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PG AND RESEARCH DEPARTMENT OF COMMERCE

FINANCIAL ACCOUNTING

FINANCIAL ACCOUNTING

INTRODUCTION:

The dictionary meaning of the word **'Branch'** is any subordinate division of a business, subsidiary shop, office etc. According to the provisions contained in section 29 of the companies' act 1956, it would appear that a branch is any establishment carrying on either the same or substantially the same activity as that carried on by head office of the company. It must also be noted that the concept of a branch means existence of a head office for, there can be no branch without a head office i.e. principal place of business.

What do you mean by branches? (or) Explain the meaning of branches.

A business may be, and generally is, divided into so many divisions. If the various divisions are situated in different places of the same town or in different towns, they are known as branches. The parent establishment is known as 'Head office' and its off-shoots are termed as 'Branches'. Where a business has several branches, it is essential that complete records be kept of the transactions relating to each branch.

Define branches (or) give the definition of branches.

According to sec 29 of the Indian Companies Act 1956, branch it would appear that a branch is "any establishment carrying on either the same or substantially the same activity as that carried on by the head office of the company".

WHAT ARE THE OBJECTIVES OF BRANCH ACCOUNTS?

All the branch transactions are recorded mainly to know the profit earned by individual branch. The following are the important objects of maintaining branch accounts.

1. **Profit of individual branch:** the purpose of preparing branch accounts is to know the profit or loss earned by individual branches. It will help to identify those branches, which will give minimum profit or no profit.
2. **Proper control:** Proper control can be exercised by head office upon those branches where a number of problems arise. Through its accounting records it identifies the areas of weakness and helps them to improve efficiently.
3. **Financial position:** Actual financial position can be found out by head office on the basis of the branch accounting records. The head office can make financial arrangements with the help of accounting records to cater its needs.
4. **Proper estimation:** The head office can estimate the needs of each branch and act immediately. These estimations can be made possible only when the head office maintains past records of individual branch accounts properly.
5. **Suggestions for improvement:** Suggestions for increasing the efficiency of the branch can be sent by head office on the basis of branch accounts. It will avoid further loss if suggestions will reach the branches in time.

BRIEFLY EXPLAIN THE CLASSIFICATION OF BRANCHES (OR) WHAT ARE THE TYPES OF BRANCHES?

TYPES OF BRANCHES

From the accounting point of view branches may be classified as follows:

1. Dependent Branch
2. Independent Branch
3. Foreign Branch

1. Dependent Branches / Branches not keeping full system of accounting/ Branches of which accounts are kept in the head office:

The term 'Dependent branch' means a branch, which does not maintain its own set of books. All records have to be maintained by the head office. When the business policies and the administration of a branch are wholly controlled by the head office, its accounts also are maintained by it. Some of the significant types of branches that are operated in this manner are described below:

1. A branch set up merely for booking orders which are executed by the head office. It transmits only the order to the head office.
2. A branch established at a commercial centre for the sale of goods supplied by the head office.
3. A branch for the retail sale of goods, supplied by the head office.

(i) Debtors system

(a) Cost Price Model:

Under cost price method goods are sent to branch as its original price only. Branches are permitted to sell goods at cash and credit basis. Credit sales should not be recorded on the credit side of branch account. All the expenses are recorded on the debit side of branch account. The purpose of preparing branch account is to know the profit (or) loss earned by the individual branch.

(b) Invoice Price Model:

Under invoice price method, the head office sends goods to its branch at invoice price, which is more than the cost price. Invoice price is fixed for the purpose of not showing the actual profit earned by the head office. Loading is the difference between invoice price and cost price

(ii) Stock and Debtors System

(iii) Wholesale Branch System

(iv) Final accounts system

2. Independent Branch / where the branch trades independently of the head office/ Branches keeping full system of accounting:

Independent Branch means a branch which maintains its own set of books and has freedom to operate independently. If a branch is big and carries on manufacturing operations also, it is allowed to operate freely within the framework of head office policies. Remittances are made by the branch in round sums as and when convenient, i.e cash may be sent to head office if there is a surplus or if the head office is in need of funds. Similarly the branch is supplied with funds for the purpose of carrying on business.

3. Foreign Branch:

A foreign branch is an independent branch located in a foreign country and maintains accounts in its respective foreign currency. The main problem is to convert the branch trial balance, which is in foreign currency into that of a head office currency in order to incorporate the branch accounts in the books of head office.

Explain the features (or) nature (or) characteristics of dependent branch:

1. This type of branch sells only those goods supplied by the head office. Sometimes the branch may be allowed to make purchase from the local parties for which the payments are made directly by head office.
2. The goods may be supplied to the branch by the head office at cost price (or) at invoice price.
3. All branch expenses such as rent, salary, advertisement etc., are paid by the head office.
4. The branch manager is provided with a small amount of cash on the imprest system for meeting petty items of expenses.
5. The branch is allowed to make only cash sales though in some cases, it may be allowed to make credit sales to approved customers.
6. Such a branch maintains a debtor ledger and a stock ledger.
7. The branch remits the sale proceeds periodically to the head office .

What are the accounting systems in respect of dependent branches (or) briefly explain the methods of maintaining the accounts.

1. **Debtors System**
2. **Stock and Debtors system**
3. **Wholesale Branch System**
4. **Final Account System**

1. DEBTORS SYSTEM (Synthetic Method):

This system is adopted in case of branches of small size. Under this system, a branch account is opened separately for each branch in the books of head office. This account is nominal in nature. The opening balance of stock, debtors, petty cash are debited to the branch account. The cost of the goods sent to branch as well as expenses of the branch paid by the head office like salaries, rent, insurance etc., and closing balance of liabilities if any are also debited to it. Conversely, the opening balance of liabilities if any, cash remitted by the branch and the cost of goods returned by the branch are credited. The branch account reveals profit or loss.

2. STOCK AND DEBTORS SYSTEM (Analytical Method):

Profit or loss of a branch can be found out by preparing branch account. In the stock and debtors method if it is desired to exercise a more detailed control over the working of a branch, the accounts of the branch are maintained under what is described as the stock and debtors method. In this method the head office keeps separate accounts relating to various types of transactions at the branch instead of one branch account.

. The following accounts are kept in the head office books relating to a branch under this system.

a. **Branch Stock Account**
b. **Branch Debtors Account**
c. **Branch Expenses Account**
d. **Branch Adjustment Account**
e. **Branch Profit and Loss Account**
f. **Goods Sent to the Branch Account**

(i) Branch Stock Account:

This account deals with all goods received, returned and sold by the branch. The account helps the head office in maintaining an effective control over the branch stock.

(ii) Branch Debtors Account:

This account is prepared to record all the transactions relating to branch debtors and ascertain either the closing balance of debtors (or) credit sales.

(iii) Branch Expenses Account:

This account is prepared to disclose branch expenses, losses on account of discount on debtors, allowances, bad debts and other charges etc., incurred at the branch.

(iv) Branch Adjustment Account:

When the goods are sent to branch at cost price, this account need not be prepared. Instead, when the goods are supplied to branch at invoice price, it must be prepared to ascertain gross profit made by the branch.

(v) Branch Profit and Loss Account:

This account is prepared to ascertain the net profit made by the branch. It is debited with
(a) The balance of branch expenses account (b) cost of surplus if any revealed by the branch stock account.
It is credited with (a) gross profit as shown in branch adjustment account (b) cost of surplus if any revealed by the branch stock account.

(vi) Goods Sent to Branch Account:

This account is prepared to find out the net value of goods sent to the branch. Goods sent to branch and goods returned by the branch and loading included in them if any are recorded in this account.

3. WHOLESALE BRANCH SYSTEM/ GOODS INVOICED AT WHOLESALE PRICE TO RETAIL BRANCHES:

Manufacturers may sell goods to the customers either through the wholesalers and approved stockists or through their branches. In order to know whether self-retailing through branch is more profitable than wholesaling, it is necessary to make distinction between profit due to wholesale and profit due to retail business of the branch.

4. FINAL ACCOUNT SYSTEM:

The head office can also ascertain the profit or Loss of a dependent branch by preparing trading and profit and loss account at cost. In such case the head office may also maintain a branch account. The branch account so prepared is personal account in nature as different from the branch account prepared by head office in case of debtors system which is of the nature of nominal account. The balance in the branch account at the end of a particular period represents the net assets at the branch.

DEBTORS SYSTEM: (Journal Entries)

a. When Goods received at cost price:

I) For opening balance

Branch a/c Dr
    To Branch Stock a/c
    To Furniture a/c
    To Branch Petty Cash a/c

II. For Opening Balance of Assets:

Branch a/c Dr
    To Branch assets a/c

III. For Opening Balance of Liabilities:

Branch Liabilities a/c Dr
    To Branch a/c

IV. When Goods are Sent to Branch:

Branch a/c Dr
    To Goods Sent to Branch a/c

V. When Goods are Returned by Branch:

Goods Sent to Branch a/c Dr
    To Branch a/c

VI. When cheque (or) Draft is sent for Branch Expenses:

Branch a/c Dr
    To Bank a/c

VII. When cheque or draft is received as remittance from branch:

Bank a/c Dr
    To Branch a/c

VIII. For closing balance

Branch stock a/c Dr
Branch petty cash a/c Dr
Branch furniture a/c Dr
    To Branch a/c

Ix. For closing balances of assets:

Branch assets a/c Dr
    To Branch a/c

X. For closing balances of liabilities:

Branch a/c Dr
    To Branch Liabilities a/c

XI. For closing the goods 'sent to branch' a/c

Goods sent to branch a/c Dr
    To trading / purchases a/c

XII. For profit if any in the branch:

Branch a/c Dr
To P&L a/c

XIII. For loss if any in the branch:

P&L a/c Dr
To branch a/c

B. When Goods are invoiced at selling price: (i.e. invoice price method)

Some times head office sends goods to branch at invoice price. The invoice price is also termed as selling price. When the goods are sent at invoice price to the branch, the branch manager will have to sell the goods to the customers at invoice price.

Journal entries

I. For loading in the branch stock at the beginning:

Stock reserve a/c Dr
To branch a/c

II. For loading in the branch stock at the closing:

Branch a/c Dr
To stock reserve a/c

III. For inflation in the goods sent to branch:

Goods sent to branch a/c Dr
To branch a/c

IV. For inflation in the goods returned by branch:

Branch a/c Dr
To goods sent to branch a/c

STOCK AND DEBTORS SYSTEM (Journal Entries):

(i) When goods are sent to branch:

Branch Stock a/c Dr
To Goods sent to Branch a/c

(ii) When goods are returned by branch:

Goods sent to branch a/c Dr
To Branch stock a/c

(iii) When sales are made at branch:

(a) For cash sales:

Cash/Bank a/c Dr
To Branch stock a/c

(b) For credit sales:

Branch Debtors a/c Dr
To Branch stock a/c

(iv) When goods are returned by branch debtors:

Branch stock a/c Dr
To Branch debtors a/c

(v) When cash is received from branch debtors:

Bank/Cash a/c Dr
To Branch debtors a/c

(vi) For discount allowed, bad debts written off, allowances etc. to debtors:

Branch expenses a/c Dr

To branch debtors

(vii) For expenses at branch paid by Head Office:

Branch expenses a/c Dr

To cash/bank a/c

(viii) For loading in the stock at branch in the beginning:

Stock reserve a/c Dr

To Branch adjustment a/c

(ix) For loading in the net amount of goods sent to branch:

Goods sent to branch a/c Dr

To Branch Adjustment a/c

(x) For transferring branch expense account to branch adjustment account:

Branch adjustment a/c Dr

To branch expenses a/c

(xi) For loading in closing stock:

Branch adjustment a/c Dr

To Stock reserve a/c

(xii) For any surplus in branch stock account:

Branch stock a/c Dr

To branch adjustment a/c

(xiii) For any Shortage (or) Spoilage in the branch stock account:

Branch adjustment a/c Dr

To branch stock a/c

(xiv) For closing the goods sent to branch account:

Goods sent to branch a/c Dr

To Trading/Purchases a/c

(xv) The difference in the branch adjustment account is either profit (or) loss:

(a) If profit, the entry is:

Branch adjustment a/c Dr

To (General) Profit and loss a/c

(b) If loss, the entry is

General Profit and loss a/c Dr

To Branch adjustment a/c

Books of Head Office

Branch Account (Nominal Account)

To balance b/d		By Balance b/d	
(Assets at beginning)		(Liabilities at beginning)	xxx
Cash	xxx	By Goods send to branch a/c	
Stock	xxx	(Return)	xxx
Debtors	xxx	By bank a/c (Remittance)	xxx
Furniture	xxx	By Balance c/d (Assets at end)	
To Goods send to branch a/c (send)	xxx	cash	xxx
To bank a/c (expenses)	xxx	Stock	xxx
To balance c/d (closing liabilities)	xxx	Debtors	xxx
To stock reserve (closing stock)	xxx	By Stock Reserve (opening stock)	xxx
To goods send to branch a/c (load) (returned)	xxx	By goods send to branch (send) (load)	xxx
To Profit & loss a/c B/F) Profit	xxx	By profit / loss a/c (B/f) (loss)	xxx
	xxx		**xxx**

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PROBLEMS:

1. The Ram & Company opened a branch at Delhi on 1988. From the following particular prepare Chennai branch account for the year 1987:

	Rs.
Goods sent to branch	15,000
Cash sent to branch for expenses	6,000
Cash received from the branch	24,000
Stock 31.12.1988	2,300
Petty cash in hand	40

2. From the following particulars of Chennai branch for the year ending 31.12.2003, prepare branch A/c in the books of head office

Stock on 1.1.2003	10,000
Debtors on 1.1.2003	20,000
Petty cash as 1.1.2003	1,500
Goods sent to branch at cost	85,000
Cash sent to branch for	
Rent	2,000
Salaries	3,000
Cash sales	50,000
Collection from debtors	30,000
Goods returned by branch to head office	5,000
Stock on 31.12.2003	15,000
Debtors on 31.12.2003	28,000
Petty cash on 31.12.2003	1,000

3. XYZ Mills Ltd opened a branch at Chennai on 1.1.1995. From the following particulars, prepare the necessary accounts for 1995 and 1996 in the books of the Head Office.

	1998	**1999**
Goods sent to branch	15,000	45,000
Cash sent to branch for:		
Rent	1,800	1,800
Salaries	3,000	5,000
Other expenses	1,200	1,600
Cash received from the branch	24,000	60,000
Stock on 31st Dec	2,300	5,800
Petty cash in hand on 31st Dec	40	30

4. Bombay Soap Mills Ltd opened a branch at Bombay on 1.1.1995. From the following particulars, prepare the necessary accounts for 1995 and 1996 in the books of the Head Office.

	1995	**1996**
Goods sent to branch	20,000	50,000
Cash sent to branch for		
rent	2,000	2,000

salaries	2,500	2,550
other expenses	1,000	1,250
Cash received from the branch	30,000	67,500
Stock on 31st Dec	4,000	12,500
Petty cash in hand on 31st Dec	75	125

5. The following information relates to Madurai branch

Stock on 1.1.1994	11,200
Branch Debtors on 1.1.1994	6,300
Goods sent to branch at cost	51,000
Cash sent to branch for:	
Rent	1,500
Salaries	3,000
Petty cash	500
Cash sales	25,000
Credit sales	39,000
Cash Received from debtors	41,200
Stock on 31.12.1994	13,600

6. From the following particulars prepare a branch account showing the profit or loss at the branch.

	Rs.
Opening stock at the branch	15,000
Goods sent to branch	45,000
Sales	60,000
Salaries	5,000
Other expenses	2,000

Closing stock could not be ascertained but it is known that the branch usually sells at cost plus 20%. The branch manager is entitled to a commission of 5% on the profit of the branch before charging such commission.

7.Ram Company Ltd., Bangalore, has a branch at Jaipur to which goods are invoiced at cost plus 30%. The following are the transactions between the Head Office and the Branch for the year ending 31.12.2006.

Stock at the Branch on 1-1-2006	13,000
Sundry Debtors on 1-1-2006	25,000
Petty Cash on 1-1-2006	125
Goods sent to Branch	65,000
Total sales effected during the year	1, 10,000
Cash sales	85,000
Cash received form Branch Debtors	42,000
Expenses incurred by the Branch for the year	11,500
Branch Stock on 31-12-2006	11,500
Petty Cash on 31-12-2006	65

Prepare the necessary journal entries for these transactions and also show how the Branch Account will appear in the books of the Head Office.

8. A head office in Bombay sends goods to its branch at Madras marked 20 percent above cost. From the following particulars show how the branch account will appear in the head office books. Also give

journal entries necessary for the head office to adjust the branch account for arriving a the profit or loss made by the branch.

