1000 shares issued @ Rs.100 per share and discount Rs.10 brought into account)				

Forfeiture of Shares

Sometimes a shareholder may fail to pay any of the instalments i.e allotment or call money. In such a situation after giving due notice and following the procedures laid down in the Articles of Association, the Directors of the company can forfeit the shares that were already issued. Forfeiture of shares means to cancel the allotment to the defaulting shareholder. Once the shares are forfeited, these shares will not form part of the share capital and the shareholders will not be the members of the company.

Forfeiture of shares – issued at Par

The effect of forfeiture is to cancel the allotment given to the shareholder. So, all entries passed earlier must be reversed now. The accounting entry passed to record the same is:

Share Capital A/c	Dr.	[No. of shares forfeited x Amount called up per share]
To Forfeited Share A/c		[Amount already received]
To Share Allotment A/c		[Amount due but was not received]
Or/and		
To Share (first / second/ third) Call A/c		

It should be noted that share capital is debited with the amount called up till the stage of forfeiture and not the nominal value of shares. The balance in the share forfeited account is shown as an addition to the total paid-up capital of the company under the heading 'Share Capital' on the liability side of the Balance Sheet.

Illustration : 11

Banu Ltd. issued 5000 shares of Rs.10 each at par payable on application Rs.3 per share, on allotment Rs.3 per share, on first call Rs.2 per share & final call Rs.2. Mr.Raju was allotted 50 shares. Give the necessary journal entry relating to forfeiture of shares in each of the following alternative cases.

a) If Mr.Raju failed to pay first call money and his shares were forfeited.

b) If Mr.Raju failed to pay both the calls and his shares were forfeited.

Solution:

Books of Banu Ltd.

Journal Entries

Date	Particulars	L.F	Debit Rs.	Credit Rs.
	Case a :			
	Share Capital A/c (50x8) Dr		400	
	To Forfeited Shares A/c (50x6)			300
	To Share First call A/c (50x2)			100
	(50 shares forfeited for non payment of first call money)			
	Case b :			
	Share Capital A/c (50x10) Dr		500	
	To Forfeited Share A/c (50x6)			300
	To Share First Call A/c			100
	To Share Final Call A/c			100
	(50 shares forfeited for non payment of first & final call)			

Forfeiture of shares – issued at Premium

1. When premium is received :

When shares originally issued at premium, on which premium amount has been received are forfeited, then the premium once collected cannot be cancelled (Sec.78). The accounting entry passed to record the same is:

Share Capital A/c	Dr.	[No. of shares forfeited x Amount called up per share]
To Forfeited Share A/c		[No. of shares forfeited x Amount already received excluding premium]
To Share Call A/c		[No. of shares forfeited x Amount not received]

2. When premium is not received:

When shares originally issued at a premium on which the premium amount has not yet been received are forfeited, Securities Premium account has to be debited now. The accounting entry passed to record the same is:

Share Capital A/c	Dr.	[No. of shares forfeited x Amount called-up per share]
Securities Premium A/c	Dr.	[No. of shares forfeited x Premium per share]
To Forfeited Share A/c		[No. of shares forfeited x Amount already received]
To Share Allotment A/c		[No. of shares forfeited x Amount not received including premium]
To Share Call A/c		[No. of shares forfeited x Amount not received]

Illustration : 12

Kumar Ltd issued 1000 shares of Rs.10 each at Rs.12 per share. The amount is payable as under

Rs.3 on application; Rs.5 on allotment (including premium); Rs.2 on first call; Rs.2 on final call.

The Company did not make the final call, Mr.Mani was allotted 25 shares. Give journal entries for forfeiture in the following cases.

a) If Mr.Mani failed to pay first call money and his shares were forfeited.

b) If Mr.Mani failed to pay first and final call money, his shares were forfeited .

Solution:

Books of Kumar Ltd.

Journal Entries

Date	Particulars		L.F	Debit Rs.	Credit Rs.
	Case a:				
	Share Capital A/c (25x8)	Dr		200	
	Share Premiun A/c (25x2)	Dr		50	200
	To Forfeited Shares A/c (25x6)				50
	To Share First call A/c (25x2)				
	(25 shares forfeited for non payment of First call money)				

Case b:			
Share Capital A/c (25x10) Dr		250	
To Forfeited Shares A/c (25x6)			150
To Share First call A/c (25x2)			50
To Share Final Call A/c (25x2)			50
(25 shares forfeited for non payment of call money)			

Forfeiture of shares – issued at Discount:

When shares originally issued at discount are forfeited then discount on shares account should be cancelled. This can be done by crediting discount on shares account. The accounting entry passed to record the same is:

Share Capital A/c	Dr.	[No. of shares forfeited x Amount called up]
To Forfeited shares A/c		[No. of shares forfeited x Amount already received]
To Discount on issue of share A/c		[No. of shares forfeited x Discount per share]
To Share Call A/c		[No. of shares forfeited x Amount not received]

Illustration : 13

Nanda Ltd. issued 10000 shares of Rs.10 each to the public at discount of 10% payable as follows:

on application	Rs.2.50;
on allotment	Rs.3.00;
on first & final call	Rs.3.50.

All money due were received except from one shareholder Mr.Udhay, to whom 100 shares are allotted failed to pay the final call money. The directors forfeited shares after giving due notice. Pass journal entry for forfeiture.

Solution:

In the Books of Nanda Ltd.

Journal Entry

Date	Particulars	L.F	Debit Rs.	Credit Rs.
	Share Capital A/c [100 x 10] Dr		1000	
	To Forfeited shares A/c [100 x 5.50]			550
	To Discount on issue of shares A/c [100 x 1]			100
	To Final Call A/c [100 x 3.50]			350
	(Forfeiture of 100 shares for non payment of final call money)			

Reissue of forfeited shares

The Directors of a company have the right to reissue the shares that were forfeited by them already as and when they find it suitable and convenient. In this connection the following points need to be noted.

Reissue Price:

Forfeited shares can be reissued at any price the company prefers. But the reissue price plus amount already collected from the defaulting member should not be less than the amount credited as paid up on reissue of shares.

When shares are fully paid: If a share of Rs.10 (face value) on which Rs.3 has been already been collected is now forfeited then the minimum reissue price should be Rs.7 (Rs.10 – Rs.3).

