

MAR GREGORIOS COLLEGE OF ARTS & SCIENCE

Block No.8, College Road, Mogappair West, Chennai – 37

Affiliated to the University of Madras
Approved by the Government of Tamil Nadu
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DEPARTMENT OF COMMERCE (ACCOUNTING & FINANCE)

SUBJECT NAME: ADVANCED FINANCIAL ACCOUNTING

SEMESTER: II

PREPARED BY: PROF.M.PARTHIBAN

ADVANCED FINANCIAL ACCOUNTING

SYLLABUS

Unit I: Branch Accounts Dependent Branches - Stock and Debtors system – Distinction between Wholesale Profit and Retail Profit – Independent Branches (Foreign Branches excluded)

Unit II: Departmental Accounts Basis of Allocation of Expenses – Calculation of Profit - Inter-departmental Transfer at cost or Selling Price.

Unit III: Partnership Accounts Admission of a Partner – Retirement of a Partner – Death of a Partner.

Unit IV: Partnership Accounts Dissolution of a Partnership Firm – Insolvency of a Partner – Insolvency of all Partners Piecemeal Distribution of cash in case of Liquidation of Partnership Firm.

Unit V: Accounting Standards for financial reporting Objectives and uses of financial statements for users-Role of accounting standards Development of accounting standards in India- Requirements of international accounting standards - Role of developing IFRS- IFRS adoption or convergence in India- Implementation plan in India- Ind AS-Difference between Ind AS and IFRS. Note: Questions in Sec. A, B & C shall be in the proportion of 20:80 between Theory and Problems.

TEXT BOOK:

1. Lt Bhupinder – principles of Financial Accounting – CENGAGE, New Delhi
2. Raj Kumar Sah – Concepts Building Approach to Financial Accounting - CENGAGE, New Delhi
3. Gupta, R. L & Gupta, V. K, Advanced Accounting, Sulthan Chand & Sons, New Delhi.
4. Jain & Narang, Financial Accounting, Kalyani Publishers, New Delhi. UNIVERS

INTRODUCTION

Local demand for the products or services of a concern is easily met from its single office. But as the area of its operation extends, it becomes increasingly difficult and costly to pursue from the same office. Sooner or later, a section of the business is segregated from the existing centre of operation and established elsewhere. Every such segregated establishment is called 'branch', as distinguished from the parent establishment, termed 'head office'.

Branch merchandising or servicing activities: Section 2(9) of the Companies Act, 1956, inter alia defines a branch office as "any establishment carrying on either the same or substantially the same activity as that carried on by the head office....or any establishment engaged in any production, processing or manufacture." Large concerns engaged in merchandising, manufacturing, banking, insurance and various other operations have numerous branches scattered at different places inside and outside the country of their origin. Accordingly, this chapter elaborates the fundamental accounting procedures applied to the operations of various branches.

DEPARTMENTS Vs. BRANCHES

Although departments (see Lesson 6.2) and branches are the intrinsic divisions of their respective concern, yet they widely differ as to the following:

(1) Departments operate along with their head office in the same premises but branches are distantly segregated from each other as also their head office. This is why L.C. Cropper calls branches as 'departments conducted at a distance.' Thus, place or physical segregation is a distinguishing feature of branches.

(2) Because of (1), the head office is in constant touch with its departments. It closely supervises and effectively controls their affairs. But in case of far off branches, it is well nigh impossible for the head office to remain in constant touch. It may exercise considerable control over closely located branches but only a nominal control on overseas branches.

(3) Functional division is a must for the existence of departments. Not all departments can pursue the same line of trade. This is not so with branches. Usually they function on the line of multiple shops. Numerous offices of a commercial bank and retail shops of Bata Shoe Company are the common examples of branch establishments. In some cases, they

also function diversely. For instance, branches of the Delhi Cloth and General Mills Ltd. are variously engaged in the manufactures of cotton textiles, sugar, chemicals, vegetable oils, engineering products, business machines, etc.

TYPES OF BRANCHES

Branches vary according to the nature and magnitude of operations pursued as well as the degree of autonomy enjoyed. Obviously, no single system of branch accounting would suit each of the varied types of branches. Accordingly, numerous systems of branch accounting have been developed and the use of any one thereof largely rests with the given type of branch. Study of the branch accounting is thus interlinked with the types of branches.

Branches may be variously classified. According to location, they are grouped into home and foreign branches. Based on practical consideration (such as autonomy, varied currencies, etc.), they are divided into dependent, independent and foreign branches.

As regards the work that is done by branches, there is no hard and fast rule. There are branches, like the Bata Shops, that only do retailing. Others carry on wholesale business. A branch may also be a full-fledged manufacturing unit. For example, the Delhi Cloth and General Mills Ltd. has 'branches' at various places which manufacture sugar, cotton textiles, hydrogenated oils, fertilizers and chemicals, etc. These "branches", however, are so big that they are better termed as divisions; they enjoy a very large degree of autonomy and trade in their own name. The same company also maintains a large number of retail shops. The parent organisation—the Head Office—may itself be engaged in manufacturing and/or selling or it may be only a controlling and co-ordinating agency. The accounting work that may be done at the branches will depend on the decision made by the head office in this behalf; but generally, more the work entrusted to a branch, the more will be the accounting work that will be done by the branch. Branches are usually divided into five classes:

- (a) A branch that receives goods only from the head office, sells only for cash and remits all the cash collected to head office, the expenses of the branch being met by remittances from the head office.
- (b) A branch that receives goods only from the head office, sells both for cash and credit

and remits all the cash collected to head office, the expenses of the branch being met by remittances from the head office.

- (c) Same as above, but with the difference that goods are invoiced by the head office to the branch at selling price.

In the above three cases, the branches will not do any accounting work except preparing statements of stocks as regards receipt, sale and balance and cash statements. Branches that are allowed to make credit sales will also maintain accounts of customers.

(d) "Independent" branches, i.e., those branches that are allowed to make purchases themselves, make sales both for cash and credit and carry on their work in an autonomous manner. Such branches usually maintain their own books of account. The results of the branch and the head office are integrated at the end of the financial period.

(e) Foreign branches: Such branches are also "independent" and have their own books of account.

ACCOUNTS OF VARIOUS TYPES OF BRANCHES

(A) Branch selling only for cash: As has been stated

above, the branch that is allowed to sell only for cash is generally not required to maintain account books. The branch will maintain a petty cash book a copy of which will be forwarded to the head office. It will also forward to the head office, each week or each month, a stock statement. This statement will show, for each item, the opening stock, the stocks received during the period, sales during the period, breakage or losses during the month (for which head office sanction will be required) and the closing stock. The stock statement will serve the purpose of controlling the stock at the branch and the purpose of guiding the head office as to which stocks should be replenished. Needless to say, the statement must be submitted by a fixed day.

The column for total sale proceeds will enable the head office to check whether the total cash realised has been remitted to the head office or not. In the remarks column, details of breakages, losses or leakages (entered in the column for Other Issues) together with head office sanction to write off the breakages, etc., should be entered. The statement should be signed by the branch manager and also by the person in-charge of the stocks. It would be better to prepare this statement every week.

The head office finds out the profit or loss made at the branch by the simple

method

of putting on one side what is sent to the branch (goods and cash for expenses) and putting on the other side the total cash received. Supposing there are no opening or closing stocks, if goods worth Rs. 10,000 are sent to the branch and a sum of Rs. 3,000 is incurred as expenses at the branch and if the branch remits a sum of Rs. 15,000, there is a net profit of Rs. 2,000 at the branch. The entries to be made at the head office will be as follows:-

1. When goods are sent: Debit the Branch Account
Credit Goods Sent to Branch Account
2. When Cash is sent to branch (for expenses): Debit the Branch Account
Credit Cash
3. When Cash is received from the branch: Debit Cash (or Bank)
Credit Branch Account.

If the branch has no stock left and no balance of cash, the Branch Account will reveal profit or loss made at the branch. But usually, there is a closing stock and a closing balance of cash. The entry to record these at the end of the year is:

Debit Stock at Branch Account;
Debit Cash at Branch Account;
and Credit Branch Account.

Profit or loss should be ascertained after making this entry. The profit or loss should be transferred to the General Profit and Loss Account. "Goods Sent to Branch Account" should be transferred either to the credit of the Trading Account in case of manufacturing concerns or to the credit of the Purchases Account in case of trading concerns. "Stock at Branch" and "Cash at Branch" are assets and will appear in the balance sheet. Next year, in the beginning, both these accounts will be transferred to the debit of the Branch Account.

To summarize, the Branch Account should be debited with (1) the opening balance of stock or cash; (2) the value of goods sent to the branch, and (3) the cash sent for expenses. It should be credited with cash received from the branch and the value of closing stock and cash in hand. The difference in the two sides will be profit or loss.

Illustration 1: Branch selling for cash only and invoiced at cost:

Pondicherry Papers Ltd. invoices goods to its Mahe Branch at cost. All the expenses are paid direct from the head office, except petty cash expenses which are paid by branch manager. Branch is advised to sell for cash only, and deposit the day's sale proceeds in the Head Office Account with a local bank. From the following details, ascertain the profit of the Mahe Branch through Debtors System.

	Rs.		Rs.
Stock (Jan. 1)	2,100	Salaries and Wages	1,860
Petty Cash (Jan. 1)	50	Advertisement	240
Furniture (Jan. 1)	250	Rent and Rates	360
Goods supplied from H.O.	7,800	Stock (Dec. 31)	1,950
Goods returned back to H.O.	300	Petty Cash (Dec. 31)	30
Cash Sales	15,250	Furniture (Dec. 31)	230

**SOLUTION: Books of
Pondicherry Papers
Ltd. (H.O.) Mahe Branch
Account**

		Rs.	Rs.			Rs.	Rs.
Jan 1	To Branch Assets:			Dec. 31	By Return of Goods to H.O.		300
	Stock	2,100			Bank (Sale proceeds)		15,250
	Petty Cash	50			By Branch Assets:		
	Furniture	250	2,400		Stock	1,950	
Dec. 31	Goods supplied to Branch		7,800		Furniture (1)	230	
	Cash:				Petty Cash (2)	30	2,210
	Salaries & Wages	1,860					
	Rent and Rates	360					
	Advertisement	240	2,460				
	Profit transferred to Profit & Loss A/c		5,100				
			17,760				17,760

(A) Branch selling both for cash and credit: In this case also, the main accounting work is done at the head office. The branch will keep a petty cash book and prepare, periodically, the stock statement to be sent to the head office. It will also have to keep accounts of credit customers so that the customers can be reminded about the balances due from them. The head office will keep accounts of the branch much in the same way in which in the accounts of the first type of branch are kept. The only exception is that the following additional entries will be made:

1. To transfer the branch debtors in the beginning of the

year: Branch Account . . . Dr.

To Branch Debtors

2. To record the branch debtors at the end of the

year: Branch Debtors . . . Dr.

To Branch Account

The Branch profit or loss will be ascertained only after the above entries are made. The "Branch Debtors," like "Branch Stock," are assets and will be shown in the Balance Sheet.

Note: No entry is made for credit sales at branch in the head office books. Cash received from the debtors will be remitted to the head office along with cash received for cash sales. The head office will make entry only for cash received by it. It will debit cash and credit the branch. By the same token, the head office makes no entry for discounts allowed, bad debts written off or returns by the branch debtors. If the branch has received a bill of exchange, it will be sent to the head office. The entry then will be to debit Bills Receivable Account and credit Branch Account.

Illustration 2: Messrs VST & Sons are having their Head Office at Pondicherry and Branch at Madras. The following are the transactions of the Head Office with Branch for the year ended 31st August, 1995.

Stock at Branch as on 1.9.94	30,800	
Debtors at the Branch as on 1.9.94	16,500	
Petty Cash as on 1.9.94	500	
Goods supplied to the Branch	1,51,200	
Remittances from Branch:		
Cash Sales	10,500	
Realization of Debtors	1,57,740	1,68,240
Amounts sent to Branch:		
Salary	7,440	
Rent	2,400	
Petty Cash	3,000	12,840
Stock at Branch as on 31.8.95		23,150
Sundry Debtors at the Branch as on 31.8.95	50,460	

PettyCash as on 31.8.9 750

Show the Branch Account in the books of the Head Office.

Solution

VST & SONS Madras Branch Account

		Rs.	Rs.			Rs.	Rs.
1994	To Balance b/d:			1994	By Bank/Cash :		
Sep.1	Stock at Branch	30,800		Sep.1	Cash	10,500	
	Branch Debtors	16,500		1995	Sales Debtors	1,57,740	1,68,240
	To Goods sent to Branch A/c	<u>500</u>	1,51,200	Aug.31	By Balance c/d	23,150	
	To Bank (Remittances)				: Stock at Branch	50,460	
	Salary	7,440			Branch Debtors	750	74,360
	Rent	2,440			Cash at Branch		
	Petty Cash	<u>3,000</u>	12,840				
	To P & LA/c		30,760				
			2,42,600				2,42,600

Illustration 3:

From the following particulars relating to Madurai branch for the year ending December 31, 1991 prepare Branch Account in the books of Head Office:

Stock at branch on January 1, 1991	10,000
Branch debtors on January 1, 1991	4,000
Branch Debtors on Dec. 31, 1991	4,900
Petty Cash at branch on January 1, 1991	500
Furniture at branch on January 1, 1991	2,000
Pre-paid fire insurance on January 1, 1991	150
Salaries outstanding at branch on January 1, 1991	100
Goods sent to Branch during the year	80,000
Cash sales during the year	1,30,000
Credit Sales during the year	40,000
Cash received from debtors	35,000
Cash paid by the branch debtors direct to Head Office	2,000
Discount allowed to debtors	100
Cash sent to branch for expenses:	
Rent	2,000
Salaries	2,400
Petty Cash	1,000
Insurance upto March 31, 1992	600
Goods returned by the branch	1,000
Goods returned by the debtors	2,000
Stock on December 31	5,000
Petty expenses by the branch	850

Provided depreciation on furniture 10% p.a
Goods costing Rs. 1,200 were destroyed on account of fire and a sum of Rs. 1,000 was received from the Insurance Company.

Solution

Madurai Branch Account

	Rs.	Rs.		Rs.	Rs.
To Opening Balances:			By Opening Balances:		
Stock		10,000	Salaries Outstanding		
Debtors		4,000	By Remittances:		
Petty Cash		500	Cash sales	1,30,000	
Furniture		2,000	Cash received from debtors	35,000	
Prepaid Insurance		150	By Cash paid by debtors direct to H.O.	2,000	
To Goods sent to branch		80,000	By Received from Insurance Company	1,000	1,68,000
To Bank (expenses):			By Goods sent to branch (return of goods by the branch to H.O.)		1,000
Rent	2,000		By Closing Balances:		
Salaries	2,400		Stock		5,000
Petty Cash	1,000		Petty Cash		650
Insurance	600	6,000	Debtors		4,900
To Net Profit		78,950	Furniture		1,800
			Prepaid Insurance (1/4 • Rs. 600)		150
		1,81,600			1,81,600

- Alternatively the amount of liabilities could have been deducted from assets.

Working Note:

Calculation of petty cash balance at the end:

Opening balance	Rs.	500
Add: Cash recd. from the Head Office	Office	1,000
Total Cash with branch		1,500
Less: Spent by the branch		850
Closing Balance	Rs.	650

(B) Goods invoiced at selling price or inflated price: Some firms choose to "invoice" goods to its branches at selling price. This presupposes that there will be a fixed selling price. The purpose of making out the invoice at selling price is to control stocks at the branch easily. We shall see how this is done later. But at the moment we must remember that to ascertain profit we must compare the sale proceeds only with the cost. If the Branch Account is debited with more than the cost, the difference must be credited to the Branch. Stock at the end will also be valued according to the "invoiced" value. This will be more than the cost. The difference between the cost of the stock and its "invoiced" or loaded price must be put right. The Branch Account is debited and Stock Reserve Account is credited with the difference. Both Branch Stock Account and Stock Reserve Account are carried forward to the next year and then transferred to the Branch Account.

To recapitulate, the entries to be made are:

- (a) When goods are sent to the branch
Debit Branch Account (at the invoiced figure)
Credit Goods sent to Branch Account
- (b) When cash is sent to the branch for expenses
Debit Branch Account and
Credit Cash Account.
- (c) When cash is received from the branch-
Debit Cash Account and
Credit Branch Account.
- (d) for amount of debtors at the end at the branch-
Debit Branch Debtors Account and
Credit Branch Account.
- (e) for value of stock at the branch-
Debit Branch Stock Account (according to the invoiced price)
Credit Branch Account
- (f) to remove the loading (or inflation) from goods sent to the branch-
Debit Goods Sent to Branch Account (with the amount added to the cost)
Credit Branch Account
- (g) to "correct" the amount of the stock-
Debit Branch Account and
Credit Stock Reserve Account.