		Rs			Rs
Stock on 1.7.03 at the branch		1,800	Cheques sent to branch:		
Debtors on 1.7.03 at the branch		3,000	Salary	900	
Petty cash in hand at the branch		30	Rent and Taxes	150	
Goods supplied to the branch		30,000	Petty Cash	110	1,160
Remittance from the branch			Stock at branch on 30.6.04		3,000
Cash Sales	6,000		Debtors at branch on 30.6.04		4,800
Money received from debtors	21,000	27,000	Petty cash at branch 30.6.04		20

9. The Calcutta commercial company invoiced goods to its Jaipur branch at cost. The H.O. paid all the branch expenses from its bank except petty cash expenses which were paid by the branch. From the following details relating to the branch prepare, (i) Branch stock a/c (ii) Branch Debtors a/c (iii) Branch expenses a/c (iv) Branch P&L a/c

Particulars	**Rs**
Stock (opening)	21,000
Debtors (opening)	37,800
Petty cash (opening)	600
Goods sent from H.O.	78,000
Good returned to H.O.	3,000
Cash sales	52,500
Advertisement	2,400
Cash received from debtors	85,500
Stock (closing)	19,500
Allowances to customers	600
Discount to customers	4,200
Bad debts	1,800
Goods returned by customers to branch	1,500
Salaries and wages	18,600
Rent and rates	3,600
Debtors(closing)	29,400
Petty cash (closing)	300
Credit sales	85,200

10. The head office of Charan Ltd at Chennai, has a branch at Tirupur and sends goods at cost price. The following details are relating to the branch. (i) Branch stock a/c (ii) Branch Debtors a/c (iii) Branch expenses a/c (iv) Branch P&L a/c

Particulars	**Rs**
Stock (opening)	10,000
Debtors (opening)	30,000
Petty cash (opening)	800
Goods sent from H.O.	50,000
Good returned to H.O.	5,000
Cash sales	40,000
Cash from debtors	20,000
Allowances to customers	500
Credit sales	45,000
Discount to customers	800

Bad debts	200
Goods returned by customers	2,000
Salaries	12,000
Rent and rates	4,000
Debtors(closing)	51,500
Closing stock	8,000
Closing petty cash	500
Other expenses	2,000

11. A Head Office at Bhopal invoices goods to its branch at Indoor at cost, and the branch sells the goods not only the cash but on credit also. The expenses of the branch are paid by the Head office. From the following particulars relating to the branch opened on 1.1.1996. Prepare the necessary accounts under stock and debtors system in the head office books.

Particulars	**Rs**
Goods sent to be at cost	5,000
Goods returned by the branch at cost	300
Expenses paid by the H.O.	1,000
Remittance from branch	4,200
Receipts from debtors not paid in by branch	300
Credit sales	5,200
Discount allowed to customers	180
Cash sales	250
Branch stock (31.12.1997)	1,700
Branch debtors (31.12.1997)	770

12 B.K Ltd opened a new Branch at Baroda on 1st Jan where goods are sent by H.O at 25% above cost. All expenses at Branch are met from Branch cash and the balance remitted to H.O Branch sells goods both for cash and credit. From the following particulars, prepare the necessary accounts in the books of H.O and ascertain the profits or loss made by branch for the ended 31st Dec assuming that the Branch does not maintain double entry books of accounts:

Cost of goods sent to Branch	1, 00,000
Goods received by Branch till 31st Dec (Invoice Price)	90,000
Normal loss during transit (at invoice price)	5,000
Debtors on 31st Dec	10,000
Cash at Branch on 31st Dec	4,000
Cash remitted to H.O	90,000
H.O remitted cash to Branch	5,000
Expenses paid by H.O	10,000
Credit sales	95,000
Bad Debts and Allowances to customers	1,000
Closing Stock at Invoice Price	20,000

13 The Bright Trading Company Ltd. Invoices goods to its Delhi Branch t cost plus 25%. Both cash and credit sales are effected by the Branch. Branch expenses are paid direct from Head Office, all cash received by the Branch being remitted to Head Office. The following are the details for the transactions for the six months ended on 30th Sep 2005:

Goods received from the Head Office at Invoice Price	20,000
Returns to Head Office at Invoice price	500
Stock at Invoice Price on 1.4.05	5,000
Credit sales for the half year	11,000

Debtors on 1.4.05	3,800
Bad Debts written off	300
Rent, Rates etc	240
Salaries and Wages	800
Sundry Expenses	120
Sundry Debtors on 30.09.05	2,540
Stock at Invoice Price on 30.09.05	4,000
Returns from customers	200
Discounts allowed to customers	160
Cash received on ledger accounts	11,600
Cash Sales for the half year	10,800

Record the above transactions in the Head Office books and close the accounts concerned at 30th Sep 2005.

14 Corkwood Industries, Mumbai has a Branch at Mangalore to which office goods are invoiced at cost plus 25%. The Branch makes sales both for cash and on credit. Branch expenses are paid direct from Head Office and the Branch has to remit all cash received into the Head Office Bank Account at Mangalore.

From the following details, relating to calendar year 2005, prepare the accounts in the Head Office ledger and ascertain Branch profits. Branch does not maintain any books of account, but sends weekly returns to Head Office.

	Rs
Goods received from Head Office at invoice price	60,000
Returns to Head Office at invoice price	1,200
Stock at Mangalore Branch on 1st Jan 2005	6,000
Sales in the year for cash	20,000
Sales in the year against credit	36,000
Sundry Debtors at Mangalore on Jan 2005	7,200
Cash received from Debtors	32,000
Discount allowed to Debtors	600
Bad debts in the year	400
Sales returns at Mangalore Branch	800
Rent, Rates and Taxes at Branch	1,800
Salaries, Wages and Bonus at Branch	6,000
Office Expenses	600
Stock at branch pm 31st Dec 2005	12,000

15. Simyon Bros. of Cochin have a branch at Kotayam. Goods are sent to the branch at cost plus 50%. From the following information, prepare (a) Branch expenses (b) Branch stock A/c and c) Branch adjustment A/c

Stock on 01.01.2005 at invoice price	90,000
Goods sent to branch at invoice price	2,70,000
Branch expenses:	
Salaries	3,000
Rent	1,800
Other expenses	6,000
Depreciation	1,800
Cash sales	75,000
Credit sales	2,40,000
Stock on 31.12.2005 at invoice price	45,000

16. A head office invoices goods to its branch at cost plus 50%. Branch remits all cash received to the head office and all expenses are met by the H.O. From the following particulars, prepare the necessary accounts on the stock and debtors system to show the profit or loss at the branch.

	Rs
Stock on 01.01.2009(at invoice price)	27900
Debtors on 01.01.2009	20400
Goods invoiced to the branch (at invoice price)	153000
Cash sales	75000
Credit sales	93000
Cash collected from debtors	91200
Goods returned by debtors	3600
Goods returned to H.O by branch	4500
Shortage of stock	1350
Discount allowed	600
Expenses at the branch	16200
Bad debts	600

17. A Bombay had office sent goods to Madras branch at 25% profit over cost. From the following details, prepare the necessary ledger accounts in the books of head office under stocks debtors system.

Particulars	Rs.
Opening stock of goods at branch at invoice price	20,000
Goods sent to branch at invoice branch	90,000
Loss of goods in transit at invoice price	6,000
Pilferage at branch at the cost of branch	1,200
Closing stock at branch at its cost to branch	16,000
Sales at branch	1,05,000
Salaries and wages at branch	6,000
Other expenses at branch	3,000

Madras branch received Rs.4, 000 from the insurance company in settlement of the claim for the loss of goods in transit.

18. A head office has its branches at Lucknow and Jaipur. The head office sent goods to the branches at invoice price which was cost plus 25%. Sales are made only at the branches which remit all cash received to head office. From the following details, prepare the branches' stock and stock adjustment A/c's and goods sent to branches A/C's as they would appear in the Bombay books.

Particulars	Lucknow Branch Rs.	Jaipur branch Rs.
Goods from head office at invoice price	40,000	25,000
Returns to head office at invoice price	600	500
Cash sales	19,000	17,500
Credit sales	12,000	9,500
Stocks – 1st Jan	6,000	8,000
Stocks – 31st Dec	18,000	11,000

DEPARTMENTAL ACCOUNTS

Introduction and Meaning:

When a business sells different types of goods or carries on several activities under one roof, it is generally split up into a number of departments. Each department may deal in a particular class of goods or render a specialized type of service. This is generally done to have smooth and efficient running of business.

What is mean by Departmental Accounting?

When accounts are finalized at the end of the year, the usual method of trading and profit & loss account is not suitable for such organizations. The owner or the management may desire to ascertain the trading results of each department and the overall result of the organization. The method of accounting followed to obtain such results is known as 'departmental Accounting'.

WHAT ARE THE NEED/CAUSES/REASONS/OBJECTIVES FOR PREPARING DEPARTMENTAL ACCOUNTS?

1) **Ascertaining the trend:** It is possible to compare the results of each department with the results of previous years and ascertain the trend of the business whether the business is in progress or not.
2) **Comparative results:** The various department results may be analyzed in the same year and proper steps are to be taken to improve the efficiency of each department.
3) **Assess stock position:** The stock position of each department may be assessed accurately which will help the management to know the exact profit earned by each department
4) **Identify areas of weakness:** It helps to locate the weak areas of branches immediately and help them to control the cost and improve their efficiency.
5) **Decision making:** The management needs some information about individual departments to frame policy matters and some wise decisions. It will also help them to decide upon expansion, discontinuation and investment policies.

LOGICAL APPORTIONMENT / BASIS ALLOCATION OF COMMON EXPENSES TO DIFFERENT DEPARTMENTS:

EXPENSES	BASIS OF APPORTIONMENT
1.All Expense relating to building like Rent and Rates, taxes, Repairs to buildings, Maintenance of Premises, Building insurance, Depreciation etc.	Floor area (or) Space occupied by each department.
2. Selling expenses like sales commission, salesmen's salaries, advertising, bad debts, carriage outwards etc.	Sales (or) Turnover ratio of each departments.
3. Depreciation, Renewals and Repairs of fixed assets.	Value of Assets in each department.
4. Lighting and Heating	Light points or floor area occupied in each department.
5. Carriage Inward	Purchase Value.
6. Insurance Premium: (i) Insurance premium for stock (ii) Insurance premium for premises (iii)Insurance premium for workmen's	 (i) Value of stock (ii) Area Occupied (iii) Wages of each department.

Compensation.	
7. Power	Horse power of the machines and the working time in hours (Or) days.
8. Advertisement	Advertisement space
9. Workmen's amenities and welfare expenses.	Number of workers in each department.
10. ESI, PF etc. payable by employer	Wages of each department.
11. Factory manager's salary	Time devoted to each department.
12. Premium for the loss of profits insurance.	Profits of each department in the previous year.

DISTINCTION BETWEEN DEPARTMENTS AND BRANCHES

S.NO	DEPARTMENT	BRANCHES
1.	All the departments are located within single premises.	Branches are located in different geographical areas, physically separated from the head office and one another.
2.	All the accounting records are centralized and maintained within the same premises for all the departments.	Branches keep records of their operations separately. The head office consolidates the accounts of all the branches.
3.	All adjustment and reconciliation of accounts does not arise in departmental accounts.	In case of independent branch some adjustments and reconciliation of H.O and the branch accounts are required to be done at the end of the year.
4.	The problem of conversion of foreign currency into home currency does not arise.	The problem of conversion of foreign currency into home currency does arise.

METHODS AND TECHNIQUES OF DEPARTMENTAL ACCOUNTING.

(1) TRADING AND PROFIT AND LOSS A/C:

When accounts are finalized, departmental, trading and profit and loss account is prepared in columnar form to find gross profit and net profit of each department. A general profit and loss account is also prepared to find the overall profit (or) loss of the firm. The balance sheet is common and shows the position of the business as a whole.

(2) MAINTENANCE OF RECORDS:

Firms with huge turnover and large number of transactions can maintain separate subsidiary books for each department. In the ledger separate accounts are opened for sales, purchase, wages, cash etc. of each department. Closing stock can be separately ascertained at the time of stock taking.

(3) DEPARTMENTALIZATION OF EXPENSES:

In order to find out profit (or) loss of each department apart from sales, purchases, returns and stocks, various expenses must be charged to the departments appropriately. Business expenses are usually divided into two types:

(i) Direct Expenses and
(ii) Indirect Expenses

(i) Direct Expenses:

Expenses which can be directly identified with or incurred for particular departments are called direct expenses. Ex. Wages, Carriage Inwards, salary of the department staff, insurance of stock etc.

(ii) Indirect Expenses:

Expenses which cannot be identified with a particular department but incurred for their common benefit are called indirect expenses. Indirect expenses are further sub-divided into:

(a).Expenses which cannot be apportioned

(b).Expenses which can be apportioned

(a) Expenses which cannot be apportioned:

Expenses which have no connection with the departments or those which have no reasonable basis for apportionment must be shown in the general profit and loss account. Any forced division of such expenses will distort the results of the departments unnecessarily.

Examples:

Debenture interest, income-tax, dividends paid, director fees, bank charges, legal expenses etc.

(b) Expenses which can be apportioned:

All indirect expenses which are amenable for division on some logical or appropriate basis among the departments should be charged to the departments after dividing them on a suitable basis.

Examples:

Selling expense, salaries, rent, depreciation, lighting, power, repairs etc.

(4) Inter-Departmental Transfers:

Goods may be transferred from one department to another. Similarly, services of one department may be used by another department. In such cases, the transfer may be made at cost price or at usual selling price.

(a) Inter-Departmental transfer at cost price:

For the department which receives the transfer, it is like a purchase or expenditure. The trading account of the receiving department is debited with the value of the transfer. The department which makes the transfer, it is like a sale or an income. The trading account of transferring department must be credited with the amount of transfer.

(b) Inter-Departmental transfer at selling price (or) Loaded price:

When goods or services are transferred at a price above cost, the receiving department must be debited with the amount of transfer in the departmental trading account and the transferring department must be credited in the department must be credited in the departmental trading account with the same amount.

(5)Stock Reserve:

If a part of the goods transferred is still in the closing stock of the receiving department at the time of finalization of accounts, provision must be made for unrealized profit in the stock of the receiving department.

WHAT ARE THE ADVANTAGES OF DEPARTMENTAL ACCOUNTING?

1) **Calculation of profit**: Gross profit and net profit can be ascertained for each department on a reliable basis by preparing the final accounts in columnar form
2) **Comparison**: The results of different departments can be compared in terms of Profit, expenses, and return on investment etc. which will be useful to improve further.
3) **Individual responsibility**: Individual who is responsible for improved results or decline in performance can be identified. Promotions and other extra benefits can be provided on the basis of efficiency of individual concerned in a particular department.
4) **Identification of poor performance:** Areas of poor performance can be identified for implementing remedial measures. If possible they can be improved to earn some profit or they may be permitted to close immediately to avoid further losses.

5) **Wise decisions**: Decision to expand or discontinuance and diversify profitable lines of business becomes easier. It can be possible only by way of referring the final accounts of last few years.
6) **Helps the management**: Management policies towards inventories extending credit, additional investments etc are facilitated. They may concentrate on those departments which give maximum profit.

PROBLEMS:

1. From the following details, prepare departmental trading accounts.

Particulars	Department A	Department B
Opening stock	9000	8400
Total purchases	27000	21600
Total sales	42000	36000
Closing stock	10800	4800
Credit purchase	17000	10600
Credit sales	5000	6000

2. Shailesh mishra of Raj Nagar purchased goods for his three departments as follows:

Department A – 200 Pieces
Department B - 1400 Pieces Total Cost Rs.5, 100
Department C – 400 Pieces

Sales of three departments were as follows:

Department A 180 Pieces at Rs.15 per piece
Department B 1500 Pieces at Rs.18 per piece
Department C 450 Pieces at Rs.6 per piece

Other information about stock in the beginning was as follows:

Department A 100 pieces
Department B 400 pieces
Department C 60 pieces

Mehta Ram informs you that the rate of gross profit is the same in all departments. You are required to prepare trading account for the three departments.

3) The following purchases were by a business house three departments:

Dept X 1,000 units
Dept Y 2,000 units at a total cost of Rs 1, 00,000
Dept Z 2,400 units

Stock on Jan 1 were

Dept X 120 Units
Dept Y 80 units
Dept Z 152 units

The sales were

Dept X 1,020units at Rs 20 each
Dept Y 1,920 units Rs 22.50 each
Dept Z 2,496 units Rs 25 each

The rate or gross profit is the same in each case. Prepare the department trading accounts.

4. Following is The Profit And Loss A/C of Hindustan Electronics For The Year Ending 31-3-94.

Particulars	Rs	Particulars	Rs
Purchases Transistors (x)	 160000	Sales Transistors (x)	175000
Tape recorders (y)	125000	Tape recorders (y)	140000
Repairs (z)	80000	Repairs (z)	35000
Salaries and wages	48000	Stock st 31-3-94 Transisiters (x) Tape recorders (y) Repairs (z)	 60100 20300 44600
Sundry expenses	11000		
Rent	10800		
Profit	40200		
	475000		**475000**

Additional information

1. Tran sisters and tape records have been sold in showroom and repairs are made in the factory.
2. Apportionment of salaries and wages i.e. showroom ¾ and factory ¼ salaries and wages of showroom are to be divided in 1:2 ratio in x and y departments.
3. Rent of factory is rs.500p.m. Rent of showroom is apportioned equally in x and y departments.
4. Sundry expenses are apportioned in the sales ratio of the departments.