When shares are partly paid: In the above example if the company has called only Rs.8 then the minimum reissue price should be Rs.5 (Rs.8 – Rs.3).

Forfeited shares account:

The discount on reissue (paid-up value – reissue price) of forfeited shares is debited to 'Forfeited shares account'. The accounting entry passed to record the same is:

Bank A/c	Dr	[No of shares x reissue price]
Forfeited Shares A/c	Dr	[No of shares x (paid up value –reissue price]
To Share Capital A/c		[No of shares x paid up value]

(Reissue of___shares at Rs.___)

Capital Reserve:

The balance if any in the forfeited share account is a capital profit and will be transferred to 'Capital reserve account'. The entry for transferring the balance in the Shares Forfeited Account is

Forfeited Shares A/c Dr

To Capital Reserve A/c

(Profit on reissue of forfeited shares transferred to capital reserve)

Illustration : 14

The Directors of a Company after due notice forfeited 100 Shares of Rs.10 each on which the final call money of Rs.3 was not paid. Later these shares were reissued at Rs.8 per share. Pass entries.

Solution:

Journal Entries

Date	Particulars	L.F	Debit Rs.	Credit Rs.
	Share Capital A/c [100 x 10] Dr		1,000	
	To Forfeited shares A/c [100 x 7]			700
	To Share Final Call A/c [100 x 3]			300
	(100 shares forfeited for non payment of final call money)			
	Bank A/c [100 x 8] Dr		800	
	Forfeited Shares A/c [100 x 2] Dr		200	
	To Share Capital A/c [100 x 10]			1000
	(100 Shares reissued at Rs.8)			
	Forfeited Shares A/c Dr		500	
	To Capital Reserve A/c			500
	(Profit on reissue of forfeited share transferred to Capital Reserve)			

Note :	Calculation of profit on reissue.		
	Amount received on forfeiture	100 shares x Rs.7 =	Rs. 700
Less:	Loss on reissue	100 shares x Rs.2 =	Rs. 200
	Profit on reissue (Capital Reserve)	100 shares x Rs.5 =	Rs. 500

Illustration : 15

A company forfeited 200 shares of Rs.10 each on which the first call money of Rs.3 and final call of Rs.2 per share were not received. These shares were subsequently reissued at Rs.7 per share fully paid up. Pass journal entries for forfeiture and reissue.

Solution:

Journal Entries

Date	Particulars	L.F	Debit Rs.	Credit Rs.
	Share Capital A/c [200 x 10] Dr		2,000	
	To Forfeited shares A/c [200 x 5]			1,000
	To Share First Call A/c [200 x 3]			600
	To Share Final Call A/c. [200 x 2]			400
	(200 shares forfeited for non payment of call money)			
	Bank A/c [200 x 7] Dr		1,400	
	Forfeited Shares A/c [200 x 3] Dr		600	
	To Share Capital A/c [200 x 10]			2,000
	(200 Shares reissued at Rs.7)			
	Forfeited Shares A/c Dr		400	
	To Capital Reserve A/c			400
	(Profit on reissue of forfeited share transferred to Capital Reserve)			

Reissue of shares issued at Premium:

When shares previously issued at a premium on which premium has been already received fully, share premium need not be recorded again on reissue of shares.

Illustration : 16

A Company issued 10,000 equity shares of Rs.10 each at premium of Rs.3 per share payable as follows:

on application	Rs.4 per share
on allotment	Rs.5 per share (including premium)
on first and final call	Rs.4 per share

Subscriptions were received for 13,000 shares. The excess money was refunded and the allotment money was received in full. The first and final call was made in due course and the amount due was received with the exception of 100 shares. These shares were forfeited and subsequently re-issued as fully paid for Rs.8 per share. Pass Journal entries recording the above transactions.

Solution:

Journal Entries

Date	Particulars	L.F	Debit Rs.	Credit Rs.
	Bank A/c Dr		52,000	
	To Share Application A/c			52,000
	(Application money received for 13,000 shares @ Rs.4 per share)			
	Share Application A/c Dr		52,000	
	To Share Capital A/c			40,000
	To Bank A/c			12,000
	(Application money received on 10,000 shares transferred to Share Capital A/c and that on 3,000 shares refunded)			
	Share Allotment A/c Dr		50,000	
	To Share Capital A/c			20,000
	To Securities Premium A/c			30,000
	(Allotment money due on 10,000 shares including premium,)			
	Bank A/c Dr		50,000	
	To Share Allotment A/c			50,000
	(Allotment money received)			
	Share First and Final Call A/c Dr		40,000	
	To Share Capital A/c			40,000
	(First and final call money due on 10,000 shares @ Rs.4 per share)			
	Bank A/c (Rs.40000 – 100 x 4) Dr		39,600	
	To Share First and Final Call A/c			39,600
	(First and Final call money received)			

	Share Capital A/c (100 x Rs.10) Dr To Share First & Final Call A/c (100 x Rs. 4) To Forfeited Shares A/c (100 x Rs.6) (Forfeiture of 100 shares on which first and final call was due)		1,000	 400 600
	Bank A/c (100 x Rs.8) Dr Forfeited Share A/c (100 x Rs.2) Dr To Share Capital A/c (Re-issue of 100 forfeited shares at Rs.8 per share as fully paid up)		800 200	 1,000
	Forfeited Shares A/c Dr To Capital Reserve A/c (Profit on re-issue of forfeited shares transferred to Capital Reserve)		400	 400

Illustration : 17

Surya Ltd. issued 50,000 equity shares of Rs.10 each at premium of 10% payable as under:

on application	Rs.3
on allotment	Rs.5 (including premium)
on first and final call	Rs.3

The whole of the issue was called for by the company and all the money were duly received except call money on 500 shares. These shares were, therefore, forfeited and later on re-issued at Rs.9 per share as fully paid.

Solution:

In the Books of Surya Ltd.