The Branch Account will now reveal profit and loss which is transferred to the Profit and Loss Account.

The balance in the Goods sent to Branch Account is transferred to the Trading Account or Purchases Account.

Illustration 4: Dinesh & Co. Ltd. opened in 1993 a branch at Goa. It invoiced goods to the Branch at cost plus 25%. Information about 1993 and 1994 is given below:

	1993 Rs.	1994 Rs.
Goods sent to the Branch (invoice price)	50,000	80,000
Cash sent to the Branch for expenses	8,000	10,000
Sales-		
Cash	22,000	33,000
Credit	23,000	48,000
Cash received from debtors	20,000	47,000
Bad Debts written off	600	400
Stock on 31st December (invoice price)	4,800	4,000

Journalise the entries to be made in the Head Office for 1993 and give ledger accounts for both the years.

Solution

Journal

1993	GoaBranchAccount	Dr.	50,000	
	ToGoods sentto Branch A/c [Goodssent tothe GoaBranch(invoicevalue)]			50,000
	GoaBranchAccount	Dr.	50,000	
	ToCashAccount (CashremittedtotheBranchforexpenses)			50,000
	CashAccount.	Dr.	42,000	
	To Goa Branch Account(Cashreceivedfromthe Branch CashSales22,000fromDebtors20,000)			42,000
Dec.31	BranchDebtorsAccount	Dr.	2,400	
	ToGoaBranch Account [Thebalancesdue from BranchDebtors Rs.23,000 -(Rs. 20,000 plus Rs. 600)]			2,400
	BranchStockAccount	Dr.	4,800	
	ToGoaBranch Account (Invoicevalueof thestocklyingatthe Branch)			4,800
	GoodssenttoBranchAccount	Dr.	10,000	
	ToGoaBranch Account (Loading in the goods sent to Branch creditedtoGoaBranchA/c50,000*25/125=10,000)			10,000

BranchandDepartmentalAccounts

1993 Dec.31	GoaBranchAccount	Dr.	960	
	ToStock ReserveAccount (Reserveagainststockcreatedequaltotheloading in theClosingStock)			960
	GoodssenttoBranchAccount	Dr.	40,000	
	ToTradingAccount (Thebalanceintheformeraccounttransferredto theTradingAccount)			40,000
	GoaBranchAccount	Dr.	240	
	ToProfitand LossAccount (ProfitatGoa BranchtransferredtotheProfitandLossAccount)			240

GoaBranchAccount

1993		Rs.	1993		Rs.
Dec.31	To Goods Sent toBranchA/c	50,000	Dec.31	ByCash A/c	42,000
	To Cash – ExpensesToStockRes erveA/cloading	8,000 960		ByBranchDebtorsA/cB yBranch Stock A/c	2,400 4,800
	ToProfit&Loss	240		ByGoodssenttoBranchA/ c-loading	10,000
		59,200			59,200

GoodsSenttoBranchAccount

1993		Rs.	1993		Rs.
Dec. 31	ToGoaBranch A/c loading	10,000	Dec.31	ByGoaBranch A/c	50,000
	ToTradingA/c-transfer	40,000			
		50,000			50,000

GoaBranchDebtors Account

1993		Rs.	1993		Rs.
Dec. 31	ToGoaBranchA/c	2,400	Dec.31	ByBalancec/d	2,400
1994			1994		
Jan. 1	ToBalanceb/d	2,400	Jan. 1	ByGoa Branch A/cTransfer	2,400

GoaStockAccount

1993		Rs.	1993		Rs.
Dec. 31	ToGoaBranchA/c	4,800	Dec.31	ByBalancec/d	4,800
1994			1994		
Jan. 1	ToBalanceb/d	4,800	Jan. 1	ByGoa Branch A/c-Transfer	4,800

StockReserveAccount

1993 Dec.31		Rs.	1993 Dec.31		Rs.
	ToBalance c/d	960		ByGoa Branch A/c Transfer	960
1994			1994		
Jan. 1	ToGoaBranchA/c Transfer	960	Jan. 1	ByBalanceb/d	960

GoaBranchAccount

1993		Rs.	1993		Rs.
Dec.31	ToOpeningBalances:		Dec.31	ByCash A/c	80,000
	Stock	4,800		ByBranch Debtors A/c	3,000
	Debtors	2,400		ByBranch Stock A/c	4,000
	ToGoodssenttoBranchA/ c	80,000		ByStockReserve A/c (onopeningstock)	960
Dec.31	ToCash-expenses	10,000		ByGoods sent to BranchA/c(loading)	16,000
	ToStock-ReservesA/c (on closingstock)	800			
	ToProfit&LossA/c Profittransferred*	5,960			
		1,03,960			1,03,960

*The student should note that if there is opening stock at inflated price, there will be a stockreserveA/cshowingacredit balanceequal totheloading.

GoodsSenttoBranchAccount

Dr.			Cr.		
1993		Rs	1993		Rs.
Dec.31	ToGoaBranch A/cloading	16,000	Dec.31	ByGoa Branch A/c	80,000
	ToTradingA/ctransfer	64,000			
		80,000			80,000

BranchDebtorsAccount

		Rs.			Rs.
1993 Dec.31	ToGoaBranchA/c	3,000	1993 Dec.31	ByBalancec/d	3,000
1995 Jan. 1	ToBalanceb/d	3,000			

BranchStockAccount

		Rs.			Rs.
1993 Dec.31	ToGoaBranchA/c	4,000	1993 Dec.31	ByBalancec/d	4,000
1995 Jan. 1	ToBalanceb/d	4,000			

StockReserveAccount

		Rs.			Rs.
1994 Dec.31	ToBalance c/d	800	1993 Dec.31	ByGoa Branch A/c	800
				ByBalancec/d	800

Illustration 5: X & Co. of Delhi has a branch at Madras. 'Goods are sent by the Head Office at invoice price which is at the profit of 25% on cost price. All expenses of the branch are paid by the Head Office. From the following particulars, prepare branch account in the Head Office books: (a) when goods are shown at cost price, and (b) when goods are shown at invoice price.

	Rs.
Opening Balance:	
Stock at invoice price	11,000
Debtors	1,700
Petty Cash	100
Goods sent to branch at invoice price	20,000
Expenses made by head office:	
Rent	600
Wages	200
Salary, etc.	900
Remittances made to Head Office:	
Cash sales	2,650
Cash collected from Debtors	21,000
Goods Returned by Branch at invoice price	400
Balance at the end:	
Stock at invoice price	13,000
Debtors at the end	2,000
Petty Cash	25

Solution

**(a) When goods are shown at cost price
Madras Branch Account**

To Opening Balance		By Cash:	
Stock		Cash Sales 2,650	
(Rs. 11,000-2,200)	8,800	Cash collected from	
Debtors	1,700	Debtors 21,000	23,650
Petty Cash	100	By Goods sent to Branch A/c (at cost)	320
To Goods sent to Branch A/c (at cost)	16,000		
To Bank Expenses		By Closing Balances:	
Rent 600		Stock (at cost)	10,400
Wages 200		Debtors	2,000
Salaries 900	1,700	Petty Cash	25
To Net Profit transferred to General Profit & Loss A/c	8,905		
	36,395		36,395

(b) When goods are shown at invoice price in Branch Account.

To Opening Balance Stock	11,000	By Cash:	2,650
Debtors	1,700	Cash Sales	21,000
Petty Cash	100	Cash collected from Debtors	400
To Goods sent to Branch A/c	20,000	By Goods sent to Branch A/c (returned)	
To Bank		By Goods sent to Branch A/c (loading on net goods sent)	3,920
Rent 600		By Stock Reserve (loading in Op. stock)	2,200
Wages 200		By Closing Balances:	
Salaries 900	1,700	Stock (at cost) 13,000	
To Stock Reserve (Loading on closing stock)	2,600	Debtors	15,025
To Net Profit transferred to General Profit & Loss A/c	8,905	Petty Cash 25	
	45,195		45,195

Ascertainment of Branch Stock and Branch Debtors

In case in an examination question, the balance (opening or closing) of the Branch Stock or Branch Debtors Account is not given, the students should prepare a Memorandum Branch Stock Account or a Memorandum Branch Debtors Account. The accounts will be prepared as follows:

Memorandum Branch Stock Account

To Balance b/d	By Sales:
To Goods received from H.O.	Cash
	Sales Credit
	Sales
To Goods returned by Branch Debtors	
	By Goods returned to Head Office
Surplus of Stock	By Shortage of Stock
	By Balance c/d

It should be noted that the Branch Stock Account should be prepared either at cost or at invoice price. In case some of the items have been given at invoice price and the others

at cost price, they should be suitably decreased or increased to bring all items at a uniform price. In case goods have been sent to the branch at invoice price, it will be better to prepare the Branch Stock Account at invoice price.

Memorandum Branch Debtors Account

To Balance b/d	By Cash received
To Credit Sales	By Bills receivable received
To Bills receivable	
	By Bad debts
dishonoured	By Discount
	By Sales returns
	By Balance c/d

The Memorandum Branch Debtors Account as shown above is prepared on the same pattern on which a Total Debtors Account is prepared under Single Entry System.

Illustration 6: Vasan of Madras has a branch at Calcutta. Goods are invoiced from the Head Office at cost plus 33.5%. Branch is allowed to make sales at invoice price only. Expenses of the Branch except petty expenses are paid directly by the Head Office.

From the following particulars, you are required to prepare the necessary accounts to ascertain the net profit at the branch according to the Debtors System.

Debtors on 1.1.1981		10,000
Petty Cash on 1.1.1981 with the Branch		1,000
Stock on 1.1.1981 (at invoice price)		8,000
Goods invoiced by the Head Office		88,000
Furniture on 1.1.1981		2,000
Cash sent by Head Office for petty expenses at the Branch		2,000
Sales: Cash	50,000	
Credit	36,000	
		86,000
Sales Returns by Branch Debtors		800
Goods damaged at invoice price		1,000
(amount recovered from the insurance company Rs.500)		
Goods returned by Branch to Head Office		2,000
Cash remitted by Branch to Head Office		70,500
Branch Expenses:		
Freight and cartage		500
Rent		1,000
Salary		3,900

Baddebts	50
Depreciationonfurniture	80
Advertisementforthe branch	200
Pettyexpenses	1,500

Solution**BranchAccount**

ToOpeningBalances	Rs.		
PettyCash	1,000	ByRemittances:	
Debtors	10,000	CashSales	50,000
Stock	8,000	RecoveryfromInsuranceCo.	500
Furniture	2,000	CollectionsfromDebtors	20,000
ToGoodssenttoBranch	88,000	ByGoods sentto Branch(returns)	2,000
ToBank (expenses)	5,600	ByStock Reserve(loading)	2,000
ToBank(for pettyexpenses)	2,000	ByGoods sent toBranch(loading)	21,500
ToStockReserve(Loading)	1,950	ByClosingBalances:	
ToNetProfit	13,820	Stock	7,800
		Debtors	25,150
		PettyCash	1,500
		Furniture	1,920
	1,32,370		1,32,370

GoodssenttoBranchAccount

To.Branch Account(Returns)	2,000	ByBranch A/c	88,000
ToBranchAccount (LoadingonRs.86,000)	21,500		
ToTradingAccount(Cost ofgoods sentto branch)	64,500		
	88,000		88,000

WorkingNotes:**(i) MemorandumBranchPettyCashAccount**

ToBalanceb/d	1,000	ByPettyExpenses	1,500
ToCashfromHeadOffice	2,000	ByBalance	1,500
	3,000		3,000

(ii) MemorandumBranchStockAccount

ToBalanceb/d	8,000	BySales	
ToGoodssenttoBranch	88,000	Cash50,000	
ToSalesReturns	800	Credit36,000	86,000
		ByGoods returned byBranch	2,000
		ByGoods damaged	1,000
		ByBalancec/d	7,800
	96,800		96,800

(i) Memorandum Branch Debtors Account

To Balance b/d	10,000	By Sales Returns	800
To Credit Sales	36,000	By Cash	20,000
		By Bad Debts	50
		By Balance c/d	25,150
	46,000		46,000

Stock and Debtor System

In case of this system, the Head Office maintains a number of accounts for keeping a record of Branch transactions in place of one branch account. A brief description of each of these accounts is given below:

(i) Branch Stock Account : This account is on the pattern of a goods account. The account helps the Head Office in maintaining an effective control over the Branch Stock. It tells about shortage or surplus of stock and the closing stock at the Branch.

(ii) Branch Debtors Account : The account is maintained to keep a record of all transactions relating to

Branch and ascertainment of the balance of the debtors at the end of the accounting period.

(iii) Branch Fixed Assets Account : A separate account for each of the Branch Fixed assets is maintained to record all transactions relating to each of these fixed assets.

(iv) Branch Cash Account : The account is maintained to record all cash transactions of the Branch. This is particularly helpful in those cases where the Branch is not required to send immediately all collections of cash made by it but to remit money at regular intervals. The account helps the Head Office in having a control over Branch Cash.

(v) Branch Expenses Account: The account is prepared to give to the Head Office a summary picture of different expenses, bad debts and discounts etc. incurred at the Branch.

(vi) Branch Adjustment Account: The account is maintained for ascertaining the gross profit made at the Branch. All loadings in the goods sent to the branch, opening and closing stocks at the branch and shortage and surplus of stock etc., are recorded in this account.

Branch Profit and Loss Account : The account is prepared to ascertain profit or loss made at the Branch. The gross profit or loss from the Branch Adjustment Account is transferred to this account. It is debited with all other expenses and losses and credited with all gains and profits. The balance of the account represents the net profit or loss.

(vii) Goods sent to the Branch Account : The account is prepared to ascertain the net value of goods sent to the Branch. Goods sent to the Branch and goods returned by the Branch and loading included in them are recorded in this account.

Journal Entries

The following Journal entries are passed in the books of the Head Office in case the transactions are recorded according to the Stock and Debtors System:

- (i) For goods sent to the Branch (at invoice price)

Branch Stock Account	Dr.
To Goods sent to the Branch Account	
- (ii) For goods returned by the Branch to the Head Office

Goods sent to the Branch Account	Dr.
To Branch Stock Account	
- (iii) For Credit Sales at the Branch (at invoice price)

Branch Debtors Account	Dr.
To Branch Stock Account	
- (iv) For Cash Sales at the Branch (at invoice price)

Cash Account	Dr.
To Branch Stock Account	
- (v) For goods returned by Branch Debtors to the Branch (at invoice price)

Branch Stock Account	Dr.
To Branch Debtors Account	
- (vi) For goods returned by Branch Debtors directly to the Head Office (at invoice price)

Goods sent to the Branch Account	Dr.
To Branch Debtors Account	
- (vii) For Goods sent by one Branch to Another.

It will be recorded as if the Branch has first returned the goods to the Head Office, and then the Head Office has sent goods to another Branch. For example, if Branch X sends goods to Branch Y, the following entries will be passed:

- (a) Goods sent to X Branch Account

To X Branch Stock Account	Dr.
---------------------------	-----
- (b) Y Branch Stock Account

To Goods sent to Y Branch Account	Dr.
-----------------------------------	-----
- (viii) For Bad Debts, Discount etc.

Branch Expenses Account	Dr.
To Branch Debtors Account	
- (ix) For Expenses at Branch

Branch Expenses Account	Dr.
To Bank Account	
- (x) For Abnormal Shortage (or pilferage or loss) of Stock

Branch Adjustment Account	Dr.
(with the amount of loading)	
Branch Profit & Loss Account	Dr.
(with shortage at cost)	
To Branch Stock Account	Dr.
(with the shortage at invoice price)	

For surplus at Branch, a reverse entry will be passed.

No entry is required for normal loss of stock. The Branch Stock balance will be shown as a net amount as found by physical verification.

Any amount received from the Insurance Company for abnormal loss of stock (if insured), will be debited to Branch Cash Account and credited to Profit & Loss Account.

(i) For transfer of Branch Expenses

Branch Profit & Loss Account Dr.
To Branch Expensed Account

(ii) For adjustment of loading in the Opening

Stock Reserve Account Dr.
To Branch Adjustment Account

(iii) For adjustment of loading in Closing

Stock Branch Adjustment Account Dr.
To Stock Reserve Account

(iv) For adjustment of loading in Net Goods sent to the Branch Account (i.e.,

goods sent less goods returned by branch) Goods sent to the Branch Account Dr.

To Branch Adjustment Account

(v) For transfer of the balance in goods sent to the Branch Account

Goods sent to Branch Account Dr.
To Purchases/Trading Account

(vi) For transfer of Gross Profit shown by the Branch Adjustment Account

Branch Adjustment Account Dr.
To Branch Profit & Loss Account

In case of gross loss, the entry will be reversed.