5. The following information is given by balan, a merchant, for the year ended 31-12-96

Particulars	Amt	Particulars	Amt
Sales dept I Dept II	70000 30000	Purchase dept I Dept II	43000 25000
Stock 1-1-96 Dept I Dept II	 3400 1100	Salary	5400
Debtors	23000	Commission	2200
Office furniture	1080	Advertisement	5800
Rent	1800	Bank charges	120
Insurance	2400	Stationery	2700
		Wages	10000

Provide depreciation at 10% on furniture. Bad debts rs.300. Create 10% provision for discount on debtors. Stock position on 31-12-96: dept I rs.4000 and dept II rs. 1680. From above particulars prepare the departmental trading and profit and loss account .expenses is allocated on the basis of sales.

6. X ltd, carries on his business through five departments A,B,C,D and E. The following information for 2007 is made available to you

Particulars	Rs.
Salaries and Commission	22,040
Rent and Rates	5,800
Insurance premium	2,320
Miscellaneous Expenses	5,220

The opening stock and closing stock have been valued at cost. All these expenses chargeable to each department in proportion to the cost of articles sold the respective department. The following balances in as at 31.12.2007 were ascertained

Particulars	A	B	C	D	E
Opening stock at branch	20,000	12,000	30,000	16,000	18,000
Purchases	2,00,000	1,20,000	40,000	1,04,000	1,20,000
Sales	1,92,000	1,24,000	38,000	92,000	1,20,000
Closing stock	46,000	16,000	12,000	4,000	22,000

Show the final result and the percentage on sales in each department and also combined result with percentage to sales.

7. Giridhani limited has three departments A,Band C from the particulars given below compute:

a) the values of stock as on 31st Dec 2000 and
b) the departmental trading results

	A	B	C
Stock as on 1st Jan 2000	24,000	36,000	12,000
Purchases	1,46,000	1,24,000	48,000
Actual sales	1,72,500	1,59,400	74,600
G.P on normal selling prices	20%	25%	331/3%

ii) During the year certain items were sold at discount and these discounts were reflected in the values of sales shown above. The items sold at discount were:

	A	B	C
Sales at normal prices	10,000	3,000	1,000
Sales at actual prices	7,500	2,400	600

8. A, B and C are in partnership in a business with two departments X and Y Dept. X is managed by B and Dept Y by C

B is entitled to a salary of Rs 500 p.a and to 30% of the net profits of his department after charging his salary and interest at 10% p.a on the average net assets (exclusive of cash) of the department while C is entitled to a similar salary and percentage of the Y Dept profits.

Interest at 5% p.a is allowed on partner’s capital accounts but not charged on drawings.

The balance of profits is divisible as to ½ to A 3/10 to B and 1/5 to C

The following is the summarized list of balances as on 31st July 2005 after closing the profit and loss accounts of the departments.

	Debit	Credit
Capital and drawing Accounts:		
A	3,000	20,000
B	1,750	8,000
C	1,400	6,000
Assets (other than cash) and liabilities:		
Dept X	9,380	1,220
Dept Y	7,210	950

Profit for the year to 31st July 2005:

Dept X (before charging salary)		3,190
Dept Y (before charging salary)		2,760
Cash	4,265	

It was reported that net assets at Dept X have increased during the year by Rs 520 and at Dept Y by Rs 320. You are required to prepare a statement showing the division of profit between partners.

9. The following Trial balances for the year ended 31st March 2000 was extracted from the books of Shri Ram Singh:

	Debit	Credit
Capital on 1-4- 99		50,000
Drawings account	10,000	
Stock on 1-4-99		
Radios	45,000	
Watches	21,000	
Sales:		
Radios		2, 94,000
Watches		1, 46,000
Purchases:		
Radios	2, 25,000	
Watches	1, 15, 000	
Salaries	12,600	
Publicity expenses	8,900	
Rent, Rates & Taxes	3,200	
Commission	10,600	
Miscellaneous expenses	5,000	
Furniture and fixtures	12,400	
Sundry debtors	16,800	
4% Government of India loan	10,000	
Sundry creditors		8,800
Interest		400
Provision for bad and doubtful debts		800
Cash balance	4,500	
	5,00, 000	5, 00, 000

10. On 31-12-95 the trial balance of shyam a merchant was extracted and from it the following balances were taken:

Particulars	Amt	Particulars	Amt
Stock 1-1-95 Dept x Dept y	 14000 10000	Sales Dept x Dept y	 52000 26000
Purchase Dept x Dept y	 20000 16000	Inter dept transfer Dept y	 1000
Inter dept transfer			

Dsept x	1000		
Return inward : Dept x Dept y	 800 1200		
Rent,rates and taxes	2000		
General expenses	2400		
Salaries	2200		
Carriage inward	1800		
Wages : Dept x Dept y	 4000 3600		

Make out departmental account6s for the year ended 31-12-95b from the above information assuming that the departments occupy similar floor.

11). From the following information, prepare departmental trading and profit and loss a/c in a columnar form of the three departments of Ashok dry cleaners Ltd.

Particulars	Dry cleaning	Darning	Dyeing
Stock on 1.1.96	4,00,000	3,40,000	9,40,000
Stock on 31.12.96	3,30,000	4,38,000	8,17,000
Purchases	19,59,000	6,97,000	13,73,000
Sales	40,00,000	20,00,000	40,00,000
Wages	7,28,000	3,00,000	2,46,000

Goods were transferred from one dept to another at cost price as follows:

i) Darning to dry cleaning Rs.2400 and to darning Rs.40200
ii) Dyeing to dry cleaning Rs.25800 and to darning Rs.18000
iii) Dry cleaning to darning Rs.3000 and to dyeing Rs.24000

Apportion equally :

Stationery	rs.5418
Postages	rs.4050
General expenses	rs.237618
Insurance	rs.10080
Depreciation	rs.32598

Rent & rates Rs.180000 is to be split in proportion to space occupied (i.e.) dry cleaning 4, darning 2, dyeing 2, and other space 2.

12. Green & Co. has two departments P and Q. Department P sells goods to department Q at normal selling prices. From the following particulars prepare departmental Trading and profit and loss account for the year ended 31.03.2010 and also ascertain the net profit to be transferred to Balance sheet.

Particulars	Dept P	Dept Q
Opening stock	1,00,000	NIL
Purchases	23,00,000	2,00,000
Sales	23,00,000	15,00,000
Goods from Department P	----	7,00,000

Wages	1,00,000	1,60,000
Traveling expenses	10,000	1,40,000
Closing stock at cost to the department	5,00,000	1,80,000
Printing and stationary	20,000	16,000

The following expense incurred for the both the departments were not apportioned between the departments:

a). Salaries Rs.2,70,000

b). Advertisement expenses Rs. 90,000

c). General expenses Rs. 8,00,000

d). Depreciation @ 25% on the machinery value of Rs.48, 000. Advertisement expenses are to be apportioned in the turnover ratio. Salaries in 2:1 ratio and depreciation in 1:3 ratios between the departments P and Q. General Expenses are to be apportioned in 3:1 ratio.

13. A firm had two departments, cloth and readymade garments. The garments were made by the firm itself out of cloth supplied by the cloth department at its usual selling price. From the following figures, prepare the departmental trading and profit and loss account fort the year ended 31-3-94

Particulars	Cloth dept	Readymade dept
Opening stock on 1-4-93 Purchase sales	300000 2000000 2200000	50000 15000 450000
Transfer to readymade garments dept	300000	Nil
Expenses-manufacturing -selling	20000	6000
Stock 31-3-94	200000	60000

The stock in the readymade garments department may be considered as consisting of 75% cloth and 25% other expenses. The cloth department earned gross profit @ 15% in 1992-93.general expenses of the business as a whole came to rs.110000

UNIT II
SINGLE ENTRY SYSTEM

INTRODUCTION:

Business people, without systematic accounting knowledge, follow single entry system of accounting. Single entry does not mean that there is only one entry for each transaction. Infact, it is a combination of (a) Double entry for some transactions (b) Single entry for some transactions and (c) No entry for some transactions.

MEANING:

There is no system of accounts called single entry system. The term single entry is vaguely used to refer to any method of maintaining accounts which does not conform to strict principles of double entry.

DEFINITION:

According to R.N.Carter, "Single entry cannot be termed as a system, as it not based on any scientific system, like double entry system. For this purpose, single entry is now – a – days known as preparation of account from incomplete records".

DIFFERENCE BETWEEN SINGLE ENTRY AND DOUBLE ENTRY SYSTEM

S.no	BASIS	DOUBLE ENTRY SYSTEM	SINGLE ENTRY SYSTEM
1.	**Recording of Transaction**	Both debit and credit aspects of all transactions are recorded.	In some cases both aspects and in some others a single aspect (or) no aspect is recorded.
2.	**Opening of Accounts**	All personal, real and nominal accounts are opened.	Only personal and cash accounts are opened.
3.	**Preparation of Trial Balance**	Trial balance can be prepared	Trial balance cannot be prepared
4.	**Ascertaining Profit and Loss**	Accurate profit (or) loss can be found by preparing trading and profit and loss account.	Accurate profit (or) loss cannot be found due to the absence of trading and profit and loss account.
5.	**Revealing financial Position**	Reliable financial position can be found through balance sheet.	Balance sheet cannot be prepared. So it is difficult to ascertain the financial position
6.	**Acceptability**	Acceptable for income tax and other tax purposes, for raising of bank loans etc.	Not acceptable for taxation, claims, raising of loans.
7.	**Acceptable Evidence**	In case of disputes, accounting records can be produced in courts of law.	The accounting records are not acceptable as evidence.
8.	**Utility**	Suitable for any type of business of any size.	It can be followed by small businessmen who can exercise personal control over the business.
9.	**Internal Check**	Internal check is possible	Internal check is not possible.

CHARACTERISTICS OF SINGLE ENTRY SYSTEM:

The following are the important features of the single entry system.

(i) Absence of uniformity:

It is not a specific system governed by definite rules of operation. It is highly flexible according to the capabilities of individuals maintaining the records.

(ii) Records maintained:

Usually personal accounts are fully written and cash book is also maintained. Normal accounts and most of the real accounts completely omitted.

(iii) Mixing of transactions:

Business dealings as well as personal transactions are mixed while writing the cash book.

(iv) Suitability:

Sole traders, partnership firms and professional who cannot afford a paid book keeper usually follow this method to write their own account joint stock companies have to follow double entry system under the provisions of companies Act'1956.

(v) Dependence on original vouchers:

No entries are made for a large number of transactions. For Ex. Credit purchases and sales have to be ascertained from the copies of invoices.

(vi) Finalization of accounts:

Regular final accounts cannot be prepared. Profit and loss can be computed in a crude way, which is not reliable.

ADVANTAGES OF SINGLE ENTRY SYSTEM:

(i) Less Expensive Method:

Single entry system involves less labour and less expensive because only a few books of accounts are maintained.

(ii) Suitability:

It is more suitable for small concerns, which are having few business transactions regularly. It can implement only in those concerns where proper control is also possible.

(iii) Convenience of Owner:

Accounting records are maintained as per the convenience of owners and size of the business concern.

(iv) Net Profit:

Net profit of the business concern can easily be calculated by comparing the closing capital with that of opening capital.

(v) Statement of Affairs:

Estimated assets and liabilities can be finding out by preparing statement of affairs which is just like balance sheet.

(vi) Few Accounts Only:

Only personal and cash accounts are maintained by the businessman. If the businessman is relieved form maintaining so many books of accounts, which leads to confusion. So, it is best for a businessman.

ASCERTAINMENT OF PROFIT:

When business records are incomplete, profit or loss can be found through any one of the following methods.

1. Networth method.(Statement of affairs method).

2. Conversion method.

1. Networth method.(Statement of affairs method):

1.MEANING OF STATEMENT OF AFFAIRS METHOD:

The statement of affairs is prepared out of the information obtained under the single entry system. This statement is a list of assets and liabilities on a particular date. The value of these assets and liabilities are only the estimates made by the owners and not the balances brought from the accounts. Therefore, the statement is called as statement of affairs and not as balance sheet. By this statement, the financial position of a concern can be ascertained to a certain extent. The excess of assets over the liabilities shown in this statement should be taken as capital.

Under this method the capital contributed by the owner in the beginning of an accounting year is compared with the capital at the end of the year and the result is called profit (or) loss of the business.

DIFFERENCES BETWEEN BALANCE SHEET AND STATEMENT OF AFFAIRS:

BASIS	BALANCE SHEET	STATEMENT OF AFFAIRS
1. Basis of Preparation	Balance sheet is based on all ledger account balances.	Statement of affairs is prepared from balances, valuations,

		information inquiry etc.
2. System of Accounting	It can be prepared only when double entry system is followed.	It is prepared in single entry system.
3. Trial Balance	Trial balance is prepared before preparing a balance sheet.	Statement of affairs has no foundation like trial balance.
4. Omission	Omission of any assets and liabilities is automatically found in balance sheet.	Statement of affairs cannot reveal any omissions.
5. Financial Position	It reveals the exact financial position of a business.	It shows only estimated financial position.

<u>Following the procedures is to be followed for ascertaining profit or loss under Networth Method:</u>

In order to calculate the capital on a particular date, we have to prepare a statement just like a balance sheet, which is called statement of affairs.

<u>Step: 1 Calculating Opening Capital:</u>

Opening capital can be found by preparing a statement of affairs at the beginning of the year. A statement of affairs is just like a balance sheet. Assets are shown on the right hand side and liabilities are shown on the left hand side of the statement of affairs. The differences between both the sides representing **'Opening Capital'.**

<u>Step: 2 Ascertainment of Drawings during the year:</u>

This is difficult task in most of the cases because cash book may show a part of the withdrawals only. Money may be used for personal purposes out of sale proceeds and the balance only may be recorded in cash book or deposited in the bank.

<u>Step:3 Ascertaining Capital Introduced During the Year:</u>

Additional capital provided by the owner during the year may be in cash or in the form of assets or goods. The total amount must be recorded, in whatever form it was brought in.

<u>Step:4 Computing Closing Capital:</u>

Closing capital can be found by preparing a statement of affairs at the end of the year, in the same way as opening statement was prepared. However, all adjustments relating to depreciation, provision for doubtful debts etc., must be made in the closing statement of affairs which were not necessary in the opening statement.

Specimen Statement showing Profit (or) Loss:

closing capital		xxx
<u>Add:</u>		
Drawings		xxx
		xxx
<u>Less:</u>		
1.Additional capital introduced	xxx	
2.Opening capital	xxx	xxx
Net profit (or) loss for the year		xxx

1. Conversion method:

MEANING:

The process of collecting, computing and recording missing information along with the available data in the incomplete books of a business is called **'Conversion Method'.** Once the books are 'converted', all future transactions can be recorded as per 'Double Entry System'.

Need for Conversion:

The net worth method does not provide a clear picture of the operating results of a business. It does not show sales, purchases, gross profit, operating expenses etc. so it is not possible to make a meaningful analysis of the financial statements and initiate effective steps to improve the financial position of the business.

PROCEDURE FOR ASCERTAINMENT UNDER CONVERSION METHOD OF SINGLE ENTRY SYSTEM:

This method is useful for the preparation of final accounts when single entry system is followed. Before preparing the trading, profit and loss account and the balance sheet. Under this method the following procedure should be adopted.

(i)Opening statement of affairs is to be prepared to find out the opening capital.

(ii)Cash book should be prepared and the difference in the cash book is to be taken as missing figures such a opening (or) closing cash balance (or) cash sales (or) cash purchases as the case may be.

Table showing the accounts to be prepared to find out the missing information:

Name of the account	**Missing information**
Total debtors a/c	Opening debtors or closing debtors or amount received from debtors
Total creditors a/c	Opening creditors or closing creditors or amount paid to creditors
Bills Receivable a/c	Opening or closing bills receivables or B/R received during the year
Bills Payable	Opening or closing bills payable or B/P accepted during the year
Cash a/c Bank a/c	Opening or closing cash or bank balance or cash sales or cash purchases
Opening or closing balance sheet	Opening or closing capital
Memorandum trading a/c	Closing stock

Thus the procedure can be summarized for calculating profits:

1) First prepare statement of affairs at the beginning for calculation of capital in the beginning.
2) Second, prepare statement of affairs at the end for calculating capital in the end.
3) Adjust the capital at the end by adding drawings and deducting therefrom capital introduced during the year.
4) From the adjusted capital at the end deduct capital in the beginning. This difference is either a profit (or) loss.

CALCULATION OF MISSING FIGURES BY PREPARING NECESSARY LEDGER ACCOUNTS:

I) PREPARATION OF TOTAL DEBTORS ACCOUNT:

PROFORMA OF A TOTAL DEBTORS A/C

	Rs.		**Rs.**

To balance b/d (opening balance)	xxx	By cash received (either given or balancing figure)	xxx
To B/R (dishonored)	xxx	By bank	xxx
To freight (charged)	xxx	By B/R	xxx
To interest on overdue a/c	xxx	By discounts	xxx
To cash (refund for return)	xxx	By return inwards	xxx
To credit sales if given (if not given, balancing figure is credit sales)	xxx	By bad debts	xxx
		By transfer to creditors	xxx
		By balance c/d (closing balance)	xxx
	xxx		xxx

A total debtor's account is to be prepared to find out the missing items of credit sales or closing debtors or opening debtor or cash collected from debtors.