Journal Entries

Date	Particulars	L.F	Debit Rs.	Credit Rs.
	Bank A/c Dr To Share Application A/c (Application money received for 50,000 shares @ Rs.3 per share)		1,50,000	 1,50,000

	Share Application A/c Dr		1,50,000	
	To Share Capital A/c			1,50,000
	(Transfer of share application money to share Capital A/c)			
	Share Allotment A/c Dr		2,50,000	
	To Share Capital A/c			2,00,000
	To Securities Premium A/c			50,000
	(Allotment money due on 50,000 shares including premium)			
	Bank A/c Dr		2,47,500	
	To Share Allotment A/c			2,47,500
	(Allotment money received on 49,500 shares)			
	Share First and Final Call A/c Dr		1,50,000	
	To Share Capital A/c			1,50,000
	(Final call money due on 50,000 shares @ Rs.3 per share)			
	Bank A/c Dr		1,48,500	1,48,500
	To Share First and Final Call A/c			
	(Final call money received on 49,500 shares)			
	Share Capital A/c Dr		5,000	
	To Share First and Final Call A/c			1,500
	To Forfeited Shares A/c			3,500
	(Forfeiture of 500 shares on which allotment and first call were due)			
	Bank A/c Dr		4,500	
	Forfeited Shares A/c Dr		500	
	To Share Capital A/c			5,000
	(Re-issue of forfeited shares as fully paid up at Rs.9 per share)			
	Forfeited Shares A/c Dr		3,000	
	To Capital Reserve A/c			3,000
	(Profit on re-issue transferred to capital reserve)			

Note: Securities Premium A/c has been debited on forfeiture because the amount of premium remains in arrear.

Reissue of shares issued at Discount:

When shares previously issued at discount are reissued after forfeiture the discount should be brought into account.

Illustration : 18

Madhina Company Ltd. issued 1000 shares of Rs.10 each at discount of Re.1 payable as follows:

Rs.3 on Application

Rs.3 on Allotment (along with discount)

Rs.3 on First & Final call

All shares were duly subscribed and money was received except from a shareholder who failed to pay the final call amount on 100 shares. The directors forfeited the shares after giving due notice. Later these shares were reissued for Rs.8 fully paid. Pass entries to record forfeiture and reissue.

Solution:

In the Books of Madhina Company Ltd.

Journal Entries

Date	Particulars		L.F	Debit Rs.	Credit Rs.
	Share capital A/c	Dr		1000	
	To Forfeited shares A/c				600
	To Discount on issue of shares A/c				100
	To Final call A/c				300
	(Forfeiture of 100 shares for non-payment of call money)				
	Bank A/c.	Dr		800	
	Discount on issue of shares A/c	Dr		100	
	Forfeited shares A/c	Dr		100	
	To Share capital A/c				1000
	(Reissue of 100 shares @ Rs.8 per share)				

Date	Particulars	L.F	Debit Rs.	Credit Rs.
	Forfeited shares A/c Dr		500	
	To Capital reserve A/c			500
	(Profit on reissue transferred to capital reserve)			

Illustration : 19

Kanchana Ltd. forfeited 1000 shares of Rs.10 each issued at a discount of 10% for non payment of first call Rs.2 and second call Rs.3

These shares were reissued to Mr.Arun upon a payment of Rs.7,000 as fully paid.

Solution:

In the books of Kanchana Ltd.

Journal Entries

Date	Particulars	L.F	Debit Rs.	Credit Rs.
	Share Capital A/c Dr		10,000	
	To Forfeited Shares A/c			4,000
	To Discount on Issue of Share A/c			1,000
	To First Call A/c			2,000
	To Second Call A/c			3,000
	(Forfeited of 1000 shares on non payment of call money)			
	Bank A/c Dr		7,000	
	Discount on Issue of Share A/c Dr		1,000	
	Forfeited Shares A/c Dr		2,000	
	To Share Capital A/c			10,000
	(Reissued of Rs.7 as fully paid)			
	Forfeited Shares A/c Dr		2,000	
	To Capital reserve			2,000
	(Profit on reissue transferred to Capital reserve)			

Partial Reissue :

When all forfeited shares are not reissued then only profit made on such reissued shares is transferred to capital reserve. The amount relating to that part of shares that are not reissued will remain in the shares forfeited account which will be transferred to the liability side of the Balance Sheet.

Illustration : 20

The Directors of a company forfeited 100 equity shares of Rs.10 each on which the first call of Rs.3 and final call of Rs.3 had not been paid. Of these 40 shares were reissued upon payment of Rs.300. Journalise the transactions of forfeiture and reissue of shares.

Solution:

Journal Entries

Date	Particulars		L.F	Debit Rs.	Credit Rs.
	Share Capital A/c (100 x Rs.10)	Dr		1,000	
	To Forfeited Shares A/c (100 x 4)				400
	To First Call A/c. (100 x 3)				300
	To Final Call A/c. (100 x 3)				300
	(100 shares of Rs.10 each forfeited for non-payment of calls)				
	Bank A/c (40 x Rs.7.50)	Dr		300	
	Forfeited Shares A/c (40 x Rs.2.50)	Dr		100	
	To Share Capital A/c.				400
	(40 of the forfeited shares reissued at Rs.300)				
	Forfeited Shares A/c.	Dr		60	
	To Capital Reserve A/c.				60
	(Profit on reissue transferred to Capital Reserve Account)				

Note : Calculation of profit on reissue.

Amount received on forfeiture	100 shares x Rs.4	=	Rs. 400
Amount received on forfeiture	40 shares x Rs.4	=	Rs. 160
Less: Loss on reissue	40 shares x Rs.2.50	=	Rs. 100

Profit on reissue	40 shares x Rs.1.50	=	Rs. 60
(Capital Reserve)			

Note : The balance in the forfeited shares account Rs.240 will be shown as an addition to paid-up capital in the liabilities side of the Balance Sheet.

Ledger Accounts

Dr. **Forfeited Shares Account** **Cr.**

Particulars	Rs.	Particulars	Rs.
To Share Capital A/c	100	By Share capital A/c	400
To Capital Reserve A/c	60		
To Balance c/d	240		
	400		400
		By Balance b/d	240

Two Types of Shares:

If a company issues both types of shares, Preference and Equity, the accounts will be prefixed by the terms 'Preference Share' or 'Equity Share' as the case may be.

Illustration : 21

Priya Ltd. offer to the public 1,00,000 Equity Shares and 50,000 Preference Shares of Rs.10 each payable as under.