(vii) For transfer of Net Profit at the Branch Profit & Loss Account

Dr. To General Profit & Loss Account

In case of net loss, the entry will be reversed.

Illustration 7: Kalyani Bros. have two retail sales branches selling goods supplied to them by the firm's central warehouse. All such supplies of goods are charged at the fixed selling price of cost plus 50 per cent.

Sales are mainly for cash but in approved cases limited credit sales are authorised. The whole book-keeping work is centralised at the Head Office.

From the following particulars in respect of the transactions of the branch at Lowhill, Delhi, for the period of 3 months ending on 31st March, 1982, you are required to record them in the Journal and Ledger accounts in the Head Office Books showing clearly how any balances thereon are dealt with (i.e., prepare Branch Stock Account, Branch Debtors Account, Branch Adjustment Account, Branch Profit and Loss Account and Goods sent to Branch Account).

Stock (at selling price) January 1, 1982

Rs.
26,700

Debtors, January 1, 1982	1,400
Cash sales	72,940
Cash remitted to Head Office by customers	2,800
Goods Returned: by Branch to Head Office	1,170
by credit customers to Branch	570
by credit customers to Head Office	120
Goods transferred by the Branch to Low Hill Branch	4,500
Goods issued to Branch by Head Office (at selling price)	78,300
Bad debts written off	150
Cash remitted to Head Office by the Branch	72,000

The amount due by credit customers on March 31, 1982 was Rs.960. Head Office to Goods (at a sales value of Rs.660) lost in transit from the Branch, the actual stock on that date was in agreement with the figures. A claim was made on the insurance company in respect of the lost stock and a sum of Rs.500 was accepted in full settlement.

Solution**Journal Entries**

Particulars	Dr. Rs.	Cr. Rs.
Branch Cash A/c To Branch Stock A/c (Cash Sales at Branch)	Dr. 72,940	72,940
Cash A/c To Branch Debtors A/c (Cash remitted by Branch Debtors)	Dr. 2,800	2,800
Goods sent to Branch Account To Branch Stock Account (Goods returned by Branch)	Dr. 1,170	1,170
Branch Stock Account To Branch Debtors Account (Goods returned by Branch Debtors to Branch)	Dr. 570	570
Goods sent to Branch Account To Branch Debtors Account (Goods returned by Branch Debtors to Head Office)	Dr. 120	120
Goods sent to Branch Account To Branch Stock Account (Goods transferred to Low Hill)	Dr. 4,500	4,500
Branch Stock Account To Goods sent to Branch Account (Goods sent to Branch)	Dr. 78,300	78,300
Branch Profit & Loss Account To Branch Debtors Account (Bad debts at Branch)	Dr. 150	150

Branch Adjustment Account	Dr.	220	
Branch Profit & Loss Account	Dr.	440	660
To Branch Stock Account (Loss at stock)			
Branch Cash Account	Dr.	500	500
To Branch Profit & Loss Account (For recovery of money from Insurance (Company))			
Branch Debtors Account	Dr.	3,200	3,200
To Branch Stock Account (For Credit Sales)			
Goods sent to Branch Account	Dr.	24,170	24,170
To Branch Adjustment Account (Loading of goods sent to Branch net)			
Goods sent to Branch Account	Dr.	48,340	48,340
To Purchases Account (For transfer of cost of goods sent to Branch)			
Branch Adjustment Account	Dr.	7,700	7,700
To Stock Reserve (For loading in closing stock)			
Stock Reserve Account	Dr.	8,900	8,900
To Branch Adjustment Account (For loading in opening stock)			
Branch Adjustment Account	Dr.	25,150	25,150
To Branch Profit & Loss Account (For transfer of Gross Profit)			
Branch Profit & Loss Account	Dr.	25,060	25,060
To General Profit & Loss Account (Transfer of Branch Profit)			
Cash Account	Dr.	72,000	72,000
To Branch Cash Account (Remittance received from the Branch)			

Notes:

1. Alternatively, the amount may be debited to Branch Expenses Account which may later on be transferred to Profit & Loss Account
2. Alternatively, the amount may be transferred to Head Office Trading Account.

LEDGER ACCOUNTS
Branch Stock Account

	Rs.		Rs.
To Balance b/d	26,700	By Cash (Sales)	72,940
To Goods sent to Branch A/c	78,300	By Branch Debtors (credit sales)	3,200
To Branch Debtors	570	By Goods sent to Branch A/c (returns)	1,170
		By Goods sent to Branch A/c (transferred to Low Hill branch)	4,500
		By Branch Adj. A/c	220

		ByBranch P & LA/c(Loss in transit)	440
		ByBalance(Balancingfigure)	23,100
	1,05,570		1,05,570

BranchDebtorsAccount

	Rs.		Rs.
ToBalanceb/d	1,400	ByCash received	2,800
ToBranchStockA/c(creditsales) (Bal.fig.)	3,200	ByBranch StockA/c (returns) 570	570
		ByGoods sent to BranchA/c (directreturnstoH.O.)	120
		ByBranch P & L(bad debts) 150	150
		ByBalancec/d 960	960
	4,600		4,600

GoodsSenttoBranchAccount

	Rs.		Rs.
ToBranchStockA/c(returns)	1,170	ByBranch Stock A/c	78,300
ToBranchStockA/c	4,500		
ToBranchDebtorsA/c	120		
ToBranch Adj. A/c(loading1/3of Rs.72,510)	24,170		
ToPurchaseA/c(transfer)	48,340		
	78,300		78,300

BranchAdjustmentAccount

	Rs.		Rs.
ToStock Reserve(ClosingStock)	7,700	ByStock Reserve(openingstock)	8,900
ToBranchStockA/c(loadingin lossintransit)	220	Goodssent to BranchA/c(1/3 of 72,510)	24,170
ToGrossProfittakentoBranch P& LA/c	25,150		
	33,070		33,070

BranchP&LAccount

	Rs.		Rs.
ToBranchDebtors A/c(baddebts)	150	ByGross Profit	25,150
ToBranchStockA/c(lossin transit)	440	ByCash (Insuranceclaim)	500
ToNetProfittakento GeneralP &L A/c	25,060		
	25,650		25,650

BranchCashAccount

	Rs.		Rs.
ToBranch StockAccount	72,940	ByCash Account	72,000
ToBranchProfit& LossA/c	550	ByBalancec/d	1,490

	73,490		73,490
--	--------	--	--------

Cash Account (Head Office)

	Rs.		Rs.
To Branch Debtors Account	2,800	By Balance c/d	74,800
To Branch Cash Account	72,000		
	74,800		74,800

Illustration 8: Shri X has a retail branch at Allahabad. Goods are sent by the H.O. to the Branch marked at a selling price which is cost plus 25%. All the expenses of the Branch are paid by the H.O. All cash collected by the Branch (from customers and from cash sales) is deposited to the credit of H.O.

From the following particulars of the Branch, prepare Branch Stock Account, Branch Debtors Account, Branch Expenses Account and Branch Adjustment Account in the books of the Head Office.

Debtors on 1.1.1980	12,000
Debtors on 31.12.1980	14,000
Inventory with the Branch at invoice	
Price on 1.1.1980	16,000
On 31.12.1980	17,000
Cash Sales during the year	60,000
Total amount deposited in the H.O.	
Account during the year	1,27,000
Return of goods to H.O. at invoice price	5,000
Salaries paid	6,000
Rent paid	4,000
Discount allowed to customers	2,000
Bad Debts written off	1,000
Spoilage	2,000

Solution

BOOKS OF SHRI X

Branch Stock Account

	Rs.		Rs.
To Balance b/d	16,000	By Cash A/c (cash sales)	60,000
To Goods sent to Branch A/c (balancing fig.)	1,40,000	By Goods sent to Branch A/c (returns)	5,000
		By Branch Adjustment A/c (loading on spoilage)	400
		By Branch P & LA/c (actual spoilage)	1,600
		By Branch Debtors (credit sales)*	72,000
		By Balance c/d	17,000
	1,56,000		1,56,000

Branch Debtors Account

	Rs.		Rs.
To Balance b/d	12,000	By Cash (received from Debtors)	67,000**
To Branch Stock A/c (Credit sales)	72,000	By Branch Exp. A/c (discount)	2,000
(balancing figure)		By Branch Expenses (bad debts)	1,000
		By Balance c/d	14,000
	84,000		84,000

Branch Expenses Account

	Rs.		Rs.
To Cash A/c		By Branch Adjustment A/c (balancing figure)	13,000
Salaries paid 6,000			
Rent paid 4,000	10,000		
To Branch Debtors A/c	2,000		
(discount) To Branch Debtors A/c (bad debts)	1,000		
	13,000		13,000

Goods Sent to Branch A/c

	Rs.		Rs.
To Branch Stock (return to H.O)	5,000	By Branch Stock A/c	1,40,000
To Branch Adjustment A/c (1/5 x 1,35,000)	27,000		
To Balance tr. to Trading A/c	1,08,000		
	1,40,000		1,40,000

Branch Adjustment Account

	Rs.		Rs.
To Branch Stock A/c (1/5 x 2,000) (loadings spoilage)	400	By Goods sent to Branch A/c (loading)	27,000
To Stock Reserve (adjustment of closing stock (1/5 x 17,000))	3,400	By Stock Reserve (adjustment of stock 1/5 x 16,000)	3,200
To Gross Profit c/d	26,400		
	30,200		30,200

Branch P&L Account

	Rs.		Rs.
To Branch Stock A/c (spoilage at cost)	1,600	By Gross Profit b/d	26,400
To Branch Expenses A/c	13,000		
To Net Profit	11,800		
	26,400		26,400

****Working Note:**

Amount (collected) recovered from Drs. = Total amount deposited in H.O
A/c during the year - Cash Sales 1,27,000 -
60,000 = 67,000

Independent branch or branch keeping own accounts: We have so far considered branches that do not maintain accounts themselves. The accounting is done at the head office. Now

weshallconsider thebranchthat keeps itsown books of account.

The method of accounting is really simple; in essence it means treating the branch as a sort of special customer. The branch keeps its accounts like anyone else. The head office will have a "Branch Account" in its books. All goods sent to the branch or cash sent to it will be debited to this account and cash received from the branch will be credited to it. Entries are made in the usual manner. The balance in this account will show the amount invested by the head office at the branch. Similarly, the branch will open "Head Office Account" in its books. The balance shown by this account will usually be credit. The balance shown by the Branch Account (in head office books) will be debit. The amounts in both cases should be the same. But due to certain reasons there may be a difference. If there is a difference, the cause of it must be located and suitable entries passed at the end of the financial year.

Cash or goods in transit: One of the reasons for difference in the balance of the two accounts may be cash sent by branch but received by the head office after the close of the year. Similarly, the goods sent by the head office may reach the branch after the close of the financial year. Entries are passed immediately by the branch when cash is sent by the branch but the head office will not pass entry for receipt until cash is actually received. So also for goods in transit. A record must be made for cash or goods in transit. The entry is usually made by the party which sent the cash or goods. If cash sent by the branch has not yet reached head office, the branch will pass the entry:

Cash in Transit A/c

Dr.

To Head Office Account.

If goods sent by the head office are in transit, the head office will record it as under

: Goods in Transit A/c

Dr.

To Branch Account

But there is no hard and fast rule about it. In fact it is enough if either party makes a record of the items in transit.

Both the cash in transit and goods in transit are assets and shown in the Balance Sheet.

Note: In examination problems, cash or goods in transit may have to be inferred. This is done by comparing the balance of the Branch Account (in head office books) and of the Head Office Account (in branch books). Suppose the Branch Account shows a debit balance of Rs. 16,000 in the Head Office Account, it can be taken to be either Cash in Transit or Goods in transit.

Accounts of branch's fixed assets kept in H.O. books: Often the accounts of branch's fixed assets are kept in head office books and not in branch's books. Even if the branch pays for them the amount is debited to Head Office Account. The Head Office will debit the asset account and credit Branch Account. At the end of the year, the question of depreciation will arise. The entries to be passed are:

In Head Office Books

Branch Account Dr.

To Branch Asset

A/c In Branch Books-

Depreciation Account Dr.

To Head Office A/c

Head Office expenses: The head office will always do some work for the branch. At the end of the year, the head office may charge the branch with an amount representing the value of the time devoted to the branch. The entries required are:

In Head Office Books-

Branch Account

Dr.

To Salaries Account.

In Branch Books

Head Office Expenses

A/c Dr. To Head Office A/c

Illustration 9: Preliminary accounts made by the Kanpur Branch on 31st December, 1968 showed a profit of Rs.9,500. It was found that the following items were not yet taken into account:

Cash remitted to H.O. not yet received there	5,000
Goods sent by the H.O. not yet received at Kanpur	4,000
Depreciation on Branch assets (accounts kept in H.O. books)	1,200
H.O. expenses charged to the branch	2,500

Journalise the above in the books of both the Head Office and the Branch. Also show how much is the real profit at Kanpur.

Solution

H.O. Journal

1978		Dr.	Cr.
------	--	-----	-----

Dec.3	Goods in Transit A/c To Kanpur Branch A/c (Goods sent to Kanpur, not yet received there)	Dr.	4,000	4,000
Dec.31	Kanpur Branch A/c to Kanpur Branch Assets A/c (Depreciation on Kanpur Branch assets charged to the Branch account of assets being kept in own books)	Dr.	1,200	1,200
Dec.31	Kanpur Branch A/c To Salaries Account (Amount of expenses charged to the Branch for work done on its behalf)	Dr.	2,500	2,500

Branch Journal

1978			Rs.	Rs.
Dec.31	Cash in Transit A/c To Head Office Account (The amount of the cash sent to the H.O. not yet received there)	Dr.	5,000	5,000
Dec.31	Depreciation Account To Head Office Account (Depreciation of Branch assets whose accounts are in Head Office Books)	Dr.	1,200	1,200
Dec.31	Head Office Expenses A/c To Head Office A/c (Amount charged to the branch in respect of work done at the H.O.)	Dr.	2,500	2,500

The profit at the Branch is reduced by Rs.1,200 and Rs.2,500, It now stands at Rs.5,800.

Incorporation of Branch accounts in H.O. books: The branch sends its trial balance to the Head Office which will then incorporate branch figures to prepare consolidated Profit and Loss Account and Balance Sheet. The entries to be passed in the Head Office Books are:

- (a) Debit Branch Trading Account (with the items debited to Trading A/c
Credit Branch Account
such as opening stock, purchases, wages, etc., at the branch.)
- (b) Debit Branch Account
(with the sale and closing stock at the Credit Branch Trading Account
branch.)
- (c) Debit Branch Trading Account (transfer of gross profits.)
Credit Branch Profit and Loss A/c
- (d) Debit Branch Profit and Loss A/c (with the total of expenses at

- the Credit Branch Profit and Loss Account branch.)
- (e) Debit Branch Account (with items of gain at the branch.)
Credit Branch Profit and Loss Account
- (f) Debit Branch Profit and Loss Account with the net profit at the branch, as disclosed by the Credit (General) Profit and Loss Account
Branch Profit and Loss A/c A/c
- c
(This entry will be reversed in case of loss.)

With these six entries given above, the Branch Account will show a balance equal to net assets at the branch, i.e., assets less liabilities. If it is desired to close the Branch Account two further entries will be required:

- (f) Debit Branch Assets (individually)
Credit Branch Account; and
- (g) Debit Branch Account
Credit Branch Liabilities (individually).

Illustration 10: A head office receives the following Trial Balance from its branch:

Debit	Rs.	Credits	Rs.
Opening Stock	21,800	Head Office A/c	21,000
Purchases	42,000	Sundry Creditors	5,600
Wages	10,200	Discount received	300
Salaries	6,300	Sales	81,000
General Expenses	8,300		
Sundry Debtors	18,200		
Cash at Bank	800		
	1,07,900		1,07,900

The closing stock at the branch was Rs.19,700. The Branch Account (in Head Office books) stood at a debit of Rs.26,500. Goods sent by the Head Office, Rs.1,000, had not yet reached the Branch. Head Office expenses chargeable to the Branch were Rs.3,100. Depreciation of Branch assets whose accounts are kept in Head Office books was Rs.3,600. Record the above noted items and the incorporation of Branch figures in Head Office books by means of journal entries and show Branch Account.

Solution

Head Office Journal

1978			
Dec.3	Goods in Transit A/c To Branch Account (Adjustment for goods still in transit)	Dr.	1,000
			1,000

Dec.31	BranchAccount ToSalariesAccount(Amount charged to the Branch inrespectofworkdoneonitsbehalf)	Dr.	3,100	3,100
Dec.31	BranchAccount ToBranchAssets Account (Depreciation on Branch assets whoseaccountsarekeptin H.O.Books)	Dr.	3,600	3,600
	BranchTradingAccount ToBranchAccount (TotalofitemsdebitedtotheBranch TradingAccount,viz.,openingstock,pu rchasesand wages)	Dr.	74,300	74,300

* The student is advised to first prepare Branch Trading and Profit and Loss Account and then to note the journal entries.