II) PREPARATION OF TOTAL CREDITORS ACCOUNT:

PROFORMA OF A TOTAL CREDITORS A/C

	Rs.		Rs.
To cash paid (either given or balancing figure)	xxx	By balance b/d (opening balance)	xxx
To bank	xxx	By cash (refund for returns etc.)	xxx
To B/P	xxx	By B/P dishonored	xxx
To returns outwards	xxx	By credit purchases (either given or balancing figure)	xxx
To discount received	xxx		
To allowances& rebates	xxx		
To transfer from debtors	xxx		
To balance c/d (closing balance either given or balancing figure)	xxx		
	xxx		xxx

A total creditor's account is to be prepared to find out the missing items of credit purchases or closing creditors or opening creditors or cash paid to creditors.

III) PREPARATION OF BILLS RECEIVABLE ACCOUNT:

PROFORMA OF A BILLS RECEIVABLES ACCOUNT

	Rs		Rs
To balance b/d (opening balance) (either given or b/f)	xxx	By cash (on presentation of bills)	xxx
To sundry debtors (B/R received during the year) (either given or balancing figure)	xxx	By sundry debtors (B/R dishonored)	xxx
		By balance c/d (closing balance) (either given or balancing figure)	xxx
	xxx		xxx

A bills receivable account is to be prepared to find out the missing items of opening bills receivable or closing bills receivable or bills receivable received or bills receivable collected.

IV) PREPARATION OF BILLS PAYABLE ACCOUNT:

PROFORMA OF A BILLS PAYABLE ACCOUNT

	Rs		**Rs**
To cash	xxx	By balance b/d (opening) (either given or balancing figure)	xxx
To sundry creditors (B/P dishonored)	xxx	By sundry creditors (bills accepted) (either given or balancing figure)	xxx
To balance c/d (closing) (either given or balancing figure)	xxx		
	xxx		xxx

A bills payable account is to be prepared to find out the missing items of opening bills payable or closing bills payable or bills payable issued or bills payable honoured.

V) CALCULATION OF OPENING AND CLOSING STOCK:

Memorandum trading account reveals any one them, if gross profit ratio is known. **(OR)**

Opening stock = Cost of goods sold + closing stock – purchases.

Closing stock = Opening stock + Purchases – Cost of goods sold.

<u>PROBLEMS ON NET WORTH METHOD / STATEMENT OF AFFAIRS METHOD:</u>

1. From the following facts, find out profit or loss of Mr. A

Capital as at 1.1.99	300000
Capital as at 31.12.99	500000
Further capital introduced at the end of the year	100000
Drawings during the year	150000
Interest on capital at 10% p.a	
Interest on drawings at 6% p.a	

2. Suresh started business with Rs.25000 as capital on 1.1.94. During the year he has withdrawn at Rs.600 p.m . He has sold his wife's jewel for Rs.4000 and introduced the same as additional capital to the business. His position on 31.12.94 was as follows:

Bank	2000	Stock	20000
Debtors	12000	Furniture	500
Cash	500	Sundry creditors	6000
Expenses outstanding	400		

He keeps his books under the single entry method. Determine his profit or loss for the year.

3. Parkash keeps books by the single entry method. His position on 31.12.87 and 31.12.88 was follows:

Particulars	**1987**	**1988**
Cash in hand	200	300
Cash at bank	3000	2000

Stock in trade	20000	19000
Sundry debtor	8500	14000
Furniture	1800	1500
Plant	15000	27000
Sundry creditor	22000	29000

During the year prakash introduced Rs 5000 as further capital and withdrew rs.750 per month. From the above, prepare a statement showing the profit or loss made by him for the year ended 31.12.1988

4. The following is the statement of affairs of Mr.Ragulmohit as on Dec.31, 2002 who kept his books on the single entry system:

Statement of Affairs

Liabilities	**Amount**	**Assets**	**Amount**
Creditors	8000	Fixtures	4000
Capital	62750	Stock	28000
		Debtors	35600
		Cash at bank	3150
	70,750		**70,750**

His capital on 31.12.2001 was Rs.42,960. He transferred to his personal account form the bank account of the firm Rs.500 every month during the year and took for private use, stock worth Rs.300. He sold his house for Rs.10,000 during the year and introduced the proceeds into the business. Depreciation on fixtures at 5% and provision for doubtful debts at 2.5% are to be provided.

Prepare the statement of profit of Mr.Ragulmohit and redraft the statement of affairs as on Dec 31,2002.

5. The following are the assets and liabilities of A at the end and beginning of the year 2010

Assets and liabilities	**31.12.2010**	**1.1.2010**
Land and Building	58,800	60,000
Plant and Machinery	1,20,000	96,000
Furniture and fixtures	16,200	16,000
Stock in trade	56,000	30,000
Sundry Debtors	3,10,000	2,80,000
Sundry Creditors	1,50,000	1,45,000
Loan from bank	1,00,000	1,20,000
Other outstanding liabilities	80,000	90,000
Cash at Bank	32,000	36,000

During the year A had withdrawn Rs.6000 in cash and Rs.3000 in goods from the business. He had also introduced Rs.1, 00,000 as additional capital. A machine book value Rs.25, 000 had been sold during the year for Rs.20, 000 and a new machine costing Rs 58, 000 was purchased in replacement. New furniture costing Rs.2000 was also purchased during the year. Prepare a statement of profit and loss for the year ended Dec 31, 2010.

II. CONVERSION METHOD:

6. from the following facts find out the credit purchase and total purchase

Cash purchase	29000
Opening balances of bills payable	7500
Opening balance of creditors	20000
Closing balance of bills payable	2500
Closing balance of creditors	18000
Cash pad to creditors	25000
Bills payable paid during the year	10500
Purchase return	1500
Allowances from creditors	800
Bills payable dishonored	300

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

Particulars	Rs.
Opening balance of debtors	30,000
Opening balance of creditors	10,000
Collection from debtors	1, 60,000
Discount received	2,500
Bad debts	1,000
Payment to creditors	14,000
Discount allowed	1,500
Return inwards	2,000
Return outwards	3,000
Cash purchases	6,000
Cash sales	10,000
Closing balance of debtors	35,000
Closing balance of creditors	15,000

B) PREPARATION OF TRADING , P/L A/C AND BALANCE SHEET:

8) Ram Commenced business on 01.01.2001 with a capital of Rs.25,000. He immediately bought furniture for Rs. 4,000. During the year, he borrowed Rs.5, 000 from his wife and introduced a further capital of Rs.3, 000. He has withdrawn Rs. 600 at the end of each month for family expenses. From the following particulars obtained from his books, you are required to prepare Trading and P&L A/c and Balance sheet as on 31.12.2001.

Particulars	Rs.
Sales (including cash sales of Rs.30, 000)	1, 00,000
Purchases (including cash Purchases of Rs.10, 000)	75,000
Carriage	700
Wages	300
Discount allowed to debtors	800
Salaries	6,200
Bad debts written off	1,500
Trade expenses	1,200
Advertisement	2,200

Ram has used goods worth Rs.1, 300 for private purposes and paid Rs.500 to his son which is not recorded anywhere. On 31.12.2001, his debtors were worth Rs. 21,000 Creditors Rs.15, 000 and stock in trade Rs.10, 000. Furniture to be depreciated at 10% P.a.

9) Mr. X keeps his account under single entry system. From the following, prepare Trading and P&L A/c and Balance sheet as on 31.03.2004.

Cash book analysis shows the following:

Particulars	Rs.	
Interest charges	100	
Personal withdrawals	2,000	
Staff salaries	8,500	
Other business expenses	7,500	
Payment to creditors	15,000	
Balance at bank as on 31.03.2004	425	
Cash in hand as on 31.03.2004	75	
Received from debtors	25,000	
Cash sales	15,000	
Details	**31.03.2003**	**31.03.2004**
Stock on hand	9,000	10,220
Creditors	8,000	5,500
Debtors	22,000	30,000
Furniture	1,000	1,000
Office premises	15,000	15,000

Provide 5% interest on X's capital balances as on 01.04.2003. Provide Rs.1, 500 for doubtful debts, 5% depreciation on all fixed assets.5% group incentive commission to staff has to be provided for on net profit after meeting all expenses and the commission.

10) Chand& sons maintained his accounting books on single entry system. He maintained a cashbook in which all receipts and payments were entered. He also kept a ledger in which accounts of debtors and creditors were opened. On 31.12.1996, he desired his accountant to prepare a regular Trading and P&L A/c and Balance sheet on the double entry system. The analysis of his cashbooks revealed the following information.

<u>Debit side:</u>

Received from sundry debtors	Rs.1,27,000
Received from cash sales	Rs. 73,000

<u>Credit side:</u>

Purchased goods for cash	Rs.32100
Cash paid to creditors	Rs.74500
Drawings	Rs.10000
Salaries and wages	Rs.42000
Printing & stationary	Rs.2500
Office expenses	Rs.31500

The following additional information was available

	01.01.1996 Rs.	31.12.1996 Rs.
Capital	185000	---
Creditors	45000	25000
Stock	43000	51100
Furniture	7000	7000
Buildings	73000	73000
Debtors	105000	102500
Cash at bank	6000	2000
Cash in hand	500	1400

Interest is to be provided at 5% on capital as on 01.01.1996.Provision is to be made at 5% for doubtful debts and depreciation is to be charged on buildings and furniture@20%.

11. X and Y equal partners in a business in which the books are kept by single entry system. The position of the business on 1.1.86 was as under:

Balance sheet

Liabilities	**Rs.**	**Assets**	**Rs.**
B/P	646	Cash in hand	27
Sundry creditors	2029	Cash at bank	220
Capital X	7340	B/R	407
Y	7340	Sundry debtors	4868
		Stock	3285
		Plant	8018
		Furniture	530
	17350		17350

The following was the state of affairs on 31.12.1986. cash in hand Rs.40, cash at bank Rs.584, debtors Rs.5629, B/R Rs.684, stock Rs.3673, creditors Rs.2147, B/P Rs.595. the partners had drawn Rs.450 each and were further entitled to interest on their capital at 5% P.a. it was agreed to depreciate plant at the rate of 20% and furniture @ 5%. Prepare the balance sheet of the partners as on 31.12.86.

UNIT III
PARTNERSHIP ACCOUNTS

INTRODUCTION:

A Sole trader is a person who owns and carries on business exclusively on his own account and risk. His organization is the simplest one. When the business expands, there arises the need for more capital, better organization, more abilities, sounder decisions etc. Thus we can have many instances of businesses in which several persons are interested. Partnership is a very common type of business organization, where two or more persons join together to carry on business and to share the resultant profit in the agreed proportions.

WHAT DO YOU MEAN BY PARTNERSHIP (OR) GIVE THE MEANING OF PARTNERSHIP?

Persons making an agreement to carry business for common purposes are called partners individually and firm collectively. The name under which their business is carried the firm name. A partnership is similar to a single proprietorship except that in a single proprietorship one person is the owner while in the partnership two or more persons share the ownership. Each member of partnership is known as a partner. The number of partners is restricted to 10 in case of banking business and 20 in case of any other type of business. Persons, constituting the partnership, are individually known As PARTNERS and collectively known as FIRM. The name under which their business is carried on is called FIRM'S NAME.

DEFINITION:

According to sec 4 of the Indian Partnership Act 1932, partnership is defined as "the relationship between persons who have agreed to share the profits of a business carried on by all (or) any of them acting for all.

WHAT ARE THE ESSENTIALS OF PARTNERSHIP? (OR) WHAT ARE ELEMENTS OF PARTNERSHIP?

1) **AGREEMENT:** A partnership is created by agreement – express or implied between the partners.
2) **BUSINESS:** It is created in order to run a lawful business.
3) **PERSONS:** There must be at least two persons: maximum is twenty but in case of banking business, the maximum is ten.
4) **PROFIT SHARING:** the business is pursued to earn profits for distribution among in partners, as a right. Sharing losses by one or two partners may be exempted.
5) **MUTUAL AND IMPLIED AGENCY:** Mutual and implied agency is the very essence of partnership. Every partner is both an agent and principal of other partners.

WHAT ARE THE DUTIES OF PARTNERS?

1. Every partner must diligently carry on the business of the firm for the greatest common advantage. There is no remuneration unless otherwise agree upon.
2. Every partner must be just and faithful to other partners
3. A partner is bound to keep and render true, proper and correct accounts of the partnership and must allow other partners to inspect and copy the accounts of the partnership.
4. A partner must not carry on a business in competition with the business of the firm. If he does so, he must hand over the profits of that business to the partnership.
5. Every partner is liable, jointly with all the other partners and also severally, for all acts of the firm done while he is partner.
6. Each partner is liable to contribute for the firm's losses equally, in the absence of any contract to the contrary.

BRIEFLY EXPLAIN THE RIGHTS OF PARTNERS

1. Every partner has a right to take part in conduct of the business of the firm.
2. Every partner has a right to be consulted and heard before any matter is decided.
3. Every partner has a right of free access to all records, books and accounts of the business and also the right to examine and copy them.
4. A partner is entitled to share equally for the losses sustained by the firm with other partners.
5. In the absence of agreement to the contrary a partner is not entitled to interest on capital
6. Every partner has a right to receive interest @6% p.a on the sum contributed over and above the sum agree to be invested on capital
7. A partner has a right to see that the partnership property is used exclusively for the purposes of the firm.
8. A partner has a right to prevent any fundamental changes in the business of the firm without his consent.

WHAT IS THE MEANING OF PARTNERSHIP DEED?

Partnership may be created by an oral agreement or an agreement in writing. It is not necessary that the agreement should be in writing. But it is better that the various terms thereof must be reduced in writing, so as to avoid future disputes. The document in writing, containing the important terms of the partnership as agreed to by the partners between themselves is called the PARTNERSHIP DEED. It is stamped according to the provisions of the Stamp Act, the partnership accounts are regulated by the Partnership Deed, it is usual to include the following therein.

CONTENTS OF PARTNERSHIP DEED:

A properly drawn up deed should contain the following particulars:

1. The name of the firm and names and addresses of the partners who compose it.
2. The nature of partnership business
3. The commencement and duration of the business
4. The amount of capital to be contributed by each partner and the system of maintaining the capital – fixed and fluctuating
5. The principal place of business
6. Duration of partnership, if any
7. Capital contributed by each partner
8. Amount permitted to be withdrawn by each partner
9. Method of computation and treatment of goodwill on the variation of profit sharing ratio, admission, retirement etc.
10. Amount of salary or commission, if any, payable to partners
11. Rate of interest, if any, on capital and drawings
12. Rate of interest, if any, on loans and advances by the partners.
13. Allocation of work among partners
14. Rights, duties and liabilities of partners
15. Provision regarding admission of new partners

WHAT ARE RULES APPLICABLE IN THE ABSENCE OF PARTNERSHIP DEED?

In the absence of an agreement, the under mentioned points should be noted for proper accounting amongst the partners.

1. Partners are entitled to share equally in the profit earned and contribute equally to losses sustained by the firm.
2. A Partner is not entitled to receive any remuneration for taking part in the conduct of the business.
3. Interest neither be allowed on partner's capital nor charged on drawings. If agreed for interest on capital, it must be allowed only out of profits of the firm.
4. If any partner has made any advance or loan besides his capital for the purpose of business, he is entitled to claim interest thereon at 6%p.a.
5. Every partner has to take interest in the management of the firm.

WHAT IS THE MEANING OF PROFIT AND LOSS APPROPRIATION ACCOUNT?

In the case of partnership accounting, it is usual to allocate interest on capital, interest on drawings, salary, commission and the respective share of profit or loss to the capital accounts of partners through the profit and loss appropriation account.

Profit & Loss appropriation is an extension of usual profit & loss account for the purpose of adjusting transactions relating to the partnership deed. Viz., interest on partners' capitals, drawings and loans; partners' salary and commission etc. Due to their peculiar nature, these transactions are termed separately without mixing up with general trading transactions. Profit or loss revealed by the usual profit & loss account is distributed among the partners without making the above adjustments. Some partners may lose for the sake of others. If the distribution of profit or loss is to be fair, the profit or loss arrived at must be true and fair. Therefore, to arrive a true and fair profit or loss before its division, the mentioned adjustments are carried out in P&L appropriation account.

Specimen of Profit & Loss appropriation account

To P&L a/c (if there is Trading Loss)	xxx	By P&L a/c (Trading profit before

		Adjustments as per deed)	xxx
To Interest on partner's capital	xxx	By Interest on drawings	xxx
To Partners' salary	xxx	By Interest on drawings	xxx
To Partners' commission	xxx	By Net Loss	
To Interest on Partner's loan a/c	xxx	(Partners' capital or current a/c)	xxx
To Net Profit (Partners capital or Current a/c)	xxx		
	xxx		xxx

PARTNERS' CAPITAL ACCOUNTS:

In partnership, there will be as many capital accounts as the number of partners. Partners' capital is the amount invested or contributed (whether in cash or kind or both) by the partners in the business. Whenever a partner contributes towards his capital, cash account or property account is debited and a separate capital account of such partner is credited with such contribution.

METHODS OF PARTNERS' CAPITAL ACCOUNT

There are two methods of maintaining capital accounts of the partners.

1. Fixed Capital Method
2. Fluctuating (Floating) Capital Method

(i) Fixed Capital Method:

Under this method, there are two accounts for each partner;

1. Partners' capital account
2. Partners' current account

1. Partners' capital account:

The partners' capital account is credited with the original amount of capital introduced by the partner into the business. It is to be credited subsequently with extra capital introduced by the partner or debited with the amount of capital permanently withdrawn by the partner. No other adjustments are made in this account.