	Equity Shares	Preference Shares
	Rs.	Rs.
On Application	2	3
On Allotment	4	4
On First and Final Call	4	3

The public applied for 1,20,000 Equity Shares and 45,000 Preference Shares. Application for Preference Shares were accepted in full. All excess money received on equity shares was rejected. All money due was received. Pass entries, prepare important ledger accounts and extract from the Balance sheet.

Solution:

In the Books of Priya Ltd.

Journal Entries

Date	Particulars	L.F	Debit Rs.	Credit Rs.
	Bank A/c Dr		2,40,000	
	To Equity Share Application A/c			2,40,000
	(Application money received on 1,20,000 Equity shares)			
	Bank A/c Dr		1,35,000	
	To Preference Share Application A/c			1,35,000
	(Application money received on 45,000 preference shares)			
	Equity Share Application A/c Dr		2,00,000	
	To Equity Share Capital A/c			2,00,000
	(Equity application money transferred to equity share capital)			
	Preference share application A/c Dr		1,35,000	
	To Preference share capital A/c			1,35,000
	(Preference share application money transferred to preference share capital)			
	Equity Share Application A/c Dr		40,000	
	To Bank A/c			40,000
	(Excess Equity share application money on 20,000 shares refunded)			
	Equity Share allotment A/c Dr		4,00,000	
	To Equity Share capital			4,00,000
	(Allotment money due on 1,00,000 Equity shares @ Rs.4 per share)			
	Bank A/c Dr		4,00,000	
	To Equity Share Allotment A/c			4,00,000
	(Allotment money received on equity shares)			

Preference share allotment A/c Dr		1,80,000	
To Preference share capital A/c			1,80,000
(Allotment money on 45,000 preference shares due)			
Bank A/c Dr		1,80,000	
To Preference share allotment A/c			1,80,000
(Allotment money received on preference shares)			
Equity First & Final call A/c Dr		4,00,000	
To Equity Share capital A/c			4,00,000
(First & Final call amount due on 1,00,000 shares)			
Bank A/c Dr		4,00,000	
To Equity Share First & Final call A/c			4,00,000
(First & Final call amount received on equity shares)			
Preference Share First & Final call A/c Dr		1,35,000	
To Preference Share capital A/c			
(Preference First & Final call amoun due on 45,000 shares @ 3)			1,35,000
Bank A/c Dr		1,35,000	
To Preference Share First & Final call A/c			1,35,000
(Amount received on Preference first & final call)			

Equity Share Capital

Dr **Cr**

Particulars	Rs.	Particulars	Rs.
		By Equity Share	
		Application A/c	2,00,000
		By Equity Share	
		Allotment A/c	4,00,000
		By Equity First &	

To Balance c/d	10,00,000	Final call A/c	4,00,000
	10,00,000		10,00,000
		By Balance b/d	10,00,000

Preference Share Capital

Dr **Cr**

Particulars	**Rs.**	**Particulars**	**Rs.**
		By Preference Share Application A/c	1,35,000
		By Preference Share Allotment A/c	1,80,000
To Balance c/d	4,50,000	By Preference Share First & Final call A/c	1,35,000
	4,50,000		4,50,000
		By Balance b/d	4,50,000

Bank Account

Dr **Cr**

Particulars	Rs.	Particulars	Rs.
To Equity Share Application A/c	2,40,000	By Equity Share Application	40,000
To Preference Share Application A/c	1,35,000		
To Equity Share Allotment A/c	4,00,000		
To Preference Share Allotment A/c	1,80,000		
To Equity First & Final call A/c	4,00,000		
To Preference First & Final call A/c	1,35,000		
		By Balance c/d	14,50,000
	14,90,000		14,90,000
To Balance b/d	14,50,000		

Extracts from Balance Sheet Entries of Priya

Liabilities	Rs.	Assets	Rs.
Share Capital:			
Authorised:	----	Current Assets:	
Issued :		Cash at Bank	14,50,000
50,000 Preference share	5,00,000		
@ Rs.10 each			
1,00,000 Equity share	10,00,000		
@ Rs.10 each			
Subscribed :			
45000 Preference Shares			
@ Rs.10 each	4,50,000		
100000 Equity shares			
@ Rs.10 each	10,00,000		
Called-up:			
45000 Preference Shares			
@ Rs.10 each	4,50,000		
100000 Equity shares			
@ Rs.10 each	10,00,000		
Paid-up:			
45000 Preference Shares			
@ Rs.10 each	4,50,000		
100000 Equity shares			
@ Rs.10 each	10,00,000		
	14,50,000		14,50,000

Illustration : 22

Thamarai Co. Ltd. issued 70,000 shares of Rs.10 each payable at a premium of Rs.2 per share.

Rs. 4 on application

Rs. 5 on Allotment

Rs. 2 on First Call

Re. 1 on Final Call

All the shares were duly subscribed. The money's due on the shares were received except the First Call amount on 1,000 shares and the Final Call amount on 1,500 shares.

The company forfeited the shares on which both the call amounts were not received. Of these 800 shares were reissued at Rs.7 per share.

Draft the necessary journal entries.

Solution:

Journal in the Books of Thamarai Co. Limited

Date	Particulars	L.F	Debit Rs.	Credit Rs.
	Bank A/c Dr		2,80,000	
	To Share Application A/c			2,80,000
	(Money received as 70,000 shares @ Rs.4 per Share)			
	Share Application A/c Dr		2,80,000	
	To Share Capital A/c			2,80,000
	(Transfer of Application money to Share capital)			
	Share Allotment A/c Dr		3,50,000	
	To Share Capital A/c			2,10,000
	To Securities premium A/c			1,40,000
	(Allotment money due on 70,000 shares including premium)			
	Bank A/c Dr		3,50,000	
	To Share Allotment A/c			3,50,000
	(Allotment money received)			
	Share First call A/c Dr		1,40,000	
	To Share Capital A/c			1,40,000
	(First call money due on 70,000 shares of Rs.2 each)			
	Bank A/c Dr		1,38,000	
	To Share First call A/c			1,38,000
	(First call money received except on 1000 shares)			

	Share Final call A/c Dr		70,000	
	To Share Capital A/c			70,000
	(Final call money due on 70,000 shares of Re. 1 each)			
	Bank A/c Dr		68,500	
	To Share Final call A/c			68,500
	(Final call money received except on 1,500 shares)			
	Share Capital A/c Dr		10,000	
	To Share First call A/c			2,000
	To Share Final call A/c			1,000
	To Forfeited Shares A/c			7,000
	(1,000 shares forfeited on which both calls were not received)			
	Bank A/c Dr		5,600	
	Forfeited Shares A/c Dr		2,400	
	To Share capital A/c			8,000
	(800 shares reissued)			
	Forfeited Shares A/c Dr		3,200	
	To Capital Reserve A/c			3,200
	(Profit on forfeited and reissued shares transferred to capital reserve A/c)			

Illustration : 23

Surya Ltd. issued 16,000 shares of Rs.20 each at par payable Rs.4 on Application, Rs.6 on Allotment, the First call of Rs.5 and Second and Final Call of Rs.5.