Branch and Departmental Accounts

			Dr. Rs.	Cr. Rs.
	BranchAccount ToBranchTradingA/c (Total of credit items credited to Branch TradingAccount)	Dr.	1,00,700	1,00,700
	BranchTradingAccount ToBranchProfitandLossAccount(T ransferof gross profit)	Dr.	26,400	26,400
	BranchProfitandLossA/c ToBranchAccount (Total expenses debited to Branch P & L a/cSalaries 6,300 GeneralExpenses8,300 H.O. Expenses3,100Deprec iation 3,600)	Dr.	21,300	21,300
	BranchAccount ToBranchProfitand LossA/c (DiscountreceivedcreditedtoBranchP&LA/c)	Dr.	300	300
	BranchProfitandLossA/c To General Profit and Loss Account (NetProfittransferredtoGeneralProfitand LossA/c)	Dr.	5,400	5,400

Branch Sundry Debtors A/c		18,200	
	Dr.	800	
Branch Bank A/c	Dr.	19,700	
Branch Stock A/c	Dr.	4,500	
Cash in Transit A/c*	Dr.		43,200
To Branch Account (Branch assets transferred to H.O. Books)			
Branch A/c	Dr.	5,600	
To Branch Sundry Creditors (Branch Liabilities transferred to H.O. Books)			5,600

Note: If the last two entries are not passed, the Branch Account will show a balance, showing the H.O. investment at the Branch at the end of the year. If the two entries are passed, the Branch Account will balance and account for various assets and liabilities will be opened in the H.O. Books.

* The difference between the Branch A/c balance and H.O. A/c balance is Rs. 5,500 (Rs. 26,500 - 21,000). Of this Rs. 1,000 is explained by goods in transit. The balance of difference is due to cash in transit.

Branch Account

Debits	Rs.	Credits	Rs.
To Balance b/d	26,500	By Goods in Transit A/c	1,000
To Branch A/c H.O. Expenses	3,100	By Branch Trading Account	74,300
To Branch A/c (Depreciation)	3,600	By Branch Profit and Loss A/c	21,300
To Branch Trading Account	1,00,700	By Sundry Assets	
To Branch P & LA/c	300	Debtors	18,200
To Branch sundry Creditors	5,600	Bank	800
		Cash in Transit	4,500
		Stock	19,700
	1,39,800		43,200
			1,39,800

Problem 2. Head office of a company invoices goods to its Madras branch at cost plus 20%. The Madras branch also purchases independently from local parties goods for which payments are remade by the head office. All the cash collected by the branch is banked on the same day to the credit of the head office and all expenses are directly paid by the head office except for a petty cash account maintained by the branch for which periodical transfers are made from the head office. From the following particulars, show branch account as maintained in the head office books, reflecting the branch profit for the year ended December 31, 1995.

Imprest cash:	
3-1-1995	2,000

31-12-1995	1,850
Sundry debtor on 1-1-1995	25,000
Stock on 1-1-1995:	
Transferred from head office at invoice price	24,000
Directly purchased by branch	16,000
Cash sales	45,000
Credit sales	1,30,000
Direct purchases	45,000
Returns from customer	3,000
Goods sent to branch from head office at invoice price	60,000
Transfer from head office for petty cash expenses	2,500
Bad debts	1,000
Discount to customers	2,000
Cash received from customers	1,25,000
Branch expenses	30,000
Stock on 31-12-1995:	
Directly purchased by branch	12,000
Transferred from head office (at invoice price)	18,000

Problem 3. Mohan Brothers had a small branch at Pondicherry. You are required to prepare Pondicherry Branch account in the books of Mohan Brothers for calculating profit made at Pondicherry branch. Transactions during the year ending on March 31, 1995 were as follows:

Stock at cost on 1-4-1994	4,000
Furniture on 1-4-1994	2,000
Goods sent to branch at cost	60,000
Cash sales made by the branch	90,000
Furniture purchased by the branch on permission from head office	1,200
Stock at the end with branch	3,500
Expenses paid by head office	5,300

It was required to write off furniture at 10% p.a. No depreciation is provided on additions made during the year. Hint: Remittances will be reduced by the amounts spent on purchases of furniture.

Problem 4. Nirmal Brothers operate a retail branch at Mahe. All purchases are made by the head office at Madargate, goods being charged out to the branch at cost price. All cash received by the branch is remitted to Madargate. Branch petty expenses are paid out of an imprest which is reimbursed by the head office from time to time. From the following particulars relating to

Mahe branch, you are required to prepare branch account (for calculating profit) in the

booksofhead office:

January1, 1993:	Rs.
Stockatcost	7,000
Pettycash	700
Plant	8,000
December31,1993:	
Stockatcost	6,300
Goodssent tobranch	40,800
Expensespaidbytheheadoffice	4,200
Pettyexpenses paidbythe branch out ofimprest	630
Cashsalesduringthe year	60,700
Sale ofplant onJuly1, 1993 (bookvalue ofplant onthe date ofsaleRs. 950)	900
Itisrequiredto writeoffplant at10%p.a.	

Hints:Pettyexpenses will appear on thedebit side ofbranch account andpettycash balancewillremain at Rs.700 becauseof imprest system.

Problem 5.The KotahDoria Ltd. with its head office at Kotah opened a branch at Ajmer on1st January, 1992. Goods are invoiced to the branch at cost plus 25%. From the followingparticulars calculate gross profit and net profit or loss at Ajmer Branch (by Stock and DebtorsSystem)and open all necessaryaccounts.

	Rs.
Goodssent toAjmerbranch atinvoiceprice	45,000
Expensespaid byhead office	7,200
Discountallowed to debtors	50
Baddebtswrittenoff	80
Sale:Cash21,000 Credit12,000	33,000
StockonDecember31(Invoiceprice)	11,800
Goodsreturned bythebranch (Invoiceprice)	600
Goods returnedbydebtors	500
Cashremittedtoheadoffice	30,800
Cashinhand onDecember31	300

(GrossprofitRs.6,500;NetlossRs.910; DebtorsattheendRs.1,570)

Problem6.SwamyBros.ofGunturhaveabranchatVijayawada.Goodsaresenttothebranchat cost price plus 1/2 of cost price. From the following particulars prepare necessary accountsonStock andDebtors systemand calculate gross profitand netprofit forthebranch.

	Rs.
--	-----

Stock in the beginning (at invoice price)	3,900
Goods sent to branch	30,000
Goods returned by the branch	3,000
Credit sales by the branch	15,000
Cash remitted by the branch	31,000
Debtors balance in the beginning	4,000
Cash received by the branch from the debtors	16,000
Cash received by the head office direct from the branch debtors	2,000
Bad debts	100
Cash discount on cash payment	20
Shortage at the branch	120
Recurring expenses paid by the head office	1,600
Non-recurring expenses paid by the head office	200

Gross profit Rs.9,800; Net profit

Rs.8,000) Note:

1. Difference between cash remitted and cash received will be treated as cash sales.
2. Non-recurring expense is a term used for direct expense. Hence, non-recurring expenses have been taken to adjustment account for calculating gross profit.
3. Recurring expenses, being indirect expenses, have been taken to branch profit and loss account.
4. Shortage has been divided into two parts. The adjustment portion of shortage is considered for calculating gross profit and rest of the portion for the net profits.

(b) **Problem 7.** Preetham and Jeethu are two partners who respectively manage Pondy and Madras branches of Messrs Preejee & Co., and have calendar year as accounting year and share profits $\frac{2}{3}$ and $\frac{1}{3}$ respectively.

(c)

(d) On 31-12-1994 the balances stood as under:

	Pondy Rs.	Madras Rs.
Opening Stock	54,000	39,000
Madras branch (Dr.)	22,500	
Pondy Branch (Cr.)	18,000
Preetham capital	1,02,000	
Jeethu capital	24,000
Purchases	96,000	51,000
Sales	1,56,000	72,000
Books debts	22,500	15,000
Creditors	21,000	6,000

Wages	18,000	12,000
Freight(Inward)	2,700	1,200
Machinery(Pondy)	36,000	
Machinery(Madras)	24,000	
Cashinhand	3,300	1,800
ClosingStock	50,400	42,600

- (e)
- (f) Madras office debited Pondy office with remittance made on 31-12-1994 for Rs. 4,500 which was received by Pondy on 2-1-1995.
- (g) Partners are to be allowed interest at 5% by the respective offices. Each of these offices has to charge depreciation at 5%.
- (h) Prepare journal entries with narration in the books of each of the offices and also the columnar trading and profit and loss account and balance sheet of the firm.
- (i) [Pondy branch-Gross profit Rs.35,700; Net profit Rs.28,800; Madras branch-Gross profit Rs.11,400; Net profit Rs.9,000; Balance sheet total-Madras Rs.63,900; Pondy Rs.1,53,300; Balance-Pondy Office Rs.20,100 (Cr.); Madras Office Rs.20,100 (Dr.)].

UNIT- 2 DEPARTMENTAL ACCOUNTS

Introduction

A business may have a number of Departments each dealing in a different type of goods. For example, one department may be dealing in medicines, the other may be dealing in textiles, still another may be dealing in provisions etc. In order to ascertain the profit or loss made by each Department, it will be advisable to prepare separately Trading and Profit & Loss Account of each Department at the end of the accounting year. Preparation of such Departmental Accounts is helpful to the business in the following respects:

- (i) It enables the business to compare the performance of one Department with that of another.
- (ii) It helps the business in formulating proper policies relating to the expansion of the business. New profitable lines of production or trading can be taken up while

the existing lines of production or trading which are running at a loss can be closed down.

- (iii) It helps in appropriate rewarding or penalising the Departmental employees on the basis of the results shown by them.

MAINTENANCE OF COLUMNAR SUBSIDIARY BOOKS

The principle of Departmental Trading and Profit & Loss Account requires maintenance of proper subsidiary books having appropriate columns for different departments. For example, if a business has three departments A, B & C, the subsidiary books such as Purchases Book, Purchases Returns Book, Sales Book, Sales Returns Book etc., should have separate columns for each of the departments. Cash Book may also have columns for recording cash sales of each of the departments separately in case the volume of cash sales is quite large. The specimen of a Purchases Book having columns for different Departments is given below:

Purchases Book

Date	Particulars	L.F.	Dept.A	Dept.B	Dept.C	Dept.D

The same pattern of rulings may be followed in case of other subsidiary books also.

DEPARTMENTALISATION OF EXPENSES

In order to ascertain the profit or loss made by each department, it is necessary that each department is charged with a proper share of the various business expenses. The following basis may be adopted for departmentalisation of such expenses:

- (i) Expenses incurred specifically for a particular department should be directly charged to that department. For example, salaries payable to each of the departmental managers will be charged to the respective departments. Similarly if there are separate electricity metres for each of the departments, the electricity should be charged to each of the departments on the basis of the electricity bills received for each one of them.
- (ii) Expenses which have been incurred for the business as a whole but capable of being apportioned over different departments on a suitable basis should be charged to the different departments, on such basis. Of course, there are no hard and fast rules as regards the basis to be applied for apportionment of such expenses. However, the following basis for apportionment may be adopted:

(a) **Departmental wages:** Expenses which directly vary with the departmental wages can be apportioned on this basis. For example, premium for work-

men's compensation, insurance, E.S.I. may be apportioned on this basis.

(b) **Capital value of the assets:** Expenses such as depreciation of buildings, plant and machinery, fire insurance premiums in respect of these assets etc. may be apportioned on this basis.

(c) **Floor area:** Expenses such as lighting (unless metered separately), rent and rates, wages of night watchman etc. may be apportioned on this basis.

(d) **Number of workers employed:** Expenses of workers' canteen, welfare, personnel and timekeeping departments etc. may be apportioned on this basis.

(e) **Production hours of direct labour:** Works manager's remuneration, general over-time expenses, cost of inter-departmental transport should be charged to the various departments in the ratio in which the Departmental Direct Labour Hours bear to the Total Factory Direct Labour Hours.

(f) **Technical estimate:** Advice of the technical personnel may also be useful for the apportionment of certain expenses e.g., the cost of steam consumed by a particular department, may be estimated on the basis of the engineer's estimate.

(iii) Expenses which cannot be allocated or apportioned over different departments in a reasonable manner, should be charged to the total profit of all the departments taken together. For this purpose, the profits shown by the different departments should be brought down in one account which will be termed as the

General Profit & Loss Account and all such expenses should be charged there. General Manager's salary, Director's fees, Auditor's remuneration, Interest on Debentures etc. are some of the expenses which fall in this category.

Departmentalisation of Expenses

Illustration 1. M/s Raju Auto Garage has three departments, viz. (i) Cars and Trucks, (ii) Two-wheelers, and (iii) Servicing. The former two sell spare parts and occupy a godown-cum-show-room. The servicing department uses a garage and adjoining site.

The following particulars are extracted from the books of the business for the year ended 31st March, 1979, from which you are required to prepare:

- (a) A Departmental Trading and Profit and Loss A/c,
- (b) A General Profit and Loss A/c, and
- (c) A Balance Sheet.

Stock 1-4-78	Rs.
Cars and Trucks	1,00,000
Two-wheelers	27,500
Purchases:	
Cars and Trucks	3,50,000

Two-wheelers	1,10,000
Sales:	
Cars and Trucks	6,00,000
Two-wheelers	3,00,000
Servicing	1,00,000
Wages of Counter-salesmen:	
Cars and Trucks	30,000
Two-wheelers	12,000
Wages of garage labour	10,800
Office salaries and wages	12,000
Godown and showroom rent	24,000
Land and Garage Building	2,72,000
Office Expenses	36,000
Garage Equipment	1,00,000
Showroom Furniture and Fittings	70,000
Office van	24,000
Sundry Debtors	12,000
Sundry Creditors	60,000
Bank Overdraft	17,200
Power and lighting	36,000
Bank Interest	1,000
Cash in hand	900
Drawings A/c	12,000
Proprietor's Capital Account	1,63,000

Following further information is available:

(i) Included in "Land and Garage Building" is cost of suite used by the servicing department

Rs. 2,00,000.

(ii) Closing stock on 31.03.1979 at the departments

: Cars and Trucks Rs. 90,000

Two-wheelers Rs. 32,500

(iii) 50% of power and lighting is to be charged to Servicing Department, the balance equally to the other departments.

(iv) Rates for depreciation are:

Building 5%, Garage Equipment 15%, Showroom furniture etc. 10% and Office Van 20%.

(v) Outstanding expenses were

Interest Rs. 150

Office expenses Rs. 2,000

(vi) Interest and all expenses relating to the office are to be considered common and charged to the General Profit and Loss A/c.

(vi) The departments using the showroom share the space and furniture and fittings equally.

Solution:

MESSRS RAJU AUTO GARAGE

Departmental Trading & Profit and Loss Account for the year ending March 31, 1979

Particulars	Cars & Trucks Rs.	Two Wheelers Rs.	Servicing Rs.	Particulars	Cars & Trucks Rs.	Two Wheelers Rs.	Servicing Rs.
To Opening Stock	100,000	27,500	---	By Sales	600,000	300,000	100,000
To Purchases	350,000	110,000	---	By Closing Stock	90,000	32,000	--
To Wages	30,000	12,000	10,800				
To Gross Profit c/d	210,000	183,000	89,200				
	690,000	332,500	100,000		690,000	332,500	100,000
To Godown & Showroom	12,000	12,000	--	By Gross Profit b/d	210,000	183,000	89,200
To Power & Lighting	9,000	9,000	18,000				
To Depreciation:							
Building			3,600				
Garage Equipment			15,000				
Furniture	3,500	3,500	--				
To Net Profit c/d	185,500	158,500	52,600				
	210,000	183,000	89,200		210,000	183,000	89,200

General Profit & Loss Account for the year ending 31st March, 1979

Particulars	Rs.	Particulars	Rs.
To Office salaries & wages	12,000	By Profit b/d:	
To Office Expenses 36,000		Cars & Trucks Dept.	1,85,500
Outstanding 2,000	38,000	Two Wheelers Dept.	1,58,500
To Depreciation on Van	4,800	Servicing Dept.	52,600
To Bank Interest 1,000			
Outstanding 150	1,150		
To Net Profit	3,40,650		
	3,96,600		3,96,600

Balance Sheet as at 31st March, 1979

Liabilities	Rs.	Assets	Rs.
Bank overdraft	17,200	Current Assets:	
Outstanding expenses		Cash-in-Hand	900
Interest 150		Sundry Debtors 12,000	
Office Expenses 2,000	2,150	Stock in trade	
Sundry Creditors	60,000	Cars & Trucks 90,000	
		Two Wheelers 32,500	1,22,500
Capital 1,63,000		Fixed Assets:	
Net Profit 3,40,650		Land	2,00,000
	5,03,650	Garage Building 72,000	
Less: Drawings 12,000	4,91,650	Less: Depreciation 3,600	68,400
		Garage Equip. 1,00,000	
		Less: Depreciation 15,000	85,000
		Show Room Furniture & Fittings 70,000	63,000
		Less: Depr. 7,000	

		Office Van	24,000	
		Less: Depr.	4,800	19,200
	5,71,000			5,71,000

Computation of Departmental Costs

Illustration 2. The following purchases were made by a business

house having three departments:

Department A 1,000 units
 Department B 2,000 units at a total cost of Rs
 1,00,000
 Department C 2,400 units

Stock on 1st January were:

Department A 120 units, Department B 80 units and Department C 152 units.