Dr **Specimen of partners' capital account** **Cr**

Particulars	Rs	Particulars	Rs
To Cash/ bank A/c (Withdrawal of capital)	xxx	By Balance b/d	xxx
		By Cash/ bank A/c (Additional capital)	xxx
To Balance c/d	xxx		
	xxx		xxx

2. Partners' current account:

The partners' current account is maintained for making all entries relating to interest on partners' capital, drawings and loan, share of profit, partners' salary and commission etc. The balance in this account will go on fluctuating but the balance of the capital account will remain fixed. If the current accounts present a debit balance, it shall be shown on the asset side of the balance sheet while the credit balance of partners' current account shall be shown on the liability side of the balance sheet.

Dr **Specimen of partners' current account** **Cr**

Particulars	Rs	Particulars	Rs
To Bank A/c (Drawings)	xxx	By Balance b/d	xxx
To Interest on Drawings	xxx	By Interest on capital	xxx
To P & L A/c (Share of loss)	xxx	By Salary	xxx
To Balance c/d	xxx	By Commission	xxx
		By P & L Appropriation A/c (Profit)	xxx
	xxx		xxx

(ii) Fluctuating or Floating Capital Method:

Under this method, the capital account of a partner does not remain at its original balance but fluctuates quite frequently. The reason is that all adjustments are made directly in the capital account itself. Naturally, the capital balance at the beginning of the accounting period is affected and it differs at the end.

Dr **Specimen of partners' capital account** **Cr**

Particulars	Rs	Particulars	Rs
To Bank A/c (Drawings)	xxx	By Balance b/d	xxx
To Interest on Drawings	xxx	By Cash/ bank A/c	xxx
To P & L A/c (Share of loss)	xxx	(Additional capital)	
To Balance c/d	xxx	By Interest on capital	xxx
		By Salary	xxx
		By Commission	xxx
		By P & L Appropriation A/c (Profit)	xxx
	xxx		xxx

Calculation of opening capital

Capital at the end of the year	**xxx**	
Add: drawings and interest ton drawings	**xxx**	
		Xxx
Less interest on capital	**xxx**	
		Xxx
Less: additional capital if any	**xxx**	
		Xxx
Less: profit credited	**xxx**	
Opening capital	**xxx**	
		Xxx

DIFFERENCES BETWEEN FIXED CAPITAL AND FLOATING CAITAL METHOD:

Basis of Distinction	Fixed Capital Method	Floating Capital Method
1.No. of accounts in the name of each partner	There will be two accounts in the name of each partner, viz., the capital account and current account	There will be only one account in the name of each partner, viz., the capital a/c.

2.Change in Capital	The capital normally remains unchanged except under special circumstances.	The capital account of a partner fluctuates from year to year.
3.Yearly adjustments	Yearly adjustments are made only in the current a/c	Yearly adjustments are made in the capital a/c's itself.
4.Position in the B/S	Both capital and current account in the name of each partner will appear in the Balance sheet.	Only capital account in the name of each partner will appear in the balance sheet.
5.Specific provision	Specific provision in the partnership deed is required for maintaining capital accounts according to fixed capital method.	No specific provision in the partnership deed is required for maintaining capital accounts according to fluctuating capital method.

PROBLEMS

1) On 1st Jan 2004, A and B enter into partnership contributing Rs 20,000 and Rs 15,000 respectively and sharing profits and losses in the ratio of 3:2. B is allowed a salary of Rs 4,000 per year. Interest on capitals is to be charged at 5% per annum and 5% interest is to be charged on drawings. During the year A withdrew Rs 3,000 and B Rs 6,000, interest on drawings being Rs 70 and Rs 50 respectively. Profit in 2004 before the above noted adjustments amounted to Rs 10,580. Show how the profit is to be distributed. Also allow the capital accounts of A and B under Fixed Capital Method and Fluctuating Capital.

2) On 1st Jan, 2006 Sunil and Kapil commenced business as partners with an initial capital of Rs 20,000 and Rs 30,000 in their respective accounts. The partnership deed provides that:

1) Profit and loss shall be shared in the ratio of 2:3 as between Sunil and Kapil.

2) Partners shall be entitled to interest on capital at the commencement of each year at 6% p.a

3) Interest on drawings shall be charged at 8% pa

During the year ended 31st Dec, 2006 the firm made a profit of Rs 19,280 before adjustment of interest on capital and drawings. The partners with draw during the year Rs 3,000 each at the ned of every quarter commencing form 31.3.2006.

You are required to prepare P&L Appropriation account and show the entries for interest on capital and drawings and distribution of profits. And also prepare Capital account.

3) On 1st Jan 2000 A,B and C enter into partnership contributing Rs 2, 50,000, Rs 1, 30,000 and Rs 1, 20,000 respectively and showing profit in the ratio of 5:3:2. B and C are entitled to a salary of Rs 16,000 and Rs 14,500 respectively per year. Interest on capitals is to be allowed at 5% p.a. 5% interest is to be charged on drawings. During the year A withdrew Rs 40,000 and B Rs 25,000 and C Rs 15,000. Interest being A Rs 2,250, B Rs 1,125, and C Rs 725. Profit in 2000 before the above mentioned adjustments was Rs 71,400 show how the profit is distributed and also prepare the capital accounts a) if they are fluctuating and b) if they are fixed.

4)Gold, Silver and copper entered into partnership on 1st Jan 2004 sharing profit and losses in the ratio of 2:2:1. Gold however personally guaranteed that Copper's share of profits, after charging interest on Capital @ 5% p.a would not be less than Rs 8,000 in any year. The Capitals were A Rs 50,000; B Rs 30,000 and C Rs 20,000. The profits for the year ended 31st Dec 2004 amounted to Rs 35,000.

Show the Profit and loss appropriation account.

5) Vijay and Bhargav are partners sharing profits and losses equally with capitals of Rs 30,000 and Rs 20,000 respectively. Their drawings during the year are as follows:

Vijay's drawings on	31-3-2004	Rs 500
	30-4-2004	Rs 600

1-7-2004	Rs 450
1-12-2004	Rs 1400

Bhargav drew Rs 300 at the end of each month. The deed provides interest on capital and drawings @6%. Calculate interest on capital and drawings.

<u>Partnership accounts problem</u>

6) Mr. X in the partners is a firm. He withdraws Rs 200 at the end of each month. His capital in the firm is Rs 8,000. He gave a loan of Rs 4,000 to the firm on 1st July, 2004. Rate of interest on capital, drawings and loan is 10% p.a. Books are closed on 31st Dec each year. Calculate the amount of interest.

7) A, B and C are partners showing profits and losses in proportion to their capitals at the beginning of the year. They are entitled annually to draw Rs 6,000, Rs 5,000 and Rs 4,000 respectively out of their anticipated shares of profits. Any drawing in excess of these amounts are to be regarded as advances taken from the firm and are to be subject to interest at an average rate of 6% p.a. The capitals as at the beginning of the year are to be allowed interest at an average rate of 5% p.a.

The capitals of the partners as at the beginning of the year were: A Rs 80,000 B Rs 60,000 and C Rs 40,000. The credit balances of their current accounts were A Rs 2,304, B Rs 3,728 and C Rs 1,152. Their drawings during the year were A Rs 10,000 B Rs 12,000 and C Rs 5,000. The profits for the year were Rs 30,096 before making any adjustment for interest as above.

Draw up the capital and current accounts of the partners.

WHAT DO YOU MEAN BY PAST ADJUSTMENTS?

Generally, the accounts closed once are not reopened. But it is sometimes found, after closing the account of a firm that interest on capitals (or) drawings (or) a partner's salary (or) commission has been omitted from being recorded in the books of accounts. When this omission is discovered, it is necessary to correct it. At the same time the consequent change in the account of the profit divided among the partners has also to be made. This is done by passing the rectifying entries.

The procedure is as follows:

1) Ascertain the capital at the beginning for each partner from the adjusted capital as at the end of the year. This is done by adding to the adjusted capital whatever had been deducted there from earlier.

2) Ascertain interest on the opening capitals. Credit the capital accounts of the partners with respective amount of interest and debit profit and loss appropriation account.

3) Debit the capital accounts of the partners with interest on drawings and credit Profit & Loss appropriation account.

4) Debit the capital accounts of the partners in profit sharing ration with the difference in the amounts of the entries passed in ii) and iii) above credit Profit & Loss appropriation account.

8) X and Y where partners in a firm showing profits in the ration of 3:2 following is the balance sheet of firm as on 31st Dec 2002.

LIABILITIES	RS	ASSETS		RS
X's capital	30,000	Drawings	X	4,000
Y's capital	10,000		Y	2,000
		Other assets		34,000
	----------			---------
	40,000			40,000
	--------			---------

Profit for the year 2002 Rs 8,000 was divided between the partners in the agreed ration but interest on capital at 5% and on drawings at 6% was omitted adjust by above, interest on drawings may be calculated on an average basis for 6 months.

9) X and Y agreed to share profits as follows: First Rs 8,000 to X and the balance in 2:1. The profits for the year are Rs 11,600. The capital being X Rs 40,000 and Y Rs 36,000. Interest on capital had been omitted from the books and is to be allowed at 5% p.a adjust.

10) A,B and C are partners in a firm Net profits on the firm for the year ended 31st March 2001 is Rs 30,000 which has been duly distributed among the partners in their agreed ration of 3:1:1 respectively. It is discovered on 10th April 2001 that the under mentioned transaction where not passed through the books of accounts of the firm for the year ended 31st March 2001.

a) Interest on capitals at 6% p.a, the capital of A, B and C being Rs 50,000 and Rs 40,000 and Rs 30,000 respectively.

b) Interest on Drawings A Rs 350, B Rs 250, C Rs 150

c) Partnership salary A Rs 5,000, B Rs 7,500

d) Commission due to A was some special transaction Rs 3,000

You are required to suggest a single entry to be made on 10th April 2001 which will not affect the P&L a/c of the time rectify the position of the partners.

11) A, B and C are partners in a firm, sharing profits and losses in the ratio of 2:1:1. It is agreed that interest on capital will be allowed at 5% per annum and interest on drawings will be charged at 4 per cent annum. (No interest will be charged or allowed on Current accounts).

The following are the particulars the Capital, Current and Drawings Accounts of the partners:

	A(Rs)	B(Rs)	C(Rs)
Capital A/c (1-1-2004)	75,000	40,000	3,000
Current a/c (1-1-2004)	10,000	5,000	5,000(Dr)
Drawings	15,000	10,000	10,000
Interest on Drawings(2004)	500	190	350

The draft accounts for 2004 showed a net profit of Rs 60,000 before taking into account interest on capital and drawings and subject to the following adjustments.

a) Life Insurance Premium of A amounting to Rs 1,000 paid by the firm on 1-10-2004 has been charged to Miscellaneous Expenditure account.

b) Repairs to machinery amounting to Rs 10,000 has been debited to Plant Account and depreciation thereon charged @ 20 %.

c) Travelling expenses of Rs 3,000 of B for a pleasure trip to U.K paid by the firm on 30.6.2004 has been debited to Travelling expenses a/c.

Prepare the Profit and Loss Appropriation Account for the year ended 31st Dec 2004 and Current Accounts of the partners of the year.

WHEN A NEW PARTNER IS ADMITTED AS PARTNER, ONE (OR) MORE OF THE FOLLOWING ACCOUNTING ADJUSTMENTS BECOMES NECESSARY

When a new partner is admitted into the firm, one or more of the following accounting adjustments become necessary

1. Adjustment in the profit sharing ratio.
2. Adjustment for goodwill
3. Adjustment for revaluation of assets and liabilities

4. Adjustment of reserves and other accumulates profits
5. Adjustment for capital.

WHAT DO YOU MEAN BY SACRIFICING RATIO?

On admission of a new partner, the old partners have to surrender some of their old shares in favour of the new partner. The surrender of share by old partners is made in certain ratio. This ratio is called sacrificing ratio. It can be found out by deducting their new share from the old share.

Sacrificing Ratio = Old Ratio- New Ratio

Case I 1) X and Y were the partners sharing profits in the ratio of 7:3. Z was admitted on 3/7 the share in the profits. Calculate new profit sharing ratio of the partners.

Case II 2) X and Y sharing profit in the ratio of 7:3 and admit Z on 3/7 shares in the new firm which he takes $2/7^{th}$ from X $1/7^{th}$ from Y calculate new ratio.

Case III 3) X and Y shared profits in the Ratio of 7:3. Z was admitted as a partner. X surrounded $1/7^{th}$ of his share and Y $1/3^{rd}$ of his share in favour of Z. Calculate the new ration.

Case IV 4) C, D are partners sharing profits &losses in the ration of 3:2. They sacrifices equally admitted E new partner for $1/5^{th}$ share. Calculate new profit sharing ratio.

Case V 5) M, N are partners sharing profits in the Ratio of 5:3. They admitted P. P getting his share only from M for 1/4. What is profit sharing Ratio?

PROBLEMS

1. A, B and C were partners sharing profits and losses in the ratio of 3:2:5. They admitted D and gave him ¼ share. This share was contributed by them in the ratio of 1:1:3. Find out the new profit loss sharing ration of all the partners.

2. A and B were partners in a firm sharing profits in the ratio of 3:2. They admit C into partnership and the new ratio for sharing profits will be 4:3:2. You are required to calculate the sacrificing ratio.

3. A and B were partners sharing profits and losses in the ratio of 3:2. They admitted C as a partner. A contributed ¾ of his share and B contributed ¼ of his share to C. Find out the Sacrifice ratio of the old partners and also the new profit – loss sharing ratio of all the partners.

Gaining Ratio: (New ratio- Old ratio)

4. X, Y and Z were partners sharing profits in the ratio of 1/2, 2/5, 1/10. Find out the new ratio of the remaining partners if Z retires and gaining ratio.

5. P,Q and R were partners sharing profits and losses in the ratio of P 5/10, Q 3/10, R 2/10 31^{st} Dec 2001. Q was decided to retire. Calculate gaining ratio of remaining partners. New share is P 3/5 R 2/5.

6. A, B and C were sharing profits in the ratio of 3:2:1 respectively and C retires, C's share of 1/6 is shared by A and B equally.

WHAT IS THE MEANING OF GOODWILL?

It is very difficult to give an exact definition for the term 'Goodwill' in accountancy. Some accountants are of the opinion that attachment of customer to a particular business is called Goodwill. It may be described as a value of all favourable attributes relating to a business enterprise. For example customer's attitude, desirable location, pleasing surroundings, superior products, absence of competition etc.

FACTORS AFFECTING THE VALUATION OF GOODWILL:

The following factors affect the goodwill

(i)Quality:

If the firm enjoys good reputation for the quality of its products, there will be a ready sale and the value of its goodwill, therefore will be high

(ii)Location or site:

If the business is located in a prominent place, its value will be more as compared top a place which is not popular at all.

(iii)Competition:

The value of goodwill will be high in those businesses where there is no competition or competition is negligible.

(iv)Capacity of management:

If the management is capable, the firm will earn more profits and that will raise the value of goodwill.

(v) Capital required:

If a business requires lesser amount of capital, it will have more buyers and hence its value of goodwill will be high as compared to a business requiring higher amount of capital.

vi)Nature of business: A business dealing in goods of monopolistic type will have a higher value of goodwill.

vii) Types of customers: The value of goodwill depends upon the capacity of the business to earn excess profit. The excess profit can be earned only if customers return to the firm in large numbers. Therefore, the type of customers which a firm has is important.

viii) Time: A business establishes some reputation in course of time. A business man who has carried on his business for a longer period, will enjoy more goodwill since he is better known to the customers.

WHAT ARE THE DIFFERENT METHODS ARE AVAILABLE OF VALUATION OF GOODWILL?

The following are the different methods of valuation of goodwill

1. Average profit method or certain number of year's purchase of average profits:

In this method, profits of some past years, preferably three to five years are added and this total is divided by the number of years whose profits have been added and thus average profit is found out. The average profit is multiplied by the number of years in which the anticipated profit will be available, to arrive at the value of goodwill. Thus the formula is

Average profit = Total profits / No. of years

Goodwill = Average profit * No. of years purchase.

Goodwill = Average profit * No. of years purchase.

2. Super profit method:

Under this method, goodwill is considered to be equal to a certain number of year's purchase of the super profit of the business concerned. Super profit is taken as a basis for calculating goodwill. Super profit is the difference (i.e excess) between the Average Annual earning (Actual) and the normal return of capital invested in similar business. In other words, excess of average profit over normal yield is known as super profit. This super profit is multiplied by number of years, so as to get the amount of goodwill.

Normal profit = Capital employed * Normal rate of return

Super profit = Average profit – Normal profit

Goodwill = Super profit * number of years of purchase.

3. Capitalization method:

This method is useful when the actual profit is less than normal profit. In this method, the average profits are first capitalized on the basis of normal rate of return and then excess of this capitalized amount over net assets of the firm is goodwill. The following formula may be used to find out the value of goodwill:

Capitalized value of profit or
Value of total investment or
Total value of business

$$= \frac{\text{Profit (adjusted)}}{\text{normal rate of return}} * 100$$

Value of goodwill = capitalized value of profit – net tangible asset

Net tangible assets = total assets except goodwill – liabilities to outsiders.