Applications were received for 24,000 shares. The shares were allotted on pro-rata basis to the applicants for 19,200 shares and the remaining were rejected. Money over-paid on Application was used towards the money due on allotment. All the money due were received except from one shareholder holding 800 shares who failed to pay the final call.

Those shares were forfeited and later reissued at Rs.18 as fully paid up.

Pass Journal Entries, prepare Ledger Accounts and the Balance Sheet.

(October, 1997)

Solution:

Journal Entries of Surya Ltd.

Date	Particulars	L.F	Debit Rs.	Credit Rs.
	Bank A/c Dr		96,000	
	To Share Application A/c			96,000
	(Share application money on 24000 applications received)			
	Share Application A/c Dr		64,000	
	To Share Capital A/c			64,000
	(The application money on 16,000 applications transferred to share capital account)			
	Share Application A/c Dr		19,200	
	To Bank A/c			19,200
	(Excess application money refunded on 4,800 shares @ Rs.4))			
	Share application A/c Dr		12,800	
	To Share Allotment A/c			12,800
	(Excess application money transferred to share allotment A/c)			
	Share allotment A/c Dr		96,000	
	To Share capital A/c			96,000
	(Allotment money on 16,000 shares)			
	Bank A/c Dr		83,200	
	To Share allotment A/c			83,200
	(Allotment money received)			
	Share first call A/c Dr		80,000	
	To Share capital A/c			80,000
	(First call money due)			
	Bank A/c Dr		80,000	
	To Share first call A/c			80,000
	(First call money received)			

Share second and final call A/c Dr To Share capital A/c (Second call money due)		80,000	80,000
Bank A/c Dr To Share second and final call A/c (Second call money received except on 800 shares)		76,000	76,000
Share capital A/c Dr To Forfeited Shares A/c To Share second & final call A/c (800 shares forfeited on which final call money was not received)		16,000	4,000 12,000
Bank A/c Dr Forfeited Shares A/c Dr To Share capital A/c (800 shares reissued @ Rs.18)		14,400 1,600	16,000
Forfeited Shares A/c Dr To Capital reserve A/c (Profit on forfeited and reissued shares transferred to capital reserve A/c)		10,400	10,400

Ledger in the books of Surya Ltd.

Dr. **Bank Account** **Cr.**

Particulars	Rs.	Particulars	Rs.
To Share Application A/c	96,000	By Share Application A/c	19,200
To Share Allotment A/c	83,200	By Balance c/d	3,30,400
To Share First Call A/c	80,000		
To Share Second Call A/c	76,000		
To Share Capital A/c	14,400		
	3,49,600		3,49,600
To Balance b/d	3,30,400		

Dr. **Share Application Account** **Cr.**

Particulars	Rs.	Particulars	Rs.
To Share Capital A/c	64,000	By Bank A/c	96,000
To Bank A/c	19,200		
To Share Allotment A/c	12,800		
	96,000		96,000

Dr. **Share Allotment Account** **Cr.**

Particulars	Rs.	Particulars	Rs.
To Share Capital A/c	96,000	By Bank A/c	83,200
		By Share Application A/c	12,800
	96,000		96,000

Dr. **Share First Call Account** **Cr.**

Particulars	Rs.	Particulars	Rs.
To Share Capital A/c	80,000	By Bank A/c	80,000
	80,000		80,000

Dr. **Share Final Call Account** **Cr.**

Particulars	Rs.	Particulars	Rs.
To Share Capital A/c	80,000	By Bank A/c	76,000
		By Share Capital A/c	4,000
	80,000		80,000

Dr. **Share Capital Account** **Cr.**

Particulars	Rs.	Particulars	Rs.
To Share second call A/c	4,000	By Share Application A/c	64,000
To Forfeited Shares A/c	12,000	By Share Allotment A/c	96,000
To Balance c/d	3,20,000	By Share First call A/c	80,000
		By Shares Second call A/c	80,000
		By Bank A/c	14,400
		By Shares forfeited A/c	1,600
	3,36,000		3,36,000
		By Balance b/d	3,20,000

Dr. **Shares Forfeited Account** **Cr.**

Particulars	Rs.	Particulars	Rs.
To Share Capital A/c	1,600	By Share Capital A/c	12,000
To Capital Reserve A/c	10,400		
	12,000		12,000

Dr. **Capital Reserve Account** **Cr.**

Particulars	Rs.	Particulars	Rs.
To Balance c/d	10,400	By Share Forfeited A/c	10,400
	10,400		10,400
		By Balance b/d	10,400

Balance Sheet of Surya Ltd.