The sales were. The sales were:

Department A 1,020 units @ Rs. 20
 each. Department B
 1,929 units @ Rs. 22.50 each. De
 partment C
 2,496 units @ Rs. 25 each.

The rate of gross profit is the same in each case. Prepare Departmental Trading Account.

Solution

In order to determine the rate of Gross Profit, it is assumed that all units purchased have been sold away.

Sales: Dept. A 1,000 units @ Rs. 20 each

	20,000
Dept. B 2,000 units @ Rs. 22.50 each	45,000
Dept. C 2,400 units @ Rs. 25 each	60,000
Total Sales	1,25,000
	Less: Cost of Purchases
	1,00,000
Gross Profit	25,000
Gross Profit as a percentage = $25,000 / 1,25,000 \times 100 = 20\%$	

Cost Price of units purchased for each Department can now be ascertained as follows:

	Selling Price	Gross Profit	Cost
Dept. A	Rs. 20	Rs. 4	16
Dept. B	Rs. 22.50	Rs. 4.50	18
Dept. C	Rs. 25	Rs. 5	20

Unit of Closing Stock	Opening Stock	+	Purchase-	Sales
Dept. A	120	+	1,000	- 1,020 = 100
Dept. B	80	+	2,000	- 1,920 = 160
Dept. C	152	+	2,400	- 2,496 = 56

Departmental Trading Account cannot be prepared as follows:

Departmental Trading Account

	Dept. A	Dept. B	Dept. C		Dept. A	Dept. B	Dept. C
--	---------	---------	---------	--	---------	---------	---------

To Opening Stock	1,920	1,440	3,040	To Sales	20,400	43,200	62,400
To Purchases	16,000	36,000	48,000	To Closing Stock	1,600	2,880	1,120
To Gross Profit	4,080	8,640	12,480				
	22,000	46,080	63,520		22,000	46,080	63,520

INTER-DEPARTMENTAL TRANSFERS

Transfers of goods or services may take place from one department to another while preparing the Departmental Trading and Profit & Loss Account. The department receiving the goods or services should be debited with the value of the goods or services supplied and the department providing such goods or services should be credited with the same amount.

The transfer of goods from one department to another is usually at cost. However, if such transfer is at a profit, the profit or loss of each department should be ascertained on the basis of the transfer price itself. However, if the goods transferred by one department to another at a profit, still remain unsold with the transferee department, an appropriate reserve for unrealised profit will have to be created by means of the following journal entry.

General Profit & Loss Account	Dr.	-
To Stock Reserve		

In case the transferee Department has also some stock in the beginning of the accounting year, including some unrealised profit, against which stock reserve was created last year, such reserve will also be transferred to the General Profit & Loss Account by means of the following journal entry.

Stock Reserve Account	Dr.	-
To General Profit & Loss Account		

Alternatively, a single journal entry may be passed for the unrealised profit on the basis of the difference between unrealised profit included in the opening and closing stocks. This will be clear with the help of the following illustration.

Illustration 3. From the following Trial Balance, prepare Departmental Trading and Profit and Loss Account for the year ending 31st March, 1974 and the Balance Sheet as at that date:

		(Rs. in '000)
Stock, 1st April, 1973	A Department	1,700
	B Department	1,450
Purchases	A Department	

		3,540
	B Department	3,020
Sales	A Department	6,080
	B Department	5,125
Wages	A Department	820
	B Department	270
Rent, Rates, Taxes and Insurance		939
Sundry Expenses		360
Salaries		300
Lighting and Heating		210
Discount allowed		222
Discount received		65
Advertising		368
Carriage Inward		234
Furniture and Fittings		300
Machinery		2,100
Sundry Debtors		606
Sundry Creditors		1,860
Capital Account		4,766
Drawings		450
Cash at Bank		1,007

The following further information is available:

1. Internal transfer of goods from A to B Department Rs. 42,000.
2. The items Rent, Rates and Taxes and Insurance, Sundry Expenses, Lighting and Heating Salaries and Carriage are to be apportioned 2/3rd to A Department and 1/3rd to B Department.
3. Advertising is to be apportioned equally.
4. Discounts allowed and received are to be apportioned on the basis of Departmental Sales and Purchases (excluding Transfers).
5. Depreciation at 10 per cent per annum on Furniture and Fittings and on Machinery is to be charged 3/4th to A Department and 1/4th to B Department.
6. Services rendered by B Department to A Department are included in wages Rs. 50,000
7. Stock on 31st March 1974 in A Department was worth Rs. 16,74,000 and in B Department it was worth Rs. 12,05,000.

Solution

Departmental Trading & Profit

Particulars	Dept. A	Dept. B	Particulars	Dept. A	Dept. B
To Opening Stock	1,700	1,450	By Sales	6080	5,125
To Purchases	3,540	3,020	By Transfer	42	50
To Wages	820	270	By Closing Stock	1,674	1,205
To Transfer	50	42			
To Carriage Inward	156	78			
To Gross Profit	1,530	1,520			
	7,796	6,380		7,796	6,380
To Salaries	200	100	By Gross Profit	1,530	1,520
To Rent, Rates, Taxes & Insurances	625	313	By Discount	35	30
To Sundry Expenses	240	120	By Net Loss	126	----
To Lighting Heating	140	70			
To Advertising	184	184			
To Depreciation on Machinery	158	52			
To Furniture	22	8			
To Discount	121	101			
To Net Profit	---	602			
	1,691	1,550		1,691	1,550

& Loss Account for the year

ending 31st March, 1974

Balance Sheet as on 31st March, 1974 (in thousand Rupees)					
Liabilities			Assets		
Capital	4,766		Machinery	2,100	
Add: Profit	476		Less: Depreciation	210	1,890
	5,242		Furniture & Fittings	300	
Less: Drawings	450	4,792	Less: Depreciation	30	270
Sundry Creditors		1,800	Stock in trade		2,879
			Sundry Debtors		606
			Cash at Bank		1,007
		6,652			6,652

QUESTIONS

Problem 1. From the following Trial Balance, prepare Departmental Trading and Profit and Loss A/c for the year ended 31st March, 1985 and Balance Sheet as at that date.

TRIAL BALANCE

		Dr. Rs.	Cr. Rs.
Stock 1.4.84	Department A	17,000	
	Department B	14,500	
Purchases	Department A	35,400	
	Department B	30,200	
Sales	Department A	---	60,800
	Department B	---	51,250
Wages	Department A	8,200	
	Department B	2,700	
Rent, rates, taxes and Insurance		9,390	
Sundry expenses		3,600	
Salaries		3,000	
Light and heating		2,100	
Discount allowed		2,220	
Discount received		---	
Advertising		3,680	
Carriage inwards		2,340	
Furniture and Fittings		3,000	
Plant and Machinery		21,000	
Sundry debtors		6,060	
Sundry creditors		---	18,600
A's Capital Account			47,660
A's Drawing		4,500	
Cash in hand		170	
Cash at Bank		9,900	
		1,78,960	1,78,960

The following information is also provided:

- Internal transfer of goods from Deptt. A to Deptt. B Rs. 420.
- The items rent, taxes and insurance, sundry expenses, lighting and heating, salaries and carriage inwards to be apportioned at 2/3rd to Dept. A and 1/3rd to Dept. B.
- Advertising to be apportioned equally.
- Discount allowed and received are apportioned on the basis of departmental sales and purchases (excluding transfers) corrected to nearest Rs. 10.
- Depreciations at 10% per annum on furniture and fittings and on plant and

machinery. This is to be charged $\frac{3}{4}$ to Dept. A and $\frac{1}{4}$ to Dept. B.

- (f) Services rendered by B Dept. included in wages Rs. 500.
 (g) Stock as at 31.3.85 A Dept. Rs. 16,740 and B Dept. Rs. 12,050.
 (h) Fixed assets remain unchanged during the year.

Problem 2. The following balances were extracted from the books of Vijay Shanker. You are required to prepare departmental Trading Account and Profit and Loss Account for the year ended 31st December 1984, after adjusting the unrealised departmental profit, if any.

	Departments	
	A Rs.	B Rs.
Opening Stock	50,000	40,000
Purchases	6,50,000	9,10,000
Sales	10,00,000	15,00,000

General expenses incurred for both the departments were Rs. 1,25,000 and you are also supplied with the following information:

- (a) Closing Stock of Department A Rs. 1,00,000 including goods from Department B for Rs. 20,000, at cost to Department A.
 (b) Closing Stock of Department B Rs. 2,00,000 including goods from Department A for Rs. 30,000, at cost to Department B.
 (c) Opening Stock of Department A and Department B includes goods of the value of Rs. 10,000 and Rs. 15,000 taken from Department B and Department A respectively at cost to transferred Departments.
 (d) The gross profit is uniform from year to year.

Problem 3. The following is the trial balance of Automatic Motors and Garage on 31st March, 1985:

	Rs.	Rs.
Capital Account		76,250
Drawings	8,500	
Opening Stock:		
Petrol and Oil	1,675	
Spare parts and tyres	5,500	
Tools	2,200	
Hire Cars	72,000	
Tools	4,000	
Spare parts and tyres	32,000	
Petrol and Oil	41,250	
Advertising Expenses	4,500	

Rent, Rates and Taxes	12,000	
Insurance Premium:		
On hire cars	4,000	
Fire, theft and burglary cases	425	
Wages:		
Drivers	12,000	
Repairs Department	16,500	
Office	7,500	
Garage	1,000	
Sales:		
Petrol and Oil		23,000
Spare parts and tyres		37,000
Garage receipts		4,000
Repairs Department		14,000
Hire Receipts		70,000
Licence fees and permit fees for hire cars	3,000	
Office Expenses	4,000	
Sundry Debtors	400	
Sundry Creditors		1,200
Commission received on cars sold		5,000
Loan		4,000
Cash in hand and at Bank	2,000	
	2,34,450	2,34,450

The following additional information is also given to you:

- (a) The loan was taken on 1st January, 1985 on which interest at 12% is to be paid;
- (b) Stocks in hand on 31st March, 1985 were as under:
 - (i) Tools 5,000
 - (ii) Petrol and Oil 4,300
 - (iii) Spare parts and tyres 10,000
- (c) Petrol and oil whose values were Rs. 15,600 and Rs. 1,800 were used by hired cars and repairs department respectively. Besides, the owner of the garage drew petrol and oil worth Rs. 3,000 for his personal car;
- (d) Repairs Department performed work during the year as under:
 - (i) on owner's car Rs. 600
 - (ii) on hire cars Rs. 7,500
- (e) Spare parts used by the Repairs Department in the year cost Rs. 4,000 and by the hired cars Rs. 750;
- (f) Depreciation on hired cars to be provided at 30% per annum;
- (g) Licences and taxes amounting to Rs. 200 on owner's car have been paid and included in Rent, Rates and Taxes;

(h) Rent, Rates and Taxes to be distributed as under:

- (i) Repairs Department 1/2
- (ii) Spare Parts 1/4
- (iii) Garage 1/8
- (iv) Office 1/8

You are required to prepare a Departmental Trading Account, a Profit and Loss Account for the year ended 31st March, 1985 and a Balance Sheet as on that date.



UNIT- 3 PARTNERSHIP ACCOUNTS

Partnership is a form of organization for doing business. Under an agreement, two or more persons join together to do a business and share its profit. The business may be run by all or by one among them acting for all.

Partnership accounts include not only finalization of accounts but also solving problems that are special in nature to partnership organization viz., appropriation of profits, admission of partner, death and retirement of partner, dissolution of partnership, insolvency of partner etc. Partnership accounts are governed by general principles of accountancy, partnership agreement (deed) and Partnership Act, 1932.

The terms of the agreement among partners may be either verbal or in writing. If it is in writing, it is known as Partnership Deed. It is desirable to have it in writing. Following are the usual contents of the Partnership Deed.

Contents of Partnership Deed

1. Names and addresses of the firm and partners.
2. Nature of the business.
3. Date of commencement of partnership.
4. Duration of partnership.
5. Amount of capital contributed or to be contributed by each partner
6. Amount of drawings allowed by the firm to each partner.
7. Rules regarding operation of bank accounts.
8. Interest on partners' capital and drawings.
9. Ratio in which profits and losses are to be shared.
10. Interest on loan by the partners to the firm.
11. Salaries, commission, etc. if payable to partners.
12. Methods of keeping accounts and audit.
13. Rights, duties and liabilities of the partners.
14. Accounting treatment in case of admission, retirement, death etc. of a partner. Mode of settlement of accounts on dissolution of the firm.
15. Method of settling disputes among the partners.

In case the Partnership Deed is silent on certain matters, the relevant provisions of the Partnership Act shall be applicable. Following are the provisions of the Partnership Act, which have a direct bearing on the accounting treatment of certain items, in case the Deed is silent on these matters.

1. Partners share profits or losses equally.
2. No interest is charged on partners' capital.
3. No interest is charged by the firm on partners' drawings.
4. No partner is entitled to salary or commission.
5. 6% interest is charged on partners' loan.

Appropriation of Profit

In a proprietary organization, the entire profit belongs to the proprietor alone, but in a partnership it has to be shared among all partners. So the profit shown by the profit and loss account is to be apportioned among partners according to the terms of partnership deed, or in case it is silent, according to the provisions of the Act.

Sometimes the Deed may provide salary to a partner, who is managing the firm, interest on partners' capital and interest on partners' drawings. These items are to be adjusted and the remaining profits are to be appropriated among the partners. In this context, a Profit and Loss (Appropriation) Account is prepared to appropriate profits among partners.

Format of Profit and Loss (Appropriation) Account

		Rs.		Rs.
To Salary to partner			By Profit & Loss a/c (Net profit)	-----
	X— Y—	-----	By Interest on drawings X — Y—	-----
To Interest on capital	X— Y—	-----		
To Reserve fund				
To Capital account	X— Y—	-----		
(Profit transferred)		-----		

Fixed and Fluctuating Capital

Capital accounts of partners are maintained either under fixed capital system or under fluctuating capital system. Under fixed capital system, a capital account and a current account is opened for each partner. A partner's original contribution is shown in his fixed capital account and all other entries like his share of profit, salary, drawings, interest on capital and interest on drawings are shown in his current account whereas in fluctuating capital system a partner's original contribution as well as other items are shown in his capital account. Here there is only one capital account for each partner.

Example 1.

On January 1, 1993, X, Y, Z entered into a partnership contributing Rs.3,00,000, Rs.2,00,000 and Rs.1,00,000 respectively and sharing the profits in the ratio 2:2:1. X and Y are entitled to an annual salary of Rs.30,000 and Rs.15,000 respectively. 5% interest on capital is to be allowed. Interest on drawings is to be charged at 6%. The drawings of X, Y and Z are Rs.1500, Rs.1000, Rs.500 per month respectively drawn at the end of every month. Profits for the year ended 1993, before the above adjustment were Rs.1,50,000. Show how the profit is distributed and also prepare the capital accounts (a) if they are fluctuating (b) if they are fixed.