Value of goodwill = capitalized value of profit – net tangible asset

Net tangible assets = total assets except goodwill – liabilities to outsiders.

IV Goodwill based on share of incoming partner:

If C is admitted for 1/4th share of profit and is required to bring Rs 4,100 as his share of goodwill in addition to Rs 10,000 as capital, then total value of goodwill can be calculated.

V Hidden Goodwill

If A and B with capitals of Rs 10,000 and Rs 20,000 respectively and sharing profits equally, admit C to a one- fourth interest in the profits of the firm on the payment of Rs 12,000. What is Goodwill?

Treatment of Goodwill

I Revaluation Method

1) Goodwill a/c Dr
To Old Partner's Capital a/c
(Being the Goodwill Raised)

2) Cash a/c Dr
To New Partner's capital
(Being entry for Goodwill paid in cash)

II Memorandum Revaluation method:

Capital account of all partners a/c Dr (including new partner)
To Goodwill
(Being the goodwill is written off)

III Premium Method: This method is adopted when the new partners being in cash the amount equal to his share of goodwill.

a) When the amount of premium privately paid by the new partner – No journal entries is required.

b) When the amount of premium is retained in the business.

i) Cash a/c Dr
To Capital a/c of the new partner

ii) Transfers of goodwill to the old partners

Capital a/c of new partner a/c Dr

To Old Partners capital a/c

(Being the transfer of goodwill to the old partners)

iii) When the amount of premium withdrawn by old partners:

Old Partners capital a/c Dr

To Cash

(Being the goodwill amount withdrawn by the old partner)

iv) When the goodwill written off

Old Partners capital a/c Dr

To All partners capital a/c (including new partner)

(Being the new value of goodwill raised in new ratio)

CALCULATION OF GOODWILL

1) Average profit method:

Value of goodwill = Average profit x No. of years.

1) If goodwill is to value at 3 years purchase on the average profits for the last five years and the profits for these years are Rs 25,000, Rs 15,000 and Rs 20,000 and Rs 30,000, Rs 35,000. Calculate the value of Goodwill.

2) Calculate the amount of goodwill in the following case:

Three year's purchase of the last four years' average profits is agreed as the goodwill value. The profits and losses for the last four years are:

I Year Rs 5,000 II Year Rs 8,000 III year Rs 3,000 (loss) IV year Rs 6,000

3) Calculate the amount of goodwill at three years' purchase of last five years average profits. The profits were:

I Year Rs9,000 II Year Rs 14,000 III year Rs 15,000 IV year Rs 5000 V year 12000

II Super Profit Method:

Super profit = Average expected profit – Normal Profit

Value of Goodwill = Super profit x No. of years

4) 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 3 years purchase of super profits.

5) Calculate the goodwill under super profit method for the past 3 years as follows:

2002 - 25,000 2003 – Rs 40,000 2004 Rs 55,000 The capital invested by the firm is Rs 2, 50,000. A normal rate of return on capital is at 10%. Goodwill is based on 3 years of purchase.

3. Capitalization method:

6) Compute the goodwill under capitalization method on average profit and on super profit. Average profit of the firm is Rs 20,000, the firm's capital is Rs 1, 50,000 and the normal rate in the industry is 10%. The tangible assets are Rs 40,000.

7) A& B are partners showing profits in the ratio of 3:2. they admit C into the firm for 3/7th profit which he takes 2/7th from A and 1/7 the from B and brings Rs 3,000 as premium out of his share Rs 3,600. Goodwill account does not appear in the books of A and B but the new form decides that Goodwill showed appear in the books at its fractional value of Rs 1,750.

8) A and B are partners capital of 8,000 & 6,000 respectively they admit C as a partner with 1/4th share in profits of the firm. C brings Rs 8,000 as his share of capital.

9) A and B are partners sharing profit in the ratio of 3:2. They admit C into the partnership firm C paying for premium Rs 1,000 and for capital Rs 10,000. No goodwill account appears in the books. Old partners withdraw the amount of goodwill. The new profit sharing Ratio is 2:2:1

10) A and B share profits and losses in the ratio of 3:2. They admit with 1/5th share who pays only Rs 1,000 for premium out of his share Rs 2,500. Goodwill account appears in the books at Rs 5,000. What entries would be made if:

- a) No goodwill should appear in the books
- b) Goodwill should appear in the books at Rs 12,500 and
- c) Goodwill should appear in the books at Rs 5,000.

11) A company yields are annual profit of Rs 10,000 and the general expectation is 10%. The net assets of the company are Rs 50,000. Calculate the value of goodwill.

12) A firm employs Rs 1, 00,000 as capital and the normal rate of return is 15%. If the firm makes an average profit of Rs 20,000. Compute goodwill by taking if to be five years' purchase of super profits.

13) A, B and C partnership and a firm showing profit & losses in the ratio of 3:1:1 on 1st Jan 2002. This balance sheet should as follows:

Balance sheet as on 1st Jan 2002

Liabilities		Rs	Assets	Rs
Capital	A	10,000	Goodwill	1,000
	B	3,000	Land & Building	10,000
	C	2,000	Machinery	5,000
General reserve		2,500	Machinery replacement investment	1,700
Machine replacement fund		2,000	Furniture	1,500
Investment fluctuation fund		2,000	Investment (Market value 2,800)	3,000
Creditors		10,000	Current Assets	12,300
Bills Payable		3,000		
		---------		--------
		34,500		34,500

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Pass journal entries which are necessary in case D is admitted on the above date in connection with accumulated profit &Loss.

ADMISSION OF A PARTNER:

A partnership firm is suffering from the shortage of funds or administrative in capabilities may decide to admit a partner. Such a person who is admitted to the firm is known as an incoming or a new partner. According to section 31(1) of the Indian Partnership Act 1932, a new partner can be admitted only with the consent of all the existing partners. On admission of a new partner, the exiting partnership agreement comes to an end and a new agreement comes into effect. A new partner acquires two main rights in the firm –

1. Right to share the assets of the firm;
2. Right to share the future profits of the firm.

The journal entries for this purpose are:

1) When the value of assets are increased:

Assets a/c Dr
To Revaluation a/c

2**) When the value of assets are reduced:**

Revaluation a/c Dr
To Assets a/c

3) When the values of liabilities are increased:

Revaluation a/c Dr
To Liabilities a/c

4) When the values of liabilities are reduced:

Liabilities a/c Dr
To Revaluation a/c

5) For Profit on Revaluation

Revaluation a/c Dr
To Old Partners' capital

6) For Revaluation Loss

Old Partners' capital a/c Dr
To Revaluation a/c

Admission of a Partner Problem

1) X and Y were in partnership sharing profits and losses as to 2/3 and 1/3. As from 1st Jan 2001 they agreed to take Z as a new partner. The hew partner will have one – sixth share the old partners agreed to share equally as between themselves in the new firm. Z brings Rs 1, 00,000 as capital and Rs 10,000 as his share of goodwill of the firm.

The following is the balance sheet of the old firm as 31st Dec 2000.

Liabilities		Assets	
Capital Account		P&M	60,000
X	1,25,000	Investments	20,000
Y	1, 00,000	Stock	1, 10,000
Creditors	58,500	Debtors	70,000
		Cash	23,500

	------------- 2, 83,500		------------- 2, 83,500

The following revaluation is agreed upon:
Plant Rs 50,000 Stock Rs 1, 25,000 Investments Rs 18,000 Debtors Rs 63,000. It is further agreed that X alone is to be charged with any loss arising from the above and partners in the new firm are to be credited 10% p.a interest on capital.

The profit for the year ended 31st Dec 2001 was Rs 1, 53,100 before allowing interest on capital and drawing of the partners were:
X Rs 30,000 Y Rs 25,000 Z Rs 15,000. You are required to journalise the opening adjustments, prepare capital accounts cash account and draw up the balance sheet as on 31st Dec 2001.

2) The following is the Balance sheet of A, B and C sharing profits and losses in the proportion of 6/14, 5/14 and 3/14 respectively.

Liabilities	Rs	Assets	Rs
Creditors	18,900	Cash	1,890
Bills Payable	6,300	Debtors	26,460
General Reserve	10,500	Stock	29,400
A's Capital	35,400	Furniture	7,350
B's Capital	29,850	Land and Buildings	45,150
C's Capital	14,550	Goodwill	5,250
	1, 15,500		1, 15,500

They agreed to take D and give him 1/8th share of the following terms.
1) That furniture depreciated by Rs 920
2) That stock is to be depreciated by 10%
3) That a provision of Rs 1,320 be made for outstanding repairs bill
4) That the value of land and building appreciated be broad upto Rs 59,850
5) That a value of goodwill be brought up to Rs 14,070
6) That D should then bring in Rs 14,700
7) That the after making above adjustment the capital a/c of the old partners be adjusted on the basis of the proportion of D's capital to his share in the business i.e to be paid of D's capital to his share in the business i.e to be paid (or) a brought in by the old partners as the case may be.

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

3) The following is the balance sheet of A and B as at 31st March 2002. C is admitted as a partner on that date when the position of A and B was as under:

Liabilities		Assets	
A's capital	10,000	Debtors	11,000
B's capital	8,000	L&B	8,000
Creditors	12,000	P&M	10,000
General reserves	16,000	Stock of goods	12,000
Workmen's		Cash and bank	

compensation fund	4,000 --------------- 50,000	balance	9,000 ------------- 50,000

A and B shared profits in the proportion of 3:2. The following terms of admission are agreed upon:

a) Revaluation of assets: L&B Rs 18,000 Stock of goods Rs 16,000

b) The liability of workmen's compensation fund is determined at Rs 2,000

c) C brought in an his share of goodwill Rs 10,000 in cash.

d) C was to bring further cash as would make his capital to 20% of the combined capitals of partner A and B are at above revaluation and adjustments are carried out.

e) The future profit sharing proportions were as under: A 2/5; B 2/5; C 1/5

Prepare the new balance sheet of the firm and the capital accounts of the partner.

4) Shri and Ram are partners in a firm showing profits and losses as Shri 75% and Ram 25%. On 1st Jan their position was as given below:

Liabilities		Assets	
Capital Account		Goodwill	10,000
Shri	50,000	Plant	30,000
Ram	30,000	Stock	10,000
Creditors	20,000	Debtors	30,000
		Cash at Bank	20,000
	--------------		-------------
	1, 00,000		1, 00,000

Seth is now to join the partnership. He agrees to pay the partners Rs 20,000 by way of goodwill and introduce ½ of the combined capital of the two existing partners after depreciating plant and stock at 20% and 10% respectively and raising a reserve of 10% against sundry debtors. The new partner is to be allowed ¼th share of the profit of the firm.

RETIREMENT OF A PARTNER

Meaning:

A partner may decide to retire from the firm because of certain reasons like old age, ill health etc. On retirement the old partnership comes to an end and a new one, between the remaining partners, comes into existence. A retiring partner will not be held liable for the debts incurred by the firm after his retirement. However he must give a public notice to that effect.

Definition:

According to section 32(1) of the Indian Partnership Act 1932, a partner may retire from the firm (i) with the consent of all the partners (ii) in accordance with an express agreement by the partners or (iii) where the partnership is at will be giving notice in writing to all the other partners of his intention to retire.

Accounting adjustments (or) Accounting Problems:

A problem that arises here is that of payments of the amount due to the retiring partner or to the legal representatives of a deceased partner. The following main problems require special attention in case of retirement of a partner.

1. Adjustment regarding profit sharing ratio
2. Adjustment for Goodwill
3. Revaluation of Assets and Liabilities

4. Adjustments regarding reserves and other undistributed profits and losses
5. Payment to the retiring partner.

ADJUSTMENT REGARDING PROFIT SHARING RATIO:

When one partner retires and nothing is mentioned about the new ratio between the remaining partners. In the absence of an agreement on the retirement of a partner, the mutual profit sharing ratio of the remaining partners will not change.

Gaining ratio:

Ratio in which the share of the retiring partner is taken over by the other partners in called gaining ratio.

Gaining ratio = new ratio – old ratio.

Distinguish between Sacrificing Ratio and Gaining Ratio

Points of Distinction	**Sacrificing Ratio**	**Gaining Ratio**
1) Meaning	It is the ratio at which old partners surrender a part of their old shares in favour of incoming partner	It is the ratio at which the continuing partners take up the retiring partner's share.
2) Purpose	It is calculated to determine the amount of compensation to be given to the old partners by the incoming partner.	It is calculated to determine the amount of compensation to be given to the retiring partner by the continuing partners.
3) When Calculated	It is calculated at the time of admitting a person as new partner	It is calculated when a partner retires from the firm.
4) Method of calculation	It is calculated by deducting new ratios from the old ratios.	It is calculated by deducting old ratios from the new ratios.

Steps:

1) Revaluation of assets and liabilities

a) When revised values of assets and liabilities are to appear in the new balance sheet framed alter the retirement (or) death of a partner

b) When revised values are not to appear in the new balance sheet prepared after the retirement (or) death of a partner.

2) Writing off accumulated profits (or) losses

3) Goodwill

a) When goodwill is only raised

b) When goodwill is first raised and written off

c) When goodwill account is not opened

4) Share out of the profits earned after the preparation of final accounts

a) Distribute the total profits (or) losses among all partners (including retire partner) (or)

b) Calculate the outgoing partner's capital account and debit the remaining partners capital accounts in the gaining ratio.

5) Disposal of the amount due to the outgoing partner.

RETIREMENT OF PARTNER (PROBLEMS)

1) A, B and C are in partnership sharing profits equally, C retired on 31st March 2000. The balance sheet of the firm on 31st Dec 2001 stood as follows:

Liabilities	Rs	Assets	Rs
Creditors	12,900	Cash in hand and at bank	5,000
General Reserve	4,000	Debtors	10,000
Investment fluctuation fund	1,200	Stock	10,000
Reserve for doubtful debts	800	Investment (at cost)	5,000
Capitals		Freehold property	40,000
A	30,000	Goodwill	18,900
B	20,000		
C	20,000		
	------------		------------
	88,900		88,900

On the date of retirement it was found that: 1) Freehold property be valued at Rs 58,000 2) Investments be valued Rs 4,700 3) Debtors were all good 4) Stocks be valued at Rs 9,400 5) Goodwill be valued at one year's purchase of the average profit on the past five years 6) C's share of profit to the date of retirement be calculated on the basis of average profit of the preceding three years.

The books showed the profits of the last five years as follows: 1996 – Rs 11,500; 97 – Rs 14,000; 98- Rs 9,000; 99 – Rs 8,000; 2000 – Rs 10,000

You are required to 1) Pass journal entries 2) Give capital account of C 3) Prepare balance sheet of the remaining partners.

2) P, Q and R were partners sharing profits and losses in the ratio of P 5/10 Q 3/10 R 2/10. They had taken out a Joint Life Policy face value of Rs 20,000. On 31st Dec 2002 its surrender value was Rs 4,000. On this date the balance sheet of the firm stood as under:

Liabilities		Assets	
Sundry Creditors	5,300	Fixed Assets	25,000
Expenses Outstanding	700	Stock	11,000
Reserve	3,000	Book debts	9,000
Capitals		Cash	2,000
P	20,000		
Q	10,000		
R	8,000		

	------------		47,000
	47,000		

On this date a decided to retire and for the purpose: 1) Goodwill was valued at Rs 15,000 2) Fixed assets were valued at Rs 30,000 3) Stock was considered as worth Rs 10,000.

Q was to be paid through cash brought in by P and R in such a way as to make their capitals proportionate to their new profit sharing ratio which was to be P 3/5 and R 2/5. Goodwill was to be passed through books without raising a goodwill account. The Joint Life Policy was also not to appear in the balance sheet.

3) The balance sheet of X, Y and Z who were sharing profits in the ratio of l4:3:2 respectively stood as follows on 31st Dec 2002.

Liabilities		Rs	Assets		Rs
Sundry Creditors		4,140	Cash at bank		3,300
Capital accounts			Sundry Debtors	3,045	
X	12,000		(-) Provision	105	2,940
Y	9,000			---------	
Z	6,000	27,000	Stock		4,800
			Plant and Machinery		5,100
			Land and Building		15,000
		31,140			31,140

Y having given notice to retire from the firm, the following adjustments in the books of the firm were agreed upon:

a) That land and building be appreciated by 10%

b) The provision for bad debts in no longer necessary.

c) That the stock be appreciated 20%

d) That adjustment be made in the accounts to rectify a mistake previously made where by Y was credited in excess by 810 while X and Z were debited in excess by Rs 420 and Rs 390 respectively.

e) That the goodwill of the firm be fixed at Rs 5,400 and Y share of the same be adjusted to that of X and Z who are going to share future profits in the ration of 2:1

f) That the entire capital of the firm, as newly constituted will be readjusted by bringing in (or) paying of cash so that the future capital of X and Z be in the ratio or 2:1.

Pass journal entries and prepare the balance sheet of the new firm sharing Y's balance as loan.