Liabilities	Rs.	Assets	Rs.
Share Capital		Current Assets:	
Authorised Capital	----	Bank	3,30,400
Issued Capital			
16,000 shares @			
Rs.20 each	3,20,000		
Subscribed Capital			
16,000 shares @			
Rs.20 each	3,20,000		
Called-up Capital			
16,000 shares @			
Rs.20 each	3,20,000		
Paid up Capital			
16,000 shares @			
Rs.20 each	3,20,000		
Reserves and surplus:			
Capital reserve	10,400		
	3,30,400		3,30,400

QUESTIONS

I. Objective type:

a) Fill in the Blanks:

1. Companies have been defined in Section ______of the Companies Act, _____.
2. _________ is considered as the official signature of the company.
3. The management of a company is done by _________ .
4. The liability of share holders are _______in a company.
5. Audit of accounts are done by practicing chartered accounts who are appointed by _______ at the _________ .
6. _________ is the maximum amount of capital that can be issued by a company.
7. Nominal capital is the capital mentioned in the _______ of the company.
8. The part of the authorised capital not offered for subscription to the public is known as _________ .
9. Reserve capital can be issued only at the time of _________ .
10. A public issue can not be kept open for more _________days.
11. Minimum subscription that should be received by the company is _________ % of the issued capital.
12. When excess application money is adjusted towards allotment it is called as _________ allotment.
13. There should be a time gap of _________ between two calls.
14. Capital Reserve represents _________ profit.
15. Forfeited shares have to be reissued at a price _________ than the face value.
16. Securities premium is shown in the ________ side of the Balance Sheet.

Answers: 1. Sec. 3(1)(i), 1956; 2. Common Seal; 3. Board of Directors; 4. Limited; 5. Shareholders, Annual General Meeting; 6. Authorised/ Nominal / Register; 7. Memorandum of Association; 8. Unissued; 9. Winding up; 10. 10 days; 11. 90; 12. Prorata/Proportional; 13. One month; 14. Capital; 15. Lesser than; 16. Liability)

b) Choose the correct answer:

1. According to Companies (Amendment) Act 2000, a company limited by share can issue _________ kinds of shares.

   a) 1 b) 2 c) 3

2. The public issue must be kept open for atleast

   a) 3 days b) 5 days c) 7 days

3. Minimum amount to be collected by a company as application money according to SEBI is _________ % of the issue price.

   a) 10% b) 25% c) 50%

4. When more number of applications are received than that are offered to the public, it is called _________ .

   a) Over subscription b) Under subscription c) Full subscription

5. The maximum calls that a company can make is

   a) one b) two c) three

6. According to Table A, interest charged on calls-in-arrears is _________%.

   a) 4% b) 5% c) 6%

7. According to Table A, interest charged on calls in advance is ________ %.

   a) 4% b) 5% c) 6%

8. A company can issue shares

   a) at par only b) at par and at premium

   c) at par, at premium & at discount

9. When the company issue shares at a price more than the face value it is called as an issue at _________ .

   a) Par b) Premium c) Discount

10. Normally companies can issue shares at _________ % of discount

    a) 5 b) 10 c) 20

11. When shares are forfeited the share capital of the company will _______ .

    a) remain same b) reduce c) increase

12. Securities premium will appear in the _______side of the Balance Sheet.

    a) Asset b) Liability c) Assets & Liability

13. The balance of forfeited share account is ______ in the Balance Sheet.

    a) added to paid up capital   b) added to authorised capital

    c) deducted from paid up capital.

14. Calls-in-arrears is shown in the Balance Sheet as

    a) deduction from called up capital

    b) addition to paid up capital

    c) addition to issued capital

15. Capital Reserve is shown on the side of Balance Sheet.

    a) Asset   b) Liability   c) Both

Answer: 1. (b); 2. (a); 3. (b); 4. (a); 5. (c); 6. b); 7. (c); 8. (c); 9. (b); 10. (b); 11. (b); 12. (b); 13. (a); 14. (a); 15. (b)

II. Other Questions:

1. Define a company.
2. What are the characteristics of a company?
3. Explain the different types of share capital of a company.
4. What is a share?
5. What are the different types of shares that can be issued by company?
6. Explain the different types of preference shares.
7. Explain the procedure for issue of shares.
8. What is allotment?
9. What is prorata allotment?
10. What do you understand by calls-in-arrears?
11. What is meant by calls-in-advance.
12. What are the differences between over subscription & undersubscription?
13. Write a note on equity shares?
14. What do you understand by issue of shares at premium?
15. What is forfeiture of shares?
16. Write notes on reissue of forfeited shares?

III. Problems

1. A company issued 20,000 shares of Rs.10 each payable

   Rs. 3 on Application,

   Rs. 3 on Allotment,

   Rs. 4 on First and Final call

   All shares were subscribed and duly paid for. Pass journal entries.

2. Preeti Ltd. invited applications for 5,000 shares of Rs.10 each payable as follows:

   Rs.3 on Application,

   Rs.2 on Allotment,

   Rs.2 on First call and

   Rs. 3 on Final call.

   All these shares were subscribed and paid for. Pass journal entries.

3. A Joint Stock Company had a Nominal Capital of Rs.5,00,000 divided into 5,000 shares Rs.100 each payable

   Rs.30 per share on application,

   Rs.20 per share on allotment

   Rs.30 on First call and

   Rs.20 on Final call.

   All the shares were subscribed and fully paid for by the public. Pass Journal entries.

4. Mary Ltd. issued 1,000 shares of Rs.10 each at premium of Rs.2 per share payable as follows:

   Rs.4 on application

   Rs.4 on allotment (including premium)

   and the balance when required. All the shares were subscribed for and duly

   paid. Pass necessary Journal entries.

5. Global Ltd. issued 6000 shares of Rs. 100 each at premium of Rs.20 per share payable as follows:

   Rs. 30 on application

   Rs. 50 on allotment (including premium)

Rs. 30 on First call and

Rs. 10 on Final call

All shares were duly subscribed and money due were fully received. Pass journal entries.

6. A Company issued 10,000 shares of Rs.10 each at discount of Re.1 per share payable

   Rs.3 on application

   Rs.4 on allotment (with discount adjustment)

   Rs.2 on first and final call.

   All the shares issued were subscribed for and duly paid. Pass Journal entries.

7. Green Ltd. issued 40,000 shares of Rs.100 each at discount of Rs.10 per share payable as follows:

   Rs. 30 on application.

   Rs. 40 on allotment (including discount) and

   Rs. 20 on final call

   The shares were applied and allotted in full and all moneys were received in time. Pass the Journal entries.

8. Vinod Company Ltd. issued 40,000 Preference shares of Rs.10 each at premium of Rs.3. Give journal entry.

   (October 1997)

9. Sridhar Ltd., issued 20,000 shares of Rs.100 each at discount of 10%. Give journal entry.

   (March 1999)

10. Suresh Ltd. issued 2000 shares of Rs.10 each at premium of Re.1 to the public payable as follows:

    Rs. 3 on application;

    Rs. 4 on allotment (including premium) ;

    Rs. 2 on first call and

    Rs. 2 on final call.