Solution
Profit and Loss (Appropriation) Account (Fig. in rupees)

		Rs.		Rs.
To Partner's Salary			By Net Profit	1,50,000
	X 30,000 Y 15,000	45,000	By Interest on drawings	X 495 Y 330 Z 165
To Interest on capital	X 15,000 Y 10,000 Z 5,000	30,000		
To Capital account	X 30,396 Y 30,396 Z 15,198	75,990		
		1,50,990		1,50,990

Date	Particulars	X	Y	Z	Date	Particulars	X	Y	Z
1993	To Drawings	18000	12000	6000	1993				
1993	To	495	330	165	Jan.	By Bank	3,00,000	2,00,000	1,00,000
Dec.	Interest on drawings				1	By Salary	2,00,000	15,000	
31					Dec.	By Interest	15,000	10,000	5,000
					31	On Capital			
						By P & L			
						(App) A/c	30,396	30,396	15,198
		3,56,901	2,43,066	1,14,033					
		3,75,396	2,55,396	1,20,198			3,75,396	2,55,396	1,20,198

Fixed Capital Accounts*(Fig. in rupees)*

Date	Particulars	X	Y	Z	Date	Particulars	X	Y	Z
1993	To Balance c/d	3,00,000	2,00,000	1,00,000	1993	By Bank	3,00,000	2,00,000	1,00,000
Dec. 31					Jan. 1				

3,00,000	2,00,000	1,00,000			3,00,000	2,00,000	1,00,000
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Current Accounts (Also known as Drawings Account) (Fig. in Rupees)

Date	Particulars	X	Y	Z	Date	Particulars	X	Y	Z
1993 Dec.31	To Drawings	18,000	12,000	6,000	1993	By Salary	30,000	15,000	---
	To Interest on Drawings	495	330	165	Dec. 31	By Interest on Capital	15,000	10,000	5,000
	To Balance c/d	56,901	43,066	14,033		By P & L (App) A/c	30,396	30,396	15,198
		75,396	55,396	20,198			75,396	55,396	20,198
					1994 Jan. 1	By Balance b/d	75,396	55,396	20,198

Note:

Calculation of interest on drawings:

If drawings are made at regular intervals and that too in fixed amounts, then interest on drawings can be calculated on the basis of average period. The calculation of average period depends whether they are made at the beginning of the month or at the end of the month. Suppose, fixed amounts are drawn at the beginning of the month, then the average period is calculated as follows:

$$= (\text{Total periods in months} + 1) / 2$$

On the other hand, if fixed amounts are drawn at the end of the month the average period is calculated as follows:

$$= (\text{Total periods in month} - 1) / 2$$

In the above problem, fixed amounts are drawn at the end of every month. So interest on drawings is calculated as below:

$$\text{Average Period} = 12 - 1 / 2$$

$$= 5.5 \text{ months}$$

$$\text{Interest on X's drawings} = 1500 \times 5.5 \times 6 / 100$$

$$= \text{Rs. } 495$$

$$\text{Interest on Y's drawings} = 1000 \times 5.5 \times 6 / 100$$

$$= \text{RS. } 330$$

$$\text{Interest on Z's drawings} = 600 \times 5.5 \times 6 / 100$$

$$= \text{Rs. } 165$$

Admission of a Partner

A person can be admitted into a partnership firm if all the existing partners agree to his admission.

A new partner is admitted to improve the business, as he may bring in additional capital or may possess business acumen. When admitted, the new partner has a right to his share of profit, as agreed, as well as to his share of assets in the firm.

In case of admission of a new partner, the following accounting problems are encountered with:

1. Calculation of new profit sharing ratios and the sacrificing ratios.
2. Calculation of goodwill and its treatment.
3. Revaluation of assets and liabilities.
4. Distribution of fund distributed reserves, profits or losses.
5. Adjustment of capital accounts.

I. Calculation of new profit sharing ratios and the sacrificing ratios

Calculation of new profit sharing ratios will depend on the terms of agreement among partners admitting the new partner. There are two variations in this regard.

1. The new partner is given his share of profit and the remaining share of profit is presumed to be divided between the old partners in the old profit sharing ratio.
2. He may acquire it in some agreed ratio from old partners.

Sacrificing Ratio

Sacrificing ratio is the difference between old profit sharing ratio and new profit sharing ratio. It will tell how much of share of profit is sacrificed by old partner due to admission of a new partner and giving him a share of profit. The following cases explain the calculation of new profit sharing ratios and sacrificing ratios.

Case 1

The new partner is given his share of profit and the remaining share of profit is presumed to be divided between the old partners in the old profit sharing ratios.

X and Y are partners sharing profits and losses in the ratio of 3:2. They admit 'Z' to the partnership for 1/3 of profits. Calculate the new profit sharing ratio and sacrificing ratio.

Solution

'Z' is given 1/3 profits.

$$\begin{aligned} \text{Therefore remaining share of profits} &= 1 - 1/3 \\ &= 2/3 \end{aligned}$$

2/3 of profits are to be shared between X and Y in the old profit sharing

$$\begin{array}{lll} \text{X's share} & = 2/3 \times 3/5 & = 2/5 \\ \text{Y's share} & = 2/3 \times 2/5 & = 4/15 \\ \text{Z's share} & = 1/3 & \end{array}$$

ratio. Therefore,

$$\begin{aligned} X\text{'s share} &= \frac{2}{3} \times \frac{3}{5} = \frac{2}{5} \\ Y\text{'s share} &= \frac{2}{3} \times \frac{2}{5} = \frac{4}{15} \\ Z\text{'s share} &= \frac{1}{3} \end{aligned}$$

Therefore,

$$\begin{aligned} \text{New profit sharing ratio } X:Y:Z &= \frac{2}{5}:\frac{4}{15}:\frac{1}{3} \\ &= 6:4:5 \end{aligned}$$

Profit ratio between X and Y remains the same. So sacrificing ratio of X and Y is nothing but the old profit sharing ratio.

Case 2(a)

A and B are partners sharing profits and losses in the ratio of 5:3. C is admitted to the partnership and he acquires $\frac{3}{16}$ share of profit from A and $\frac{1}{16}$ share of profit from B. Calculate new profit sharing ratios among all partners and the sacrificing ratios between old partners.

$$\begin{aligned} A\text{'s new share of profit} &= \frac{5}{8} - \frac{3}{16} \\ &= \frac{10}{16} - \frac{3}{16} \\ &= \frac{7}{16} \end{aligned}$$

$$\begin{aligned} B\text{'s new share of profit} &= \frac{3}{8} - \frac{1}{16} \\ &= \frac{6}{16} - \frac{1}{16} \end{aligned}$$

$$= \frac{5}{16}$$

$$\begin{aligned} C\text{'s new share of profit} &= \frac{3}{16} + \frac{1}{16} \\ &= \frac{3}{16} + \frac{1}{16} \\ &= \frac{4}{16} \end{aligned}$$

$$\begin{aligned} \text{New profit sharing ratios } A:B:C & \\ &= 7:5:4 \end{aligned}$$

Sacrificing ratios between A and B
 A gives up (sacrifices) $\frac{3}{16}$ share
 B gives up (sacrifices) $\frac{1}{16}$ share

Therefore

$$\text{Sacrificing ratio} = 3:1$$

Case 2(b)

M and N are partners sharing profits and losses in the ratio of 3:1. They admit 'O' for $\frac{1}{5}$ share in profits which he acquires equally from M and N. Calculate new profit sharing ratio and sacrificing ratio.

O gets $\frac{1}{5}$ share.

(i.e.) $\frac{1}{2}$ of $\frac{1}{5} = \frac{1}{10}$ he gets it from M and N each.

Therefore,

$$\begin{aligned} M\text{'s new share} &= \frac{3}{4} - \frac{1}{10} \\ &= \frac{15}{20} - \frac{2}{20} \\ &= \frac{13}{20} \end{aligned}$$

$$N\text{'s new share} = \frac{1}{4} - \frac{1}{10}$$

$$=5-2/20$$

$$=3/20$$

$$\text{O's share} = 1/5 \text{ or}$$

4/20 Therefore

$$\text{New profit sharing ratio} = \text{M:N:O} = 13:3:4$$

As the old partners give

up their share to new partner equally, the sacrificing ratio between M and N is 1:1.

Case 2(c)

P and Q are partners sharing profits and losses in the ratio of 3:2. They admit R for 1/5 share of profit which he acquires wholly from 'P'. Calculate the new profit sharing ratio and sacrificing ratio.

$$\text{P's new share} = 3/5 - 1/5$$

$$= 2/5$$

$$\text{Q's new share} = 2/5 \text{ (No change)}$$

$$\text{R's share} = 1/5$$

$$\text{New profit sharing ratio} = 2:2:1$$

Here, P, alone gives his 1/5 share to R. So sacrificing ratio for P is 1/5.

Calculation and Treatment of Goodwill

Goodwill is an intangible asset. The ability of a business to earn excess profit is due to its reputation. This reputation expressed in monetary terms is goodwill. A number of factors are responsible for good reputation like location, product, management, etc.

Goodwill is valued usually at the time of sale of business. But in the following cases also goodwill is valued.

1. When profit sharing ratios among existing partners is changed
2. Admission of a partner
3. Death or retirement of a partner
4. Amalgamation of two firms.

Following are the methods of valuing goodwill:

1. Average profit method
2. Super profit method
3. Capitalization method

I. Average Profits Method

In this method, goodwill is valued by multiplying the average profit of last few years by an agreed number.

$$\text{Goodwill} = \text{Average profits} \times \text{No. of years' purchase.}$$

Example 1 Compute the value of goodwill on the basis of three years' purchase of the average profits of last 4 years. The profits of the last 4 years are:

1990-Rs. 80,000

1991-Rs. 90,000

1992-Rs. 82,000

1993-Rs. 86,000

Solution

Average profit of last four years

$$80,000 + 90,000 + 82,000 + 86,000 / 4$$

$$3,38,000 / 4 = \text{Rs. } 84,500$$

$$\text{Value of goodwill} = \text{Rs. } 84,500 \times 3 = \text{Rs. } 2,53,500$$

Another variation of average profit method is weighted average method. Here weights are assigned to each year's profit and the weighted average profit is calculated. Here goodwill is

$$\text{Goodwill} = \text{weighted average profit} \times \text{No. of years' purchase}$$

Example 2

Compute the goodwill of a firm on the basis of 3 years' purchase of weighted profit of last four years (assign weights 1, 2, 3 and 4 serially to the profits).

Profit of last 4 years are:

1990-Rs. 40,000

1991-Rs. 45,000

1992-Rs. 50,000

1993-Rs. 55,000

Solution

Year	Annual Profits	Weights	Product
1990	40,000	1	40,000
1991	45,000	2	90,000
1992	50,000	3	1,50,000
1993	55,000	4	2,20,000
		10	5,00,000

$$\begin{aligned}\text{Weighted average profit} &= \text{Total product} / \text{Total weight} \\ &= 5,00,000 / 10 = \text{Rs. } 50,000\end{aligned}$$

$$\begin{aligned}\text{Value of goodwill} &= \text{Wt. average profit} \times \text{No. of years purchase} \\ &= 50,000 \times 3 = \text{Rs. } 1,50,000.\end{aligned}$$

2. Super Profits Method

Super profits are profits earned in excess of normal profits. Goodwill under this method = Super profit \times No. of years' purchase
 Normal profit = Capital employed \times normal rate of return

Example 3

From the following information, calculate goodwill using super profits method.

a) Capital employed in the business Rs. 6,00,000

b) Normal rate of return 10%

c) Profits for the last 3 years were Rs. 75,000; Rs. 80,000; Rs. 85,000

d) Goodwill is 4 years purchase of super profit

$$\begin{aligned}\text{Average profits} &= \frac{75,000 + 80,000 + 85,000}{3} \\ &= \frac{2,40,000}{3} = \text{Rs. } 80,000\end{aligned}$$

Normal profit = Capital employed \times normal rate of return

$$= 6,00,000 \times 10/100 = \text{Rs. } 60,000$$

Super profit = Rs. 80,000 - Rs. 60,000 = Rs.

20,000
 Goodwill = Rs. 20,000 \times 4 = Rs. 80,000

Capitalization Method

Under this method goodwill is the difference between capitalized value of average profits at normal rate of return and actual capital employed.

Example From the following, calculate goodwill:

a) Normal rate of return 10%

b) Average profits for last 3 years Rs. 75,000; Rs. 80,000; Rs. 85,000

c) Total assets Rs. 7,00,000 and total liabilities Rs. 2,00,000

Solution

Average profits = $\frac{75,000 + 80,000 + 85,000}{3}$

= Rs. 80,000

Capitalized value of average profits

= average profit \times 100 / Normal rate of return

= $80,000 \times 100 / 10$

= Rs. 8,00,000

Capital employed = Total tangible asset - Total liabilities

= Rs. 7,00,000 - Rs. 2,00,000

= Rs. 5,00,000

Goodwill = Capitalized value of average profit at normal rate of return - Capital employed

= Rs. 8,00,000 - Rs. 5,00,000

= Rs. 3,00,000

TREATMENT OF GOODWILL

When a new partner is admitted into a firm, the old partners give up a part of their share of profits in favour of the new partner. Also the new partner is going to enjoy the goodwill of the firm which was built up by the old partners. So the old partners have to be compensated either by payment of money by the new partner or by way of extra credits in their capital accounts.

There are three ways by which goodwill is dealt with when a new partner is admitted.

They are

1. Premium Method
2. Revaluation Method
3. Memorandum Revaluation Method

1. Premium Method

Under this method, the new partner brings his share of goodwill and the same is shared by old partners in their profits sacrificing ratios. If the payment is made privately to old partners no entry is required in the books of accounts. But if the payment is made through the books the following entries are passed.

1. Bank/cash/c Dr-

To goodwill/c

[The amount of goodwill brought in by the new partner as premium]

2. Goodwill/c Dr-

To old partner's capital/c (individually) -

[Goodwill brought in by new partner credited to old partners in their

sacrificing ratios]

Sometimes the old partners may be allowed to withdraw their amount of goodwill (full or part of it). The following entry is passed.

Old partners capital a/c Dr –
(individually)

To cash

[Amount of goodwill withdrawn by old partners]

Example

X and Y are partners in a business, sharing profits and losses @ 3:1. They admit Z for 1/5 share. Z brings Rs. 10,000 as his capital and Rs. 8,000 as goodwill. Pass Journal entry to record the transactions

- (a) when goodwill amount is returned in the business
 (b) when the entire amount of goodwill is withdrawn
 (c) when 50% of the goodwill is withdrawn

SOLUTION:

(a) When goodwill is returned in the business Bank/Cash a/c

Dr 18000

To Z's capital a/c 10000 To goodwill a/c 8000

[Amount brought in by 'Z' for capital and goodwill] Goodwill a/c

Dr 8000

To X's capital a/c 6000

To Y's capital a/c 2000

Amount goodwill brought in by new partner credited to old partners' capital accounts in their sacrificing ratios]

(a) In case the amount of goodwill is withdrawn, then apart from passing the two

entries, the following additional entry is to be passed for withdrawal.

X's capital a/c Dr. 6000

Y's capital a/c Dr. 2000

To cash/bank a/c 8000

[The goodwill credited is withdrawn]

(b) In case 50% of the goodwill is withdrawn, the withdrawal entry is as below X's

capital a/c Dr

Y's capital a/c	Dr	
To cash/bank a/c		4000
[50% of goodwill credited is withdrawn]		

Revaluation Method

When the incoming partner is not in a position to pay in cash for goodwill, the goodwill is raised in the books, by crediting the old partners' capital account in their old profit sharing ratio. There are two possibilities here

1. No goodwill account appears in the books at the time of admission
2. When there is goodwill account at the time of admission

No goodwill account appears in the books at the time of admission

In such a case goodwill is to be brought into books at its agreed value by debiting the goodwill account and crediting the capital accounts of old partners in their old profit sharing ratio. Here the goodwill account will appear in the balance sheet. The following journal entry is passed.

Goodwill a/c	Dr	-
To old partners' capital account		(individually)-

[Goodwill is raised by debiting goodwill a/c and crediting old partners' capital account in their old profit sharing ratio]

Example

X and Y are partners sharing profits and losses in the ratio of 3:1. They admit 'Z' for 1/5 share. 'Z' brings in Rs.20,000 for his capital, but is not in a position to bring cash for goodwill. The value of goodwill is agreed at Rs.12,000. No goodwill account appears in the books. Pass necessary entries.

Cash/bank a/c	Dr	20000
To Z's capital account		20000
[Being the amount brought in by Z for his capital]		
Goodwill a/c	Dr	12000
To X's capital a/c		8000
To Y's capital a/c		4000

[Goodwill account being raised in the books at its value by crediting the old partners' capital account in their old profit sharing ratio]

1. When there is goodwill account at the time of admission

In case at the time of admission of a partner there appears

goodwill account in the books, then the adjustment for goodwill in the old partners capital account is made only for the difference between the agreed value of goodwill and the amount of goodwill appearing in the books.

If the agreed value of goodwill is more than the goodwill account appearing in the books, then the goodwill account is to be further increased by crediting the old partners capital account in their old profit sharing ratio.

If the agreed value is less than the goodwill appearing in the books then the excess value of goodwill is written back by debiting the old partners capital account in the old profit sharing ratio.

Example

X and Y are partners of a firm sharing profits and losses in the ratio of 3:2. They admit Z for 1/5 share in profits. Z brings in Rs. 20,000 as his capital. The value of goodwill is estimated at Rs. 20,000. Give journal entries under the following circumstances.