Retirement and admission of a partner:

4) Ram and Rahim were working in partnership sharing profits equally on 31st Dec 2001, Ram decided to retire and in his place it was decided that Suresh his son, would be admitted as partner from Jan 1 – 2001 and his share in profits will be One – third

The balance sheet of the firm as on Dec 31 2001 was as follows:

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Liabilities		Assets	
Sundry Creditors	14,700	Goodwill	15,000
Capitals		L & B	40,050
Ram	54,300	Motor car	12,000
Rahim	48,000	Furniture	9,300
		Sundry Debtors	24,150
		Cash and bank balances	16,500
	--------------		--------------
	1, 17,000		1, 17,000

It was further decided as follows:

a) The goodwill should be raised to Rs 20,000
b) The motor car would be taken over by Ram at its book value
c) The value of L & B would be increased by Rs 8280
d) Rahim and Suresh would introduce sufficient capital to pay off Ram to leave thereafter a sum of Rs 7,350 as working capital in a manner that the capitals of the new partners will be in proportion to their profit sharing ration.
e) The capital payable by Suresh was to be gifted to him by his father

f) The new partners decided not to show goodwill as an assets
The partners introduced the capital on Jan 10, 2001 show the accounts of the partners and cash account.

5) The following is the balance sheet of Raman and Desha as at 30th June 2002 on which date Raman retired and his son Peter joined that firm from 1st July, 2002 with one fourth share in the profits of the business.

Liabilities		Assets	
Sundry Creditors	10,000	Goodwill	12,000
Capitals		Plant	40,000
Raman	50,000	Investment	14,000
Desha	31,000	Debtors	15,000
		Cash at Bank	10,000
	--------------		------------
	91,000		91,000

The following adjustments and arrangements have been agreed upon for the purposes of retirement and admission of partners.

1) Goodwill to be written upto Rs 30,000 and Plant Rs 50,000,
2) Sufficient money to be introduced so as to leave Rs 11,000. Cash after payment of amount due to Raman
3) Desha and Peter to provide such fund as would make their capitals proportionate to their share of profit. Show the journal entries to record above transactions amounting that Desha Peter have paid in the cash due on 2nd July 2002 and the amount due to Raman was paid on the same day.

UNIT IV
DEATH OF A PARTNER:

Meaning:

When a partner dies, he leaves the firm forever. Therefore, it is treated as permanent retirement. Death of a partner dissolves the partnership but the surviving partners generally carry on the business by purchasing the deceased partners share. The death of the partner may occur at any time during the course of the accounting period. It is necessary to ascertain the share of the deceased partner in the profit of the firm upto the date of death. In the event of death, the legal representative of the deceased partner will be entitled to get the share of the amount entitled to the deceased partner.

Mode of payment:

The amount due to the executors of the deceased partner may be repaid in any of the following ways.

1) Lump sum payment method:

If the firm has sufficient cash to pay off the amount due to the deceased partner, it can pay the amount immediately; this is known as lump sum payment method.

2) Installment payment method:

When a firm is not in possession of sufficient amount for making payment to the executor of the deceased partner, it can pay the amount in installment. In such a case, the total claim is first to be transferred to executors loan account and all payments by installments are recorded in this account. Payments may be made as per terms after charging interest on the amount due.

3) Annuity method:

Payment may also be made by annuity. If it is so, accounting record will be the same as in the case of payment by annuity in retirement.

Ascertainment of deceased partner's share of profit:

The actual share of the deceased partner in the profit of the firm till the date of the death can be calculated only by preparing the final accounts upto that date. Therefore the deceased partners share of profit may be estimated on the basis of time or on the basis of sales.

a) Time basis:

In order to calculate the share of profit of the deceased partner from the beginning of the accounting year to the date of death, previous year profit or average profits of the past three or four years is taken as base.

Formula for calculation of profit on the basis of time:

Profit from the date of last B/S to the date of death= $\dfrac{\text{No.of days or month from the date of last B/S to the Date of Death}}{\text{365 days or 12 months}}$ X average profit of given number of past numbers

b) Turnover or sales basis:

In order to calculate the share of profit of the deceased partners from the date of last balance sheet to the date of death on the basis of turnover, the following information is required:

1) The sales of the previous year
2) Sales up to the date of death

Formula for calculation of profit on the basis of turnover (sales)

Profit from the date of last B/S to the date of death= $\dfrac{\text{Sales from the date of last B/S to the Date of Death}}{\text{Previous year sales or average sales Of a given number of past years}}$ * Previous year's profit or average profit of a given number of past. numbers

On the basis of time:

1) A, B and C are partners in a firm sharing profits and losses in the ratio of 3:2:1. B dies on 14th March 2001. the average profit of the last 3 years is Rs 30,000. B's share of profit on the basis of time is calculated as under.

2) A, B and C are partners in a firm sharing profits and losses in the ratio of 3:2:1. B dies on 14th March 2006. Turnover from 1st Jan, to 14th March 2006 is Rs 42,000. Average turnover of the last 3 years is Rs 60,000 and profit is Rs 30,000. B's share of profit on this basis will be calculated as under.

Treatment of Life Policy

I Individual Policy:

3) A, B and C carried on business in partnership profits being divisible in the ratio of 3:2:1. The balance sheet on 31st Dec 2003 showed their capitals to be Rs 5,400 Rs 2,500 on 28th Feb 2004, A died

and you are instructed to prepare on account for presentation to his legal representative having regard to these facts.

a) The firm had insured the partners lives severally – A for Rs 4,500 and B's for Rs 2,400 C's for Rs 1,200 – The premium had been charged to P&L a/c. The surrender value on 28th Feb 2004 amounted in each case to 1/4th of the sum assured.

b) Capital carried interest at 10% per annum.

c) A's drawings from 1st Jan 2004 to the date of his death amounted to Rs 600.

d) A's share of profits for the portion of the current year for which he lived was to be taken on the average of last 3 years and goodwill has to be raised on the basis of 2 years purchase of average profits of the 3 years.

e) The annual profits were Rs 4,600 Rs 3,700 and Rs 4,300 respectively. Show A's a/c prepared.

II Joint Life Policy:

I When the premium written off to P&L a/c

1) When premium is paid

Insurance premium a/c Dr
To Bank a/c

2) When charged to P&L a/c

P&L a/c Dr
To Insurance Premium

3) When the amount is received on the death of partner:

Bank a/c Dr
To Joint Life Policy

4) When the amount is distributed the partner's capital a/c

Joint Life Policy a/c Dr
To Partner's Capital a/c

II When Surrender value is to be treated as on assets:

In this case, Insurance premium paid is first debited to policy a/c and credited to Bank a/c. The Joint Life Policy is reduced to it is surrender value by appropriate debit to the P&L a/c. The balance in the Joint Life Policy account will be shown as on assets in the Balance sheet.

III when premiums are to be written off through Joint Life Policy Reserve account

1) Premium paid;

Joint Life Policy a/c Dr
To Bank a/c

2) When a reserve equal to premium paid is created out of P&L a/c:

P&L a/c Dr
To Joint Life Policy Reserve a/c

3) When excess of Joint life policy over surrender value is written off to Joint Life policy Reserve a/c

Joint Life Policy Reserve a/c Dr
To Joint Life Policy a/c

4) When the amount of Joint life policy is received:

Bank a/c Dr
To Joint Life Policy

1) **When the balance of Joint Life policy reserve a/c is transferred to Joint Life Policy account**:

Joint Life Policy reserve a/c Dr

To Joint Life policy a/c

2) **When the Balance of Joint life Policy is distributed among the partners:**

Joint Life Policy a/c Dr

To Partner's capital a/c

4) A, B and C are partners sharing profits and losses in the ratio of 5:3:2. The balance sheet as at the end of the last year was follows:

Liabilities	Rs	Assets	Rs
Capital		Goodwill	1, 00,000
accounts	2, 00,000	Machinery	1, 00,000
A	1, 50,000	Debtors	3, 00,000
B	1, 00,000	Stocks	2, 00,000
C	50,000	Cash at Bank	50,000
Reserves	2, 50,000		
Creditors	7, 50,000		7, 50,000

Profits upto the date of death is estimated at Rs 90,000 without considering any depreciation. One Joint life policy of Rs 1, 50,000 (without profit) was taken in the last year, premium of Rs 10,000 was written off to P&L a/c. Each of the current assets (except cash and bank) is estimated to have gone up by 20%.

Creditors have increased by Rs 20,000. Goodwill is to be calculated at 2 years' purchase of average profit of 3 years. The profit was Rs 1, 80,000, Rs 2, 00,000 and Rs 2, 20,000.

Dues to deceased partners' representatives were to be settled on receipt of insurance claim to the extent possible. Balance was to carry 10% interest from the date of death and was to be paid after one year. Machinery was valued at Rs 80,000. Prepare necessary accounts and a balance sheet immediately after A's death.

5) P,Q and R are in the partnership showing profits equally. P dies on 31st March 2004 and the partnership deed provided the following.

a) The share of decreased partners capital account shall be taken at the balance on his capital account as at the date of last financial close, less drawings if any made to the date of death.

b) That his share of profit to the date of death be calculated on the basis of the average of the 3 preceding years.

c) That the goodwill of the firm shall be taken at one year at one year purchase of average profits of the preceding five years.

d) That the firm freehold property shall be taken at an independent valuation.

Liabilities	Rs	Assets	Rs
Creditors	37,800	Cash at office	1,000
Capital accounts P	60,000	Cash at bank	9,000
Q	40,000	Debtors	20,000
R	40,000	Stock	30,000
		Freehold property	80,000

	----------- 1,77,800	Goodwill	37,800 ------------ 1,77,800

Freehold property was valued at Rs 1,16,000 the profits for 5 years ended 31st Dec 2003 were – 1999Rs 23,000, 2000 Rs 28,000, 2001 Rs 18,000, 2002 Rs 16,000, 2003 Rs 20,000. Pass journal entries and show P capital account and the balance sheet of surviving partners.

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DISSOLUTION OF FIRM

INTRODUCTION:

Section 395 of the Indian partnership act lays down that "**Dissolution of partnership between all the partners of a firm is called the dissolution of the firm".** Dissolution of the firm leads to closure of the business. On the dissolution of the firm, the assets of the firm are realized and the liabilities are discharged.

MEANING:

Dissolution of firm means closing down the undertaking or suspending permanently the activities of a partnership business. In other words, it refers to the complete breakdown of a partnership and partners do not continue the firm. The dissolution of partnership between all partners of firm is called the dissolution of firm. The word dissolution is very significant. It contains the main grounds for dissolving the partnership of the firm.

BRIEFLY EXPLAIN THE MODE OF DISSOLUTION?

Dissolution of a firm takes place in the following ways:

(i) Dissolution by Agreement:

A firm may be dissolved with the consent of all the partners or in accordance with a contract between the partners. A firm is the result of an agreement; hence, it can be dissolved by an agreement.

(ii) Compulsory Dissolution (sec.41):

A firm is dissolved compulsorily by operation of law in the following ways:

a. Where all the partners or all except one becomes insolvent or insane;
b. Where the business becomes illegal;
c. Where all the partners except one decide to retire from the firm;
d. Where all the partners or all except one partner die.

(iii) Dissolution on the Happening of Contingencies (sec.42):

A firm is dissolved in any of the following ways unless there is an agreement among the partners to the contrary. These may be:

a. By the death of a partner
b. By the adjudication of a partner as insolvent
c. By completion of the venture for which it was established; and
d. By expiry of the term of the firm

(iv) Dissolution by Notice (sec.43):

In case of a partnership at will, the firm may be dissolved if any partner gives notice in writing to all the other partners of his intention to dissolve the firm. This is also known as dissolution of partnership at will.

(v) Dissolution by Court (sec.44):

A court order a partnership firm to be dissolved in case of a suit by partner on the following grounds:

When a partner becomes permanently incapable of performing his duties as a partner.

When a partner is guilty of misconduct affecting the business of the firm.

When a partner transfers whole of his interest in the firm to a third party.

ACCOUNTING TREATMENT

1) Realisation account
2) Capital accounts of partners
3) Cash account

Entries on Dissolution:

1) For Closing Assets account:

Realisation a/c Dr
To Asset a/c

(Being the assets are transferred) (Accumulated losses, cash balance, and bank balance should not be transferred)

2) For Closing Liabilities:

Bank Overdraft a/c Dr
Sundry creditors a/c Dr
B/P a/c Dr
All Provisions a/c Dr
All Reserves and fund a/c Dr
To Realisation a/c

(Being the liabilities are transferred to Realisation a/c) (Accumulated profits, liabilities due to partners should not be transferred to reailsation)

3) For Realizing Assets

Cash a/c Dr
To Realization a/c

(Being the assets are realized)

4) If some assets is taken away by the partner

Partners' capital a/c Dr
To Realization a/c

(Being the asset takeover the partners)

5) For payment of liabilities

Realization a/c Dr
To cash

6) If the partners agree to pay a liability

Realisation a/c Dr
To Partner's capital a/c

(Being the liability is paid by the partners)

7) For expenses on dissolution:

Realisation a/c Dr

To cash

(Being expenses on dissolution are paid)

8) For treatment of reserve: In case some reserve (Or) provision is made against some assets then such reserve (or) provision is transferred to realization account:

Reserves and Provisions a/c Dr

To realization a/c

(Being reserve is transferred to realization a/c)

9) For closing realization account, if there is profit on realization.

Realisation a/c Dr

To Partner's capital a/c (in profit sharing Ratio)

(Being the profit on realization is transferred)

10) For closing accumulated profits

General Reserve a/c Dr

Profit and Loss a/c Dr

To partner's capital a/c

(Being the general reserve is transferred)

11) Loans due to partners is paid

Loan a/c Dr

To cash a/c

(Being the loan due to partner is paid)

12) For closing capital accounts

Capital account of the partners a/c Dr

To cash/ bank a/c

Treatment of unrecorded assets and liabilities

1) When an unrecorded asset is realized the entry is

Cash/ Bank a/c Dr

To realization a/c

2) When an unrecorded liability is paid

Realisation a/c Dr

To cash/ bank a/c

Treatment of goodwill: No special treatment is given to goodwill it is treated like other assets. If it appears in the books on the dissolution date, if it closed by transferring if to the debit side of the realization account. If it does not appear in the books on the dissolution date and some amount is realized for goodwill the entry is:

Cash / Bank a/c Dr

To Realisation a/c

(Being the amount realized for goodwill)

PROBLEMS

1. Ram, Rahim and Suresh share profits in the ratio 3:2:1. on 31.12.2004, their balance sheet was as follows

Liabilities	**Rs**	**Assets**	**Rs.**
Capital accounts:		Goodwill	13000

Ram	20000	Machinery	25000
Rahim	15000	Stock	11000
Suresh	10000	Sundry debtors	9500
Sundry creditors	12000	Cash at bank	1500
General Reserve	3000		
	60000		60000

On the above date, the firm was dissolved. The assets except cash realized Rs.60,000. The creditors were settled at Rs.11,500. Dissolution Expenses amounted to Rs.800. Give necessary ledger Accounts.

2) The partnership between Ram and Mohan was dissolved on 31st March 1989. On that date the respective creditors to the capitals were: Ram Rs 50,000 and Mohan Rs 30,000, Rs 10,000 were owed by mohan by the firm: Rs 20,000 were owed by the firm to Ram and Rs 15,000 were due to trade creditors.

The assets represented by the above stated net liabilities realized Rs 90,000 exclusive of Rs 10,000 owed by Mohan. Trade creditors will be settled at book figure. In addition, one bill for Rs 1,000 under discount was dishonoured and had to be taken up by the firm. The expenses realization came to Rs 1,200. Prepare necessary ledger accounts to close the books of the firm.

3) Ramesh and Mahesh were in partnership sharing profits in the ratio of 3:1. They agreed to dissolve the firm. The assets realized Rs 1, 50,000. The liabilities of the firm were as follows:

Creditors Rs 90,000 Loan from Ramesh Rs 40,000 Ramesh capital Rs 20,000 and Mahesh capital Rs 30,000. Show by means of accounts the distribution of cash realized.

4) Ram, Shyam and Mohan are partners sharing profits and losses as to 2:2:1. Their balance sheet as on Dec 31, 2009 is as follows.

Liabilities		Rs	Assets	Rs
Creditors		4,000	Cash	5,000
Capitals:			Sundry debtors	4,000
Ram	10,000		Stock	5,000
Shyam	4,000		Fixtures	2,000
Mohan	2,000	16,000	P&M	9,000
Reserve fund		5,000		
		25,000		25,000

They decided to dissolve the business. The following are the amounts realized.

P&M	Rs 8,500
Fixtures	Rs 1,500
Stock	Rs 7,000
Sundry Drs	Rs 3,700

Creditors allowed a discount of 2% and Ram agreed to bear all realization expenses. For this service Ram is paid Rs 120. Actual expenses amounted to Rs 900. there was an unrecorded asset of Rs 500 which was taken over by Shyam Rs 400.

Prepare the necessary accounts to close the books of Ram, Shyam and Mohan.

3) The balance sheet of a firm as on 31st March 2009 was as follows:

Liabilities	Rs	Assets	Rs.
Creditors	2,000	Cash at bank	3,000
Capital:		Investments	2,000
X	5,000	Book debts	1,000
Y	4,000	Cash at Bank	3,000
Z	3,000		
	14,000		14,000

The partnership was dissolved on 31.03.2009. The sundry creditors were paid at a discounted rate of 5% . X agreed to atke over freehold property at Rs. 9,000. Y investment at Rs. 1,500 and Z, bookk debts at Rs. 600. The expenses of realization came to Rs. 110.