    1800 shares were subscribed by the public. All money due were received.

    Prepare ledger accounts.

(Answer: Bank Account Rs. 19,800; Share Capital Account Rs.18,000; Securities Premium Account Rs.1,800)

11. Goodwill Ltd. had an authorised capital of Rs.50,00,000 divided into shares of Rs.100 each. It issued 10,000 shares at discount of 4% payable as follows:

    Rs.20 on application,

    Rs.46 on allotment and

    Rs.30 on first and final call.

    Applications were received for 9,000 shares and all the shares allotted. All money due was received. Pass journal entries and show the extracts from Balance Sheet.

    (Answer: B/s Rs. 9,00,000)

12. On 1.1.98 Alpha Ltd., issued 1,00,000 shares of Rs.10 each payable Rs.2 On application. The company received applications for 1,20,000 shares. The excess applications were rejected and money refunded. Pass necessary entries.

    (October 2000)

13. Good Luck Co. Ltd issued 1,00,000 shares @ Rs.10 each payable

    Rs.3 on application

    Rs.3 on allotment

    and the balance when required. 1,50,000 shares were applied for. The directors rejected the excess applications and refunded the application money. All money due was received. Pass entries to record the transactions.

14. Jackson Ltd. had an authorised capital of Rs.3,00,000 divided into shares of Rs.10 each. It offered 4,000 shares @ Rs.10 each at premium of Rs.2 on the following terms:

    Rs.2 per share on application,

    Rs.5 per share on allotment, (including Rs.2 premium)

    Rs.3 per share on first call and

    Rs.2 per share on final call.

    Applications were received for 6,000 shares. Applicants for 2,000 shares were rejected. All the money due on shares were duly received. Give the necessary journal entries and show the extracts from the Balance Sheet.

    (Answer: B/s. Rs.48,000)

15. Moon Ltd. offered for subscription 20,000 shares of Rs.10 each payable at a premium of Rs.2.50 per share

    Rs.2.50 on application

    Rs.5 on allotment (including premium)

    Rs. 3 on first call and Rs.2 on final call

    Application were received for 30,000 shares. Applications for 5,000 shares were rejected. Application money for other 5,000 shares was applied towards the amount due on allotment. The balance money was received in due time. Pass journal entries.

16. A company issued 10,000 shares of Rs.20 each at a premium of Rs.5 per share payable

    Rs. 10 on Application

    Rs. 10 on Allotment (including premium)

    Rs. 5 on First and Final Call

    The company received 11,000 shares. Excess application money was rejected. All money due were received except the Final call money on 500 shares. Pass journal entries.

17. Santhosh Ltd. issued 5,000 Equity shares of Rs.100 each to the public. The shares were payable as follows:

    Rs. 30 on Application; Rs. 30 on Allotment;

    Rs. 40 on First and Final call.

    The public subscribed for 4000 shares and the shares were allotted. All money was received except the amount due on call, on 200 shares. Give Journal entries.

18. Shenbagam Ltd. issued 20,000 shares of Rs.100 each payable

    Rs.25 on Application

    Rs.25 on Allotment

    Rs.20 on First call and

    Rs.30 on Final call

    18,000 shares were subscribed for and all the shares were allotted. All money due was received except the Final call money on 250 shares. Pass journal entries.

19. Mari Ltd. issued 1,000 shares of Rs.100 each to the public at discount of Rs.5 payable as under:

    Rs.20 on Application;

    Rs. 25 on Allotment; (with discount adjustment)

    Rs. 20 on First call; and

    Rs. 30 on Final call

    All the shares were applied for and allotted. Shanmugam, to whom 100 shares were allotted, paid the final call amount due along with first call. All money were received. Pass journal entries.

20. Bhagavathi Ltd. issued 10,000 shares of Rs.10 each at discount of 10% payable as follows:

On application	Rs. 2.50
On Allotment	Rs. 3.00
On First and Final Call	Rs. 3.50

    All money due were received except the final call on 100 shares which were forfeited by the company after giving due notice. Pass the forfeiture entry.

21. Ganthimathi Ltd. was registered with a nominal capital of Rs.1,00,000 in equity shares of Rs.10 each. It offered to the public 6,000 shares for subscription.

    The applications were, however, received for 8,000 shares. The Directors had to reject the applications for 1,000 shares and to return the money received thereon. The application money received on the other 1,000 shares was adjusted to allotment account. The amount payable on shares was

    Rs.3 per share on application,

    Rs.3 per share on allotment and the balance on first and final call.

    One shareholder holding 100 shares failed to pay the call money and as a result his shares were forfeited. Pass the necessary journal entries.

22. Gani Ltd. forfeited 20 shares of Rs.10 each fully called up, held by Santha for non-payment of final call of Rs.4 per share. These shares were re-issued to Josephin for Rs.8 per share as fully paid up. Give journal entries for the forfeiture and re-issue of shares.

    (Answer: Capital Reserve Rs.80)

23. A Company forfeited 100 equity shares of Rs.100 each issued at premium of 10% (to be paid at the time of allotment) on which first call money of Rs.30 per share and

final call of Rs.20 were not received. These shares were forfeited and subsequently re-issued at Rs.90 per share. Give necessary journal entries regarding forfeiture and re-issue of shares.

(Answer : Capital Reserve Rs.4,000)

24. The Directors of a company forfeited 200 Equity Shares of Rs.10 each fully called up on which the final call of Rs.2 has not been paid. The shares were re-issued upon payment of Rs.1,500. Journalise the above transactions.

(Answer : Capital Reserve Rs.1,100)

25. The Directors of a company forfeited 100 shares of Rs.10 each fully called up for non-payment of First call of Rs.2 per share and Final call of Rs.3 per share. 60 of these shares were subsequently re-issued at Rs.6 per share fully paid up. Pass necessary Journal entries to record the above.

(Answer : Capital Reserve Rs.60)

26. The directors of Sheela Ltd. forfeited 2000 shares Rs.10 each for non-payment of final call of Rs.2.50. 1,800 of these shares were re-issued for Rs.6 per share fully paid up. Give the necessary Journal entries.