1. When there is no goodwill appearing in the books of the firm
2. When the goodwill account appears at Rs. 10,000 in the books of the firm
3. When the goodwill account appears at Rs. 30,000 in the books of the firm

Solution

(a) when there is no goodwill appearing in the

books Cash/Bank a/c	Dr	20,000
		To Z's capital account

20,000 [Being the capital introduced by Z]

Goodwill a/c	Dr	20,000
		To X's capital account
		12,000
		To Y's capital account
		8,000

[Goodwill account is raised by crediting capital accounts of X and Y in their old profit sharing ratio]

(b) when the goodwill account appears at Rs. 10,000 in the books of the firm (Agreed value is more than the book value)

Cash/Bank a/c	Dr	20,000
		To Z's capital account
		20,000

[Being the amount brought in by Z as capital] Goo

Goodwill a/c	Dr	10000	
			To X's capital a/c 6000
			To Y's capital a/c 4000

[Goodwill account is raised to its agreed value of crediting the capital accounts of X and Y in their old profit sharing ratio]

(c) When goodwill account appears at Rs.30,000 (Agreed value is less than the book value) Cash/Bank a/c Dr 20000

To Z's capital a/c
20000 [Being the amount brought in by Z as his capital]

X's capital a/c	Dr	6000
Y's capital a/c	Dr	4000
		To Goodwill a/c 10000

[Goodwill account appearing in the books is written off to the extent of Rs.10,000 to make it appear at Rs.20,000 by debiting the old partners capital account in their old profit sharing ratio].

Memorandum Revaluation Method

If all partners decide not to show the goodwill account in the books, then they can write back the same by passing the following entry.

All partners capital a/c (individually)

Dr

To Goodwill a/c –

[Goodwill a/c is written back by debiting the partners capital account, including the new partner in the new profit sharing ratio].

Example

A and B are partners sharing profits and losses in the ratio of 5:4. They admit 'C' and the new profit sharing ratio is 4:3:2. 'C' brings Rs.20,000 as his capital. The value of goodwill is estimated at Rs.36,000. Give necessary entries in the books of the firm on C's admission assuming that the partners do not want goodwill to appear in the books.

1) Cash/bank a/c Dr 20000
To C's capital a/c 20000

[Being the cash brought in by 'C' as his capital]

2) Goodwill/c	Dr	36000	
To A's capital a/c			20000
To B's capital a/c			16000
[Goodwill account raised in the books on C's			

admission by crediting the old partners' capital account in their old profit sharing ratio (i.e.) 5:4]

3) A's capital a/c	Dr		
16000 B's capital a/c	Dr	12000	
C's capital a/c	Dr	4000	
To goodwill/c			36000

[Goodwill account is written back by delivering the partners capital account in their new profit sharing ratio]

Revaluation of Assets and Liabilities

At the time of admission of a partner into a partnership firm the assets and liabilities of the firm is revalued. The logic behind this exercise is to see that the new partner is not gaining due to understated assets and overstated liabilities or losing due to overstated assets and understated liabilities.

A revaluation (also known as Profit and Loss Adjustment Account) is opened and necessary entries are passed to bring the assets and liabilities to its real value at the time of admission. Then the profit or loss arising out of revaluation of assets and liabilities is transferred to the capital accounts of the old partners in their profit sharing ratios.

The following entries are passed to record the revaluation of assets and liabilities.

- 1) For increase in the value of assets

Assets a/c	Dr –
------------	------

To revaluation a/c	
--------------------	--

- 2) For decrease in the value of assets

Revaluation a/c	Dr –
-----------------	------

To assets a/c	
---------------	--

- 3) For increase in the value of

liabilities	Revaluation a/c
-------------	-----------------

Dr –

To liabilities a/c	
--------------------	--

- 4) For any decrease in the value

of liabilities Liabilities a/c Dr –

To revaluation a/c

5) For transfer of profit on revaluation

Revaluation a/c Dr –

To old partners capital a/c (individually)

6) For transfer of loss on revaluation

Old partners' capital a/c (individually) Dr –

To revaluation a/c

Sometimes the partners may decide not to alter the value of assets and liabilities but at the same time revalue the assets and liabilities and account for its profit/loss on revaluation. In such a circumstance, a Memorandum Revaluation Account is prepared. First, entries are posted in this account for any increase/decrease in the value of assets/liabilities as explained before and the profit/loss is transferred to capital accounts of old partners. Then the entries posted for any increase or decrease in assets/liabilities are reversed and so the assets and liabilities are again brought to its original value. Any profit/loss arising out of reversal of entries for increase/decrease in the value of assets and liabilities are transferred to capital account of all partners in their new profit sharing ratio.

Journal entries in this regard are:

In case of profit on revaluation

1. Memorandum Revaluation Account Dr –

To Old partners capital account (individually)

[Profit on revaluation transferred to old partners in their old profit sharing ratio]

2. All partners' capital account (individually) Dr –

To Memorandum revaluation a/c

[Profit previously credited is now returned back by debiting all partners capital accounts in their new profit sharing ratios]

In case of loss on revaluation, the above entries are reversed.

3. Adjustment of fund distributed profits, reserves or losses

When a new partner is admitted, profits, reserves or losses appearing in the books at the time of admission is to be distributed to old partners in the old profit sharing ratio. The following journal entries are relevant in this regard. For distributing profits and reserves

Profit and loss a/c Dr -

Reserve a/c Dr -

To old partners capital a/c (individually)

[Distribution of profits and reserves at

the time of admission of a new partner to old partners in their old profit sharing ratio]

For distributing losses

Old partners capital a/c – (individually)

To profit & loss a/c (debit balance) –

[Losses at the time of admission of a partner distributed to old partner in the old profit sharing ratio]

4. Adjustments of capital accounts

At the time of admission of a partner, the partners may decide to have a balance in their capital accounts in proportion to their profit sharing ratio. So if they have excess or shortage of capital in relation to their profit sharing ratio, adjustment in their capital accounts are to be made. In case any partner has excess capital, the following entry is passed to correct this capital account in proportion to his profit sharing ratio:

Partners capital a/c Dr -

To cash/bank a/c –

[Excess capital withdrawn by the partner who is having excess capital] In case his capital falls short of the amount of capital, calculated in proportion to his profit sharing ratio, the following entry is passed:

Cash/Bank a/c Dr -

To Partners capital a/c –

[Cash is brought in by the partner to make his capital account in proportion to his profit sharing ratio]

Illustration 1

The following was the balance sheet of A, B and C who were equal partners.

Balance sheet of A, B and C as on June 1, 1982

Capital Accounts	Rupees		Rupees
A	16,800	Building	19,500
B	12,600	Furniture	2,400
C	6,000	Stock	11,400
Creditors	6,000	Debtors	10,800
Bills payable	3,300	Cash	600

	44,700		44,700
--	--------	--	--------

They agreed to take D into partnership and give him 1/4 share in the profits on the following terms:

1. That 'D' should bring in Rs. 9,000 for goodwill and Rs. 15,000 as capital.
2. That 1/2 of the goodwill shall be withdrawn by the old partners.
3. The stock and furniture be depreciated by 10%
4. That a provision of 5% on debtors be created for doubtful debts.
5. That a liability for Rs. 1,080 be created against bills discounted.
6. That the value of the building, having appreciated, should be valued at Rs. 27,000. Give journal entries and prepare Revaluation Account and the opening Balance Sheet of the reconstituted firm;

Sheet of the reconstituted firm;

- (i) in case the partners decide to show the assets and liabilities at the new value.
- (ii) in case the partners decide not to alter the value of asset & liabilities except cash.

SOLUTION:

CASE 1 :

If the partners decide to show the assets and liabilities at the new value.

Journal Entries

Cash a/c	Dr 24,000		
	To D's capital a/c	15,000	
	To Goodwill a/c	9,000	
(Cash brought in by the new partners D as his capital and goodwill) Goodwill a/c			
	Dr 9,000		
	To A's capital a/c 3,000	To B's capital a/c 3,000	To C's capital a/c 3,000
[Being the goodwill brought in by 'D' in cash distributed to old partners in their sacrificing ratio].			
	A's capital a/c Dr		
	15,000	B's capital a/c Dr	
	15,000	C's capital a/c Dr	
		15,000	
	To cash	4,500	
[Half of the goodwill credited withdrawn by old partners]			
	Revaluation a/c	Dr 3,000	
	To stock a/c		1,140
	To furniture a/c		240

To reserve for bad debts a/c 540
 To liability for bills discounted 1080
 [Entry passed to decrease the value of assets or increase the value of liabilities]
 Buildings a/c Dr 7500
 To revaluation a/c 7500
 [Entry passed to increase the value of building] Rev
 Revaluation a/c Dr 4500
 To A's capital a/c 1500
 To B's capital a/c 1500
 To C's capital a/c 1500
 [Profit on revaluation transferred to old partners in the old profit sharing ratio]

Balance sheet of A, B, C and D as on 1st June, 1982

Creditors	Rs.	Cash	20,100
Bills payable	6,000	Stock (11400 - 1140)	10,260
Liability for bills discounted	3,300	Debtors 10800	
	1,080	(-) Reserve 540	10,260
Capital accounts A	19,800	Furniture (2400 - 240)	2,160
Capital accounts B	15,600	Building	27,000
Capital accounts C	9,000		
Capital accounts D	15,000		
	69,780		69,780

Revaluation Account (Fig. in Rupees)

To Stock	1,140	By Buildings a/c	7,500
To Furniture	240		
To Reserve for bad debts	540		
To Liabilities for bills discounted	1,080		
A's Capital a/c 1500			
B's Capital a/c 1500			
C's Capital a/c 1500	4,500		
(Profit on revaluation credited to capital a/c)			
	7,500		7,500

Cash Account (Fig. in Rupees)

To Balance b/d	600	By A's Capital a/c	1,500
To D's Capital a/c	15,000	B's Capital a/c	1,500
To Goodwill a/c	9,000	C's Capital a/c	1,500
		(half of goodwill withdrawn)	20,100
	24,600		24,600

	A	B	C	D		A	B	C	D
--	---	---	---	---	--	---	---	---	---

To Cash	1,500	1,500	1,500	-	By Balance b/d	16,800	12,600	12,600	---
To Balance c/d	19,800	15,600	9,000	15,000	By Cash a/c	---	---	---	15,000
					By Goodwill a/c	3,000	3,000	3,000	---
					By Revaluation a/c	1,500	1,500	1,500	---
	21,300	17,100	10,500	15,000		21,300	17,100	10,500	15,000

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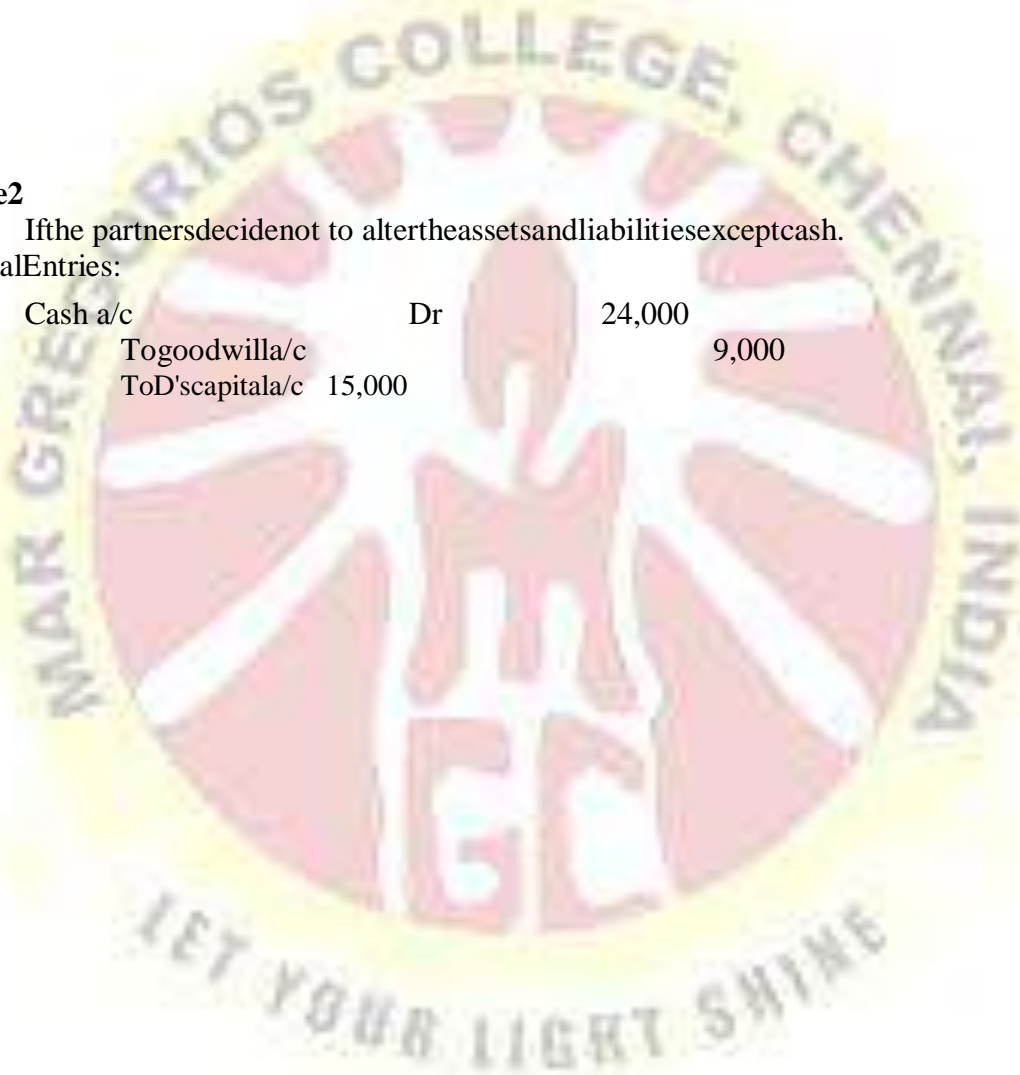
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Case 2

If the partners decide not to alter the assets and liabilities except cash.

Journal Entries:

Cash a/c	Dr	24,000	
To Goodwill a/c			9,000
To D's capital a/c	15,000		



[Cash brought in by D for his capital and goodwill]

2. Goodwill a/c	Dr	9,000
To A's capital a/c		3,000
To B's capital a/c		3,000
To C's capital a/c		3,000
[Goodwill brought in by D is distributed to old partners] Dr		
3. A's capital a/c		1500
B's capital a/c	Dr	1500
C's capital a/c	Dr	1500
To cash		4500
[Half of the goodwill withdrawn by old partners]		
4. Memorandum Revaluation Dr		4500
To A's capital a/c		1500
To B's capital a/c		1500
To C's capital a/c		1500
[Profit on revaluation distributed to old partners]		
5. A's capital a/c	Dr	1125
B's capital a/c	Dr	1125
C's capital a/c	Dr	1125
D's capital a/c	Dr	1125
To Memorandum Revaluation a/c		

Profit revaluation account is written back by debiting all the partners capital account in their new profit sharing ratio]

	A (Rs.)	B (Rs.)	C (Rs.)	D (Rs.)		A (Rs.)	B (Rs.)	C (Rs.)	D (Rs.)
To Cash a/c	1,500	1,500	1,500	-	By Balance c/d	16,800	12,600	6,000	---
To Revaluation a/c	1,125	1,125	1,125	1,125	By Cash a/c	---	---	---	15,000
To Balance c/d	18,675	14,475	7,875	13,875	By Goodwill a/c	3,000	3,000	3,000	---
					By Revaluation a/c	1,500	1,500	1,500	---
	21,300	17,100	10,500	15,000		21,300	17,100	10,500	15,000

Memorandum Revaluation Account

	Rs.		Rs.
To Stock	1,140	By Buildings	7,500
To Furniture	240		
To Provision for bad debts	540		
To Provision for bills discounted	1,080		
To A's capital a/c	1500		
To B's capital a/c	1500		
To C's capital a/c	1500		
Profit on revaluation	7,500		7,500
To Reversal of entries on credit side	7,500	By Reversal of entries on the debt side	3,000
		By A's capital a/c	1125
		By B's capital a/c	1125
		By C's capital a/c	1125
		By D's capital a/c	1125
	7,500	(Profit on revaluation is written back)	7,500

Balancesheet as on 1st June, 1982

Liabilities	Rs.	Assets	Rs.
-------------	-----	--------	-----

4. Goodwill/c Dr 8820
 ToA'scapital a/c 3780
 ToB's capital a/c 3150
 ToC's capital a/c 1890
 [Valueof goodwillis raised toRs.14070 bycreditingthe old partnerscapitalaccounts in their profit sharing ratio]

5. Generalreservea/c Dr 10500
 ToA'scapital a/c 4500
 ToB's capital a/c 3750
 ToC's capital a/c 2250
 [Generalreserveisdistributed toold partnerson admissionofDI]

6. A's capitala/c Dr 3660
 B'scapital a/c Dr 3400
 Tocash a/c 7060
 [Excess amountinthecapitalaccounts ofA&Bwithdrawn]

7. Casha/c Dr 1320
 ToC's capital a/c 1320
 [CashbroughtinbyCtomeettheshortfall inhis capitalaccount]

RevaluationAccount

	Rupees		Rupees
ToFurniture	920	ByLandandBuildings	14,700
ToStock	2,940		
ToProvisionforrepairs	1,320		
ToA'sCapital a/c4080			
ToB'sCapitala/c3400			
ToC's Capitala/c2040	9,520		
Profitonrevaluation	14,700		14,700

CapitalAccounts

	A (Rs.)	B (Rs.)	C (Rs.)	D (Rs.)		A (Rs.)	B (Rs.)	C (Rs.)	D (Rs.)
ToCasha/c	3,660	3,400	---	---	Bybalancec/d	35,400	29,850	14,550	---
ToBalance c/d	44,100	36,750	22,050	14,700	Bycasha/c	---	---	---	14,700
					ByRevaluationa/c	4,080	3,400	2,040	---
					Bygoodwilla/c	3,780	3,150	1,890	---
					Bygeneralreserve	4,500	3,750	2,250	---
					Bycash	---	---	1,320	---
	47,760	40,150	22,050	14,700		47,760	40,150	22,050	14,700

CashAccount

	Rupees		Rupees
ToBalanceb/d	1,890	ByA's capital a/c	3,660
ToD's capitala/c	14,700	ByB'scapitala/c	3,400
ToC'scapitala/c	1,320	ByBalancec/d	10,850
	17,910		17,910

Balancesheet ason.....