Prepare the necessary ledger accounts to close the books of the firm.

UNIT V
INSOLVENCY OF A PARTNER

Meaning:

Garner Vs. Murray

According to sec 42(d) of the Indian partnership Act 1932, subject to contract between the partners, the partnership firm is dissolved by the adjudication of a partner, as an insolvent. This is known as insolvency of a partner. When a partner becomes insolvent (ie) his liabilities are more than his assets, he is said to be declared as insolvent. If a partner becomes insolvent, he may not be in a position to pay his debit balance of capital account either fully or partly.

Write the rule in Garner Vs Murray:

The rule in Garner Vs Murray is applicable in case of insolvency of one or more partners but not all the partners. The following are the two effects of this rule on the account of the firm.

1) All the solvent partners should bring cash equal to their share of the loss on realization.

2) The deficiency of the insolvent partners must be borne by the solvent partners in their ratio of their capitals then standing. But if some partner is having a debit balance on his capital account and is not insolvent, then he cannot he called upon to hear loss on account of the insolvency of other partner.

ACCOUNTING TREATMENT IN CASE OF FIXED AND FLUCTUATING CAPITAL

Capital Ratio under Fixed Capital Method:

If the capital accounts of the partners are fixed throughout the existence of the partnership, the original capital of the solvent partners will be used as basis for the division of the insolvent partner’s deficiency.

All adjustments will be recorded in the current accounts of the partners. The deficiency of the insolvent partner will be ascertained after transferring the balance of the insolvent partner’s current account to his capital account. The deficiency of the insolvent partner should be transferred to the current accounts of the solvent partners in proportion to their agreed fixed capitals.

Capital Ratio under Fluctuating Capital Method:

If the capital accounts of the partners are floating, the deficiency of the insolvent partner’s capital account will be shared among the solvent partners in the ratio of those capitals which were shown in their capital accounts at the end of the last accounting period before dissolution after taking into all adjustments.

Capital ratio:

Calculate capital ratio for insolvency loss adjustment. If fixed capital as base for computing capital ratio. If fluctuating model take capitals make all adjustments and not adjusted profit (or) loss on realization account.

PROBLEMS

Insolvency of One Partner

1) **The following is the balance sheet of a firm as on 31-12-2002**

Liabilities	Rs	Assets	Rs
Creditors	2, 04,200	Bank	11,000
P's Loan a/c	60,000	Debtors	1, 92,120
Q's Loan a/c	24,000	Stock	1, 28,000
P's Current a/c	42,400	Machinery	27,200
Q's Current a/c	5,000	Land	1, 68,000
Capital A/c's		R's Current a/c	19,880
P	1, 20,000		
Q	80,000		
R	40,000		
	5, 76,200		5, 76,200

It was decided to close the firm on that date. The assets (with the exception of bank balance) realized Rs 4, 53,600. The firm had to pay Rs 3,000 for an outstanding bill not recorded in the books. R becomes insolvent and Rs 2,000 is realized from his estate prepare necessary accounts in the books of the firm assuming.

i) Partners capitals are fixed
ii) Garner vs murray is followed.

2) X, Y and Z are partners sharing profits and losses in the ratio of 4:2:3. On 1st Jan 2002 they agreed to dissolve the partnership their balance sheet was as follows:

Liabilities	Rs	Assets	Rs
Profit and loss	4,500	Buildings	45,000
Reserve fund	12,600	Machinery	15,000
Bills payable	4,100	Furniture	3,700
Creditors	9,000	Stock	19,400
Loan from X	4,000	Debtors	31,000
Capital accounts		Investments	24,000
Z	3,000	Bills Receivable	5,600
Y	46,000	Cash at Bank	6,500
X	68,000	Cash in hand	1,000
	1, 51,200		1, 51,200

The assets realized: Investments Rs 20,400 B/R and Debtors Rs 28,200. Stock Rs 14,550, Furniture Rs 2050 Machinery Rs 8,600 Buildings Rs 26,400. All the liabilities were paid off. The cost of realization was Rs 600. Z had become bankrupt and Es 1024 only was recorded from his estate once and for all. Partners were finally paid off. Show the realization account, the bank account and the capital accounts of the partners when the capitals are fluctuating.

3)A, B and C carrying on business as merchants and sharing profits and losses in the ratio of 2:2:1 dissolved that firm as on Feb 16, 2009 on which date their balance sheet was as follows:

Liabilities	Rs	Assets	Rs
Sundry creditors	20,000	Cash	4,500
Profit and loss a/c	10,000	Stock	16,000
J.L.P Reserve	8,000	Debtors 10,000	
Mrs. A's loan	3,000	(-) Provision 500	9,500
Advance from C	1,000	----------	
Capital accounts		Joint Life Policy	11,000
A	15,000	Premises	26,000
B	14,000	A's drawings	1,000
C	2,000	C's drawings	5,000
	73,000		73,000

Notes: A Liability of a bill of Rs 800 received from P is under discount. The assets except cash and joint life policy were sold to a company for Rs 45,500 cash. The policy was surrendered for and sum of Rs 10,800 was received. P proved insolvent and a sum of Rs 500 was received from his estate. Sundry creditors were paid Rs 19,500 in full settlement. Realisation expenses amounted to %Rs 3,000.

C was declared insolvent. His private estate was worthy Rs 5,000 and his personal liabilities amounted to Rs 4,900. An unrecorded assed worth Rs 2,550 was given as a gift to the manager of the firm for services rendered by him.

Prepare realization account and partner's capital accounts.

4) L, M, and N are partners sharing profits and losses in the ratio of 3:2:1 respectively. The firm was dissolved on 31.12.05 on which date its balance sheet was as follows:

Liabilities	Rs	Assets	Rs
Capital accounts:		Plant and Machinery	28,500
L	45,000	Stock	25,000
M	5,000	Sundry debtors	25,000
N	5,000	Cash at bank	1,500
L's current a/c	750	M's current a/c	1,000
Sundry creditors	20,000	N's current a/c	2,500
Bills payable	3,500	Profit and loss a/c	750
Bank loan	5,000		
	84,250		84,250

Plant and Machinery realized for Rs 20,000. Stock realized Rs 15,000; Debtors realized Rs 21,000; Goodwill was sold for Rs 300. The dissolution expenses amounted to Rs 600. N is insolvent and a dividend of 50 paise in the rupee is received from his private estate.

Pass journal entries and prepare ledger accounts to close the books of the firm applying the rule in Garner Vs Murray.

Insolvency of Two partners

5) The following is the balance sheet of Arun, Babu, Cheran and David on 31.12.94. They shared profits and losses in the ratio of 4:3:2:1.

Liabilities		**Rs**	**Assets**	**Rs**
Capitals:	A	15000	Fixed assets	20000
	B	10000	Current assets	6000
	C	1500	Goodwill	5000
Sundry creditors		5000	David's capital	500
		31500		31500

David has no separate assets and liabilities. The partners decided to dissolve the business. Fixed assets realized Rs.15000 and current assets realized Rs.5000. the goodwill is valueless. Realization expenses amount to Rs.1500. Cheran can contribute only Rs.250 from his separate resources. Prepare necessary accounts according to Garner Vs Murray assuming both Cheran and David have become insolvent.

6) The summarized balance sheet of A, B, C and D (who shared profits and losses in the ratio of 4:3:2:1) was as follows on 31st March 2006.

Liabilities	Rs	Assets	Rs
Sundry creditors	20,000	Cash	1,000
Capital		Stock	2,000
A	60,000	Debtors	15,000
B	40,000	Plant and Equipment	80,000
C	6,000	Goodwill	20,000
		Capital D	2,000
	1, 26,000		1, 26,000

The partners decide to wound up the business as C and D become insolvent. A sum of Rs 1,000 is realized from C's separate resources while D has no separate assets or liabilities.

Stock and debtors realize Rs 4,000 and Rs 9,000. Plant and equipment are sold for Rs 50,000 while goodwill is valueless. The costs of realization amount to Rs 6,000 while sundry creditors have to be paid their claims in full. One of creditors for Rs in the books of the firm actually claimed Rs 12,000 and his claim was finally settled at Rs 10,000 by arbitration.

Close the books of the firm by showing the relevant important ledger accounts.

7) The following is the B/S of A, B, C and D on 31.12.00. They shared profit and losses in the ratio of 4:3:2:1.

Liabilities	Rs	Assets	Rs
Capitals		Fixed Assets	2, 00,000
A	1, 50,000	Current assets	60,000
B	1, 00,000	Good will	50,000
C	15,000	D's capital	5,000
Sundry Creditors	50,000		
	3, 15,000		3, 15,000

D has no separate assets and liabilities. The partners decided to dissolve the business. Fixed assets realized Rs 1, 50,000 and current assets realized Rs 50,000. The goodwill is valueless. Realisation expenses amount to Rs 15,000. C can contribute only Rs 2,500 from his separate resources. Prepare necessary accounts according to Garner vs Murray assuming the both C and D have become insolvent.

Insolvency of all Partners
Meaning:

When liabilities of the firm cannot be paid in full, out of firm's assets as well as personal assets of the partners, then all the partners of the firm are said to be insolvent. Under such circumstances it is better not to transfer the amount of creditors to realization account. Creditors may be paid the amount available including the amount contributed by the partners. The unsatisfied portion of creditor account is closed by transferring it to capital accounts of the partners in the profit sharing ratio. Then capital accounts are closed (or) transferring the deficiency to other partners in accordance with rule in Garner Vs Murray. For this purpose and capital account having the worst position is taken first. The last capital account gets automatically closed.

8). X,Y and Z are equal partners, whose balance sheet on 31.12.1992 is as follows:

Liabilities	Rs	Assets	Rs
Capitals: X	1,600	Plant and machinery	4,000
Z	1,000	Land & Buildings	4,000
Z's Loan	2,000	Furniture	1,600
Sundry creditors	10,000	Debtors	2,000
		Stock	1,600
		Cash in Hand	100
		Y's Capital (overdrawn)	1,300
	14,600		14,600

Due to lack of liquidity and weak financial position of the partners, the firm is dissolved. X and Z are not able to contribute anything and a sum of Rs.400 received from Y. All of them are declared insolvent.

The assets are realized: stock- Rs.1,000; Plant and Machinery- Rs.2,000; Furniture –Rs.400; Land and Buildings-Rs.1,600; and Debtors Rs1,100 only. Realization expense amounted to Rs.100. You are required to close the books of the firm.

9) A, B and C are equal partners, whose Balance sheet on 31. 12.2006 is as follows:

Liabilities	Rs	Assets	Rs
Capital a/c's A	600	P&M	1,475
Sundry Creditors	3,900	Furniture	400
		Debtors	500
		Stock	625
		Bank	300
		B's capital	1,200
	4,500		4,500

The assets were realized as follows:

Stock Rs 350; Furniture Rs 200; Debtors Rs 500 and P&M Rs 700. The cost of collecting and distributing the estate amounted to Rs 150. A's private estate is not sufficient even to pay his private liabilities, whereas in B's private estate, there is surplus of Rs 50. Prepare Realisationa/c, cash a/c, Creditors a/c, Capital a/c and the deficiency a/c of the partners.

10) A, B and C are partners in the ratio of 2:2:1. Below is the balance sheet as on 30th Sep 2003.

Liabilities	Rs	Assets	Rs
Sundry Creditors	40,000	Current assets (including cash Rs 1,000)	8,000
Y's loan on security	10,000		
Provision depreciation – furniture	2,000	Furniture	5,000
Contingency Reserve	1,000	Other fixed assets	5,500
Capital accounts		C's capital- Overdrawn	3,500
A	5,000		
B	4,000		
	62,000		62,000

Assets of the firm proved bogus and due to its inability to pay creditors, it was dissolved on 31st Dec 2003. During these three months from the above date of balance sheet there was no change excepting current assets of the firm deceased to Rs 5,000 and a contingent liability in respect of a case against the firm of Rs 2,000 became a real liability. The contribution from the estates of A was Rs 2,000, C had a private liability of Rs 6,500 and private assets (including his life policy) Rs 7,000. Assets of the firm realized – current (other than cash) Rs 4,000. Furniture Rs 1,500 and fixed assets Rs 20,000. Prepare ledger accounts all partners were insolvent

PIECEMEAL DISTRIBUTION:

While solving various problems on dissolution of a partnership firm, it has been assumed that all the assets are realized immediately on the date of dissolution and all liabilities are paid off on the same date. But in actual practices, it seldom happens. The assets are sold gradually to realize the best price for them. Similarly, the liabilities are paid off gradually depending upon amount realized from the sale of assets. As a result, the final profit or loss on realization cannot be ascertained until all the assets are sold and all liabilities completely paid off.

When assets are realized gradually, the following order of payment is adopted:

1. Payment to creditors and other external liabilities
2. Payment of partners loan rateably
3. If any amount remains after making above payments, this is utilized in payment of capitals to the partners.

While making payment to partners, the following two methods may be adapted:

1. Proportionate capital method/ Surplus capital method
2. Maximum Loss method

I Proportionate Capital Method (or) Surplus capital or Highest Relative Capital method

It was already been said that money realized cannot be paid to partners either in the profit sharing ratio (or) capital ratio. In both the cases the final amount left unpaid will not be in profit sharing ratio. It should be distributed in such a way that the final amounts left unpaid are in profit sharing ratio. This aim is achieved by comparing capitals of partners and paying the one who has the capital in excess of what is required according to his share in the profits.

11) A, B and C are in partnership. The following is their balance sheet as at 31.12.2002 on which date, they dissolved partnership. They share profits in the ratio 5:3:2

Liabilities	Rs	Assets	Rs
Capitals:		Premises	40,000
A	50,000	Plant	30,000
B	15,000	Stock	30,000
C	45,000	Debtors	60,000
Creditors	40,000		
A' s loan a/c	10,000		
	1, 60,000		1, 60,000

It was agreed to repay the amounts due to the partners as and when the assets were realized, viz: 1.2.03 Rs. 30,000; 1.4.03 Rs 73,000; 1.6.03 47,000.

Prepare a statement showing how the distribution to the partners should be made.

12) East, South and North are in partnership showing profits and losses in the ratio 3:2:1 respectively. They decide to dissolve the business on 31st Dec 2002 on which date their balance sheet was as follows:

Liabilities	Rs	Assets	Rs
Capital Accounts		Land and Buildings	30,180
East	38,700	Motor Car	5,160
South	10,680	Investment	1,080
North	11,100	Stock	19,530
Loan account:		Debtors	11,280
North	3,000	Cash	5,940
Creditors	10,320		
	73,800		73,800

The assets were realized Piecemeal as follows and it was agree that cash should be distributed as and when realized:

15th Jan 2003	10,380
20th Feb 2003	27,900
23rd Mar 2003	3,600

15th April 2003 North took over investment at a value of Rs 1,260

27th April 2003	19,200

Dissolution expenses were originally provided for an estimated amount of Rs 2,700 but actual amount spent on 29th March 2003. The creditors were settled for Rs 10,080. You are required to prepare a statement showing distribution of cash amongst the partners.

Maximum Loss Method

13) Pinku, Rinku and Tinky were in partnership sharing profits and losses in the ratio of 3:2:1. Their balance sheet on 31st Dec 2003 was as follows:

Liabilities	Rs	Assets	Rs
Sundry Creditors	30,000	Cash	3,000

Tinku's Loan a/c	5,000	Stock	25,000
Capital accounts:		Debtors	35,000
Pinku	15,000	B/R	3,000
Rinku	15,000	Furniture and fittings	9,000
Tinku	10,000		
	75,000		75,000

The B/R were accepted on 1st Nov 2003 payable after three months.

On 1st Jan 2004, the firm was dissolved the assets realized and the expenses were as follows:

	Stock	Debtors	Furniture and fittings	Expenses
Jan 31	5,000	7,000	2,000	600
Feb 28	9,000	10,000	3,500	1,000
March 31	6,000	11,000	--	3,000
April 30	2,500	4,500	2,000	900

The bills receivable were dully honoured. Prepare a statement showing the distribution of cash. Assume payments were made on the last day of the months. Also write up the cash account and partner's capital accounts.

14) A,B and C share profits and losses in the proportion of 1/2 , 1/3, and 1/6. their balance sheet as follows:

Liabilities	**Rs**	**Assets**	**Rs**
Creditors	50,000	Land & Buildings	70,000
A's Loan	10,000	Plant & Machinery	40,000
A' s capital	50,000	Stock	25,000
B's Capital	10,000	Debtors	20,000
C's Capital	40,000	Cash	5,000
	1,60,000		1,60,000

The partnership is dissolved and the assets are realized as follows:

1st Realisation	40,000
2nd Realisation	30,000
3rd Realisation	54,000
4th Realisation	7,000

Prepare a statement showing how the distribution should be made according to maximum loss method.

COMPLETED

Reference

1. **S. P. Jain and K.L. Narang.** *Financial Accountancy*. Kalyani Publishers. New Delhi.
2. **P.**C. Tulsian. *Financial Accounting*. Tata McGraw-Hill Publishing Company Limited.
3. **Reddy and Murthy** Financial accounting.