(Answer : Capital Reserve Rs.6,300)

27. Meenakshi Limited forfeited 100 equity shares of face value of Rs.10 each, for non-payment of final call of Rs.2 per share. The forfeited shares were subsequently reissued @ Rs.7 each as fully paid. Give necessary entries in company's Journal.

(Answer : Capital Reserve Rs. 500)

28. Ashok Ltd. forfeited 300 shares of Rs.10 each fully called up held by Ram for non-payment of first call of Rs.3 per share and final call money of Rs.4 per share. Out of these shares 250 were re- issued to Shyam for Rs.2,000. Give Journal entries for forfeiture and re-issue.

(Answer : Capital Reserve Rs.250)

29. A company issued 10,000 shares of the value of Rs.10 each, payable

Rs.3 on application,

Rs.3 on allotment and

Rs. 4 on the first and final call.

All cash is duly received except the call money on 100 shares. These shares are subsequently forfeited by directors and are reissued as fully paid for Rs.500. Give the necessary Journal entries for the transactions.

(Answer : Capital Reserve Rs. 100)

30. Saraswathi Ltd. having an authorised capital of Rs.20,00,000 in shares of Rs.100 each invited applications for 10,000 shares payable as follows:

On Application	Rs. 30
On Allotment	Rs. 20
On First Call	Rs. 25
On Final Call	Rs. 25

The company received applications for 12,000 shares. Applictions for 10,000 shares were accepted in full and the money on 2000 applications rejected was returned.

All money due as stated above was received with the exception of the final call of 250 shares. Half of these shares were forfeited and re-issued as fully paid at Rs.90 per share. Pass necessary journal entries.

(Answer : Capital Reserve Rs. 8,125)

31. Arun Ltd. offered to the public 20,000 equity shares of Rs.10 each payable

Rs.4 on application,

Rs.2 on allotment,

Rs.2 on first call and

the balance on final call.

Applications received for 35,000 shares. Applications for 10,000 shares were rejected. Excess application money was utilised towards the money due on allotment. Then calls were made. One shareholder Balu holding 500 shares failed to pay the two calls and consequently his shares were forfeited. 200 of these shares were re-issued to as fully paid at Rs.6 per share. Pass journal entries.

(Answer : Capital Reserve Rs. 400)

32. Sriram Ltd. issued 10,000 shares of Rs.100 each at Rs.120 payable as follows:

Rs. 25 on application;

Rs. 45 on allotment (including premium);

Rs. 20 on first Call; and

Rs. 30 on final Call.

9,000 shares were applied for and allotted. All money was received with the exception of first and the final calls on 200 shares held by Ram. These shares were forfeited. Give the Journal entries and important ledger Accounts.

(Answer : Capital Account Rs.8,80,000; Securities Premium Account Rs. 1,80,000; Forfeited Shares Account Rs.10,000; Bank Account Rs. 10,70,000)

33. Narayanan Ltd. has an authorised capital of Rs.4,00,000 divided into shares of Rs.20 each, the whole of which is issued and subscribed at premium of Rs.2 per share. The amount was payable as follows:

on application Rs. 10

on allotment Rs.7 (including premium);

on first call Rs.5 ;

All sums due were received except from Shankar holding 2,000 shares who failed to pay the call money and his shares were forfeited. They were later re-issued at Rs.14 per share as fully paid. Pass journal entries.

(Answer : Capital Reserve Rs. 18,000)

34. A company invited applications for 10,000 shares of Rs.100 each at premium of Rs.20 per share. The shares were payable as under:

On Application	Rs. 30
On Allotment	Rs. 40 (including premium)
On First & Final Call	Rs. 50

The public applied for 9,000 shares. These were allotted. All money due were received with the exception of the call on 200 shares. These shares were forfeited and re-issued at Rs.80 per share fully paid up. Give Journal entries.

(Answer : Capital Reserve Rs. 6,000)

35. Lucy Ltd. issued 50,000 Equity shares of Rs.10 each at premium of 10% payable as under:

On Application	Rs. 2
On Allotment	Rs.5 (including premium)
On First Call	Rs. 2
On Final Call	Rs. 2

All money was duly received except the first and final call money on 500 shares. These shares were, therefore, forfeited and later on re-issued at Rs.9 per share as fully paid. Pass journal entries.

(Answer : Capital Reserve Rs. 2,500)

36. A Company issues 50,000 equity shares of Rs.100 each at a discount of 10% (allowed at the time of allotment). The net amount payable is as follows.

On application	Rs.20

On allotment	Rs.20
On First Call	Rs.25
On Final Call	Rs.25

All the shares were applied and money was duly received except one sharholder, David holding 100 shares did not pay final call money. The shares were forfeited. Out of these, 40 shares were re-issued to Siva at Rs.70 per share as fully paid up. Pass Journal entries.

(Answer : Capital Reserve Rs. 1,800)

37. Tirupur Textiles Company invited applications for 10,000 equity shares of Rs.100 each at a discount of Rs.10 per share (allowed at the time of allotment).

The amount was payable as follows:

On Application	Rs. 30
On Allotment	Rs. 30
On First and Final Call	Rs. 30

The public applied for 9,000 shares and these were allotted. All money due was collected with the exception of first and final call on 400 shares. Subsequently, these shares were forfeited. 200 of these shares were re-issued as fully paid for a payment of Rs.80 per share.

Journalise the above transactions in the books of the Company.

(Answer : Capital Reserve Rs. 8,000)

38. Basha Ltd. invited applications for 30,000 equity shares of Rs.50 each at a discount of 10%. The amount was payable as under:

On application	Rs. 25
On Allotment	Rs. 10 (with discount adjustment)
On Call	Rs. 10

The public applied for 30,000 shares and these were allotted. All money was duly received with the exception of call money on 400 shares. These shares were forfeited. Out of these, 300 shares were re-issued as fully paid up @ Rs.35 per share.

Pass necessary journal entries.

(Answer : Capital Reserve Rs.7,500)

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10. RX.Gupta, Radha Swamy - Financial Accounting.
11. R.K.Gupta, V.K.Gupta - Financial Accounting.
12. Basu Das - Practice in Accountancy.
13. M.C.Shukla - Advanced Accountancy.
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