Liabilities	Rs.	Assets	Rs.
Creditors	18,900	Cash	10,850
Bills payable	6,300	Debtors	26,460

Provision for outstanding repairs		Goodwill	14,070
Capital Accounts	1,320	Stock (29400 - 2940)	26,460
A-44100		Furniture (7350-920)	6,430
B-36750		Land and buildings	59,850
C -22050			
D-14700	1,17,600		
	1,44,120		1,44,120

Calculation of capital balances.

For 1/8 share D's capital is Rs. 14,700

A's capital (3/8) Rs. 44,100

B's capital (5/16) Rs. 36,750

C's capital (3/16) Rs. 22,050

RETIREMENT OF A PARTNER

A partner of a firm may decide to retire due to various reasons like ill-health, old age etc. He retires on the basis of retirement terms of a partner set out in the Partnership Deed. When a partner retires, the other partners enter into a fresh agreement and continue the business.

When a partner retires, the following accounting problems are to be looked into.

1. Calculation of new profit sharing ratio and profit gaining ratio.
2. Treatment of goodwill.
3. Revaluation of assets and liabilities.
4. Distribution of reserves/profit or losses.
5. Adjustment of capital accounts of continuing partners. Ascertaining amount payable to the retiring partner and the mode of payment of the amount.

1. Calculation of new profit sharing ratio and profit gaining ratio of continuing partners

When a partner retires from a firm, the continuing partner may agree upon the new profit sharing ratio among themselves, otherwise they acquire the share of profit of the retiring partner in their profit sharing ratio. Profit gaining ratio is the difference between new profit sharing ratios and old profit sharing ratio of old partners.

Case 1

A, B and

C are partners sharing profits and losses in the ratio of

4:3:3. B retires. Calculate the new profit sharing ratio, also calculate profit gaining ratio.

Solution

New profit sharing of A and C is 4:3 as there is no agreement on future profit sharing ratio, it is presumed the continuing partners purchase the retiring partner's share in their old profit sharing ratio (i.e.) 4:3. Therefore, the profit gaining ratio is also 4:3 between A:C.

Case 2

A, B and C are partners and share profits and losses in the ratio of 3:2:2. B retires from the partnership. A and C decide to share the future profits equally. Ascertain new profit sharing ratio and profit gaining ratio.

New profit sharing ratio between A and C is 1:1. Profit gaining ratio for A = $\frac{1}{2} - \frac{3}{7}$

$$= \frac{7-6}{14} = \frac{1}{14}$$

Profit gaining ratio for B = $\frac{1}{2} - \frac{2}{7}$

$$= \frac{7-4}{14} = \frac{3}{14}$$

Profit gaining ratio between A & C is 1:3.

2. Goodwill Treatment

When a partner retires from a firm, the other partners stand to gain a share of his future profits. So the retiring partner has to be compensated by way of extra credit for his share of goodwill. There are four ways for treating goodwill at the time of retirement. They are

1. Goodwill is raised in the books for its full value by crediting all partners' capital accounts in the old profit sharing ratio.
2. Goodwill raised in the books as above is written off by debiting the capital accounts of the continuing partners in the new profit sharing ratio.
3. Goodwill may be raised in the books only to the extent of retiring partner's share and is written off by debiting the continuing partners' capital accounts in the profit giving ratio.
4. Without raising goodwill, capital accounts of partners are adjusted for goodwill.

Example

A, B and C are partners in a firm sharing profits and losses in the ratio of 3:2:1. 'B' retires from the firm. The future profit sharing ratio of A and C is 2:1. The value of goodwill is estimated at Rs. 42,000. Pass entries for the treatment of goodwill in each of the above cases. **Case 1**

Goodwill is raised in the books for its full value by crediting all partners' capital accounts in their profit sharing ratio. Here the goodwill account will appear in the ba

lancesheetanasset.

Goodwill/c	Dr	42000
ToA's capitala/c		21000
ToB's capitala/c		14000
ToC'scapitala/c		7000

[Goodwillisraised forits fullvalue bycreditingallthepartners' capitala/cintheoldratio]

Case2

Goodwillraisedandwrittenoff

a) Goodwill/c	Dr	42000
ToA'scapital a/c		21000
ToB's capital a/c		14000
ToC's capital a/c		7000

[Goodwillraisedtoitsfullvaluecreditingthecapitalaccountsintheoldratio]

b)A'scapitala/c	Dr	28000
B'scapital a/c	Dr	14000
To goodwill a/c		42000

[Goodwillraised iswritten offbydebitingthe capitalaccounts of continuingpartners inthenewratio]

Case3

Goodwillraisedto theextentoftheretiringpartnersshareand writtenoff.

Goodwill/c Dr 14000

To B's capital a/c

14000[Goodwillraisedtotheextentofretiringp

artner'sshare]

a) A'scapitala/c

Dr 7000C'scapital a/cDr 7000

To goodwill a/c 14000

[Goodwillraisediswrittenoffintheprofitgivingratio]

Case4

Withoutraisinggoodwillaccountinthebook,whenadjustmentfor goodwillismade.

A's capital a/c Dr 7000

C'scapitala/cDr7000

ToB's capital a/c 14000

[Retiring partner's capital account is credited with his share of

goodwill by debiting the capital accounts of continuing partners in their profit sharing ratio]

3. Revaluation of Assets and Liabilities

When a partner retires the assets and liabilities are revalued so that he does not suffer gain because of over/understated assets and liabilities. Profit or loss arising on the revaluation of assets and liabilities is distributed to all partners in their profit sharing ratio. In case the continuing partners decide to show the value of assets and liabilities in the old value and not in the revalued value, they prepare Memorandum Revaluation Account.

4. Distribution of Reserves/Profits or Losses

Any balance of reserves/profits or losses on the date of retirement of a partner is distributed to all partners (including the retiring partner) in the old profit sharing ratio. The following entries are used in this regard.

For	distribution	of
	reserves/profits	Reserves/Pro
	fit & Loss a/c	Dr
	To all partners capital a/c	
(individually)	Fordistribution of losses	
All partners capital account	(individually)	Dr To profit &
	Loss (Dr) a/c	

5. Adjustments of capital accounts of continuing partners

The continuing partners may decide to have their balance of capital accounts in proportion to their profit sharing ratio. In such a case they bring in cash or withdraw cash in order to make their capitals in proportion to the profit sharing ratio.

6. Ascertaining the amount payable to the retiring partner and the mode of payment of the amount

The capital account of the retiring partner is prepared on the date of retirement to arrive at the amount due to him. The usual credit entries in his account are:

1. Credit balance of his capital a/c
2. Credit balance of his current a/c
3. His share of goodwill
4. His share of accumulated profits and reserves
5. His share of profit on revaluation
6. His share of profit up to the date of retirement

7. Interest on capital up to the date of retirement

8. His share of joint

life

policy The usual debit entries in

the account are

1. Debit balance of his capital account

2. Debit balance of his current account

3. His share of accumulated losses

4. His share of loss on revaluation

5. His share of loss up to the date of retirement

6. His drawings up to the date of retirement

7. Interest on his drawings up to the date of retirement

The account, after passing all relevant entries, is closed on the date of his retirement, and the balance (usually credit) is transferred to his loan account.

Later the loan account is paid off as per the terms of retirement.

ILLUSTRATION: 3 C, P and S were partners sharing profits $\frac{2}{5}$, $\frac{3}{10}$ and $\frac{3}{10}$ respectively. Their balance sheet on 31st December 1983 was as follows.

Liabilities	Rs.	Assets	Rs.
Capital Accounts		Building	18,000
P 16000		Plant	14,000
B 12000		Motor Car	4,000
C 10000	38,000	Stock	10,000
Reserve	5,000	Debtors 7000	
Bills payable	2,000	(-) Provision 1000	6,000
Creditors	8,000	Cash at Bank	1,000
	53,000		53,000

Terms on that date on the terms:

- The goodwill of the firm is to be valued at Rs. 7000
- Stock and building are to be appreciated by 10%
- Plant and motor car are to be depreciated by 10%
- Liability for the payment of gratuity to workers Rs. 2000 is not recorded in the books, but the same is to be provided for
- Provision for bad debts is no more necessary
- It is decided not to maintain goodwill account in the books
- The amount payable to P is to be paid in 3 equal annual instalments beginning from

You are required to prepare

- (i) Revaluation account
- (ii) Partners' capital accounts
- (iii) New balance sheet of M/s. Land S
- (iv) P's loan account for 1984

Solution

Revaluation Account

	Rs.		Rs.
Dec.31,1983		Dec.31,1983	
To Plant	1,400	By Stock	1,000
To Motor Car	400	By Buildings	1,800
To Liability for payment of gratuity	2,000	By Provision for bad	2,000
	3,800		3,800

[Note: There is no profit or loss on revaluation]

Capital Accounts

	C (Rs.)	P (Rs.)	S (Rs.)		C (Rs.)	P (Rs.)	S (Rs.)
Dec.31,1983				Dec.31,1983			
To Goodwill (goodwill written back)	4,000		3,000	By Balance/d	16,000	12,000	10,000
To Balance c/d	16,800	----	10,600	By Goodwill	2,800	2,100	2,100
To P's loan a/c	----	15,600	----	By Reserve	2,000	1,500	1,500
	20,800	15,600	13,600		20,800	15,600	13,600

Balance sheet of M/s. Land S as on 31-12-1983

Liabilities	Rs.	Assets	Rs.
Capital Account		Buildings	19,800
C 16,800		Plant	12,600
S 10,600	27,400	Motor Cars	3,600
P's loan account	15,600	Stock	11,000
Bills payable	2,000	Debtors	7,000
Creditors	8,000	Cash at Bank	1,000
Liability for payment of gratuity	2,000		
	55,000		55,000

P's loan account for 1984

	Rs.		Rs.
Jan. 1, 1983		Jan. 1, 1983	
To Cash	5,200	By Balance/d	15,600
Dec.31,1984		Dec.31,1984	
To Balance c/d	11,440	By Interest	1,040

Illustration 4

The Balance sheet of X, Y and Z, sharing profits in proportion to their capitals was as follows on December 31, 1975.

Liabilities	Rs.	Assets	Rs.
Sundry creditors	27,600	Cash at Bank	22,400
Capital Accounts		Sundry debtors	20,000
X-90,000		(-) Reserve for bad Debts	400
			19,600

5. X's capital a/c Dr 2400
 Z's capital a/c Dr 800
 To bank 3200
 [Cash withdrawn by the continuing partners in excess of their capital]
6. Y's capital a/c Dr 79100
 To Y's loan a/c 79100
 [Y's capital account is transferred to Y's loan account on his retirement]

Revaluation Account

Dec.31,1975		Dec.31,1975	
To Reserve for bad debts	600	By Land and buildings	20,000
To Outstanding bills for Repair	5,300	By Unexpired insurance	300
To X's Capital a/c 7200			
To Y's Capital a/c 4800			
To Z's Capital a/c 2400	14,400		
(Profit on revaluation)	20,300		20,300

Capital Accounts

	X (Rs.)	Y (Rs.)	Z (Rs.)		C (Rs.)	P (Rs.)	S (Rs.)
Dec.31,1983				Dec.31,1983			
To Goodwill	10,800	---	3,600	By Balance b/d	90,000	60,000	30,000
To Y's loan a/c	2,400	79,200	800	By Revaluation a/c	7,200	4,800	2,400
To Balance c/d	84,000	---	28,000	By X's Capital a/c	---	10,800	---
				By Y's Capital a/c	---	3,600	---
	97,200	79,200	32,400		97,200	79,200	32,400

Cash at Bank

	Rs.		Rs.
Dec.31,1975		Dec.31,1975	
To Balance b/d	22,000	By X's Capital a/c	2,400
		By Y's Capital a/c	800
		By Balance c/d	18,800
	22,000		22,000

Balance sheet of M/s. X and Zason 31-12-1975

	Rs.		Rs.
Capital accounts		Cash at bank	18,800
X 84000		Unexpected insurance	300
Y 28000	1,12,000	Sundry debtors 20000	
Y's Loan account	79,200	Less: Reserve for bad debts 1000	19,000
Outstanding bills for repair	5,300	Stock in trade	32,000
Sundry debtors	27,600	Machinery	34,000
		Land and Buildings	1,20,000
	2,24,100		2,24,100

Illustration 5

A, B and C are partners in a firm. On 31-12-1990 B relieves from the firm. After making all adjustments the balance due to him is Rs.9705. On 31-12-1990 Rs.705 is paid to him. The continuing partners agree to pay the balance in 3 annual instalments charging 5% interest, starting from 31-12-1991. Write up his loan account,

1. If the loan amount is paid in 3 equal instalments together with interest
2. If the loan amount is paid in 3 equated instalments.

Solution

(1) If the loan is paid in 3 equal instalments together with interest

B's Loan Account		(Fig. in rupees)	
1990, Dec. 31		1990, Dec. 31	
To Cash	705	By B's Capital a/c	9,705
To Balance c/d	9,000		
	9,705		9,705
1991		1991	
Dec. 31 To Cash	3,450	Jan. 1 By Balance b/d	9,000
Dec. 31 To Balance c/d	6,000	Dec. 31 By Interest a/c	450
	9,450		9,450
1992		1992	
Dec. 31 To Cash	3,300	Jan. 1 By Balance b/d	6,000
Dec. 31 To Balance c/d	3,000	Dec. 31 By Interest	300
	6,300		6,300
1993		1993	
Dec. 31 To Cash	3,150	By Balance	3,000
		By Interest	150
	3,150		3,150

(2) If the loan is paid in 3 equated installments.

B's Loan Account		(Fig. in rupees)	
1990, Dec. 31		1990, Dec. 31	
To Cash	705	By B's Capital a/c	9,705
To Balance c/d	9,000		
	9,705		9,705
1991		1991	
Dec. 31 To Cash	3,304.87	Jan. 1 By Balance b/d	9,000
Dec. 31 To Balance c/d	6,145.13	Dec. 31 By Interest a/c	450
	9,450.00		9,450
1992		1992	
Dec. 31 To Cash	3,304.87	Jan. 1 By Balance b/d	6,145.13
Dec. 31 To Balance c/d	3,147.52	Dec. 31 By Interest	307.26
	6,452.39		6,452.39
1993		1993	
Dec. 31 To Cash	3,304.87	By Balance b/d	3,147.57
		By Interest	157.30
	3,304.87		3,304.87

[Annuity table shows that Re. 1 can buy an annuity of 0.367208 at 5% for 3 years. Therefore the equated installment is Rs. 3304.82 (9000 x 0.367208)]

Death of a Partner

When a partner dies, the partnership comes to an end, but other partners may carry on the business by entering into a new agreement. The amount due to the deceased partner is ascertained as per the terms of Partnership Deed and as similar lines

when a partner retires. The amount due to the deceased partner on the date of death is paid to the executor of the deceased partner, immediately or in instalments. Retirement of a partner is a planned event and usually a partner will retire on the date of closing of the accounts of the firm. On the other hand a partner may die on any date during the accounting period. So he is entitled to his share of profit upto the date of death. The profit for the accounting period during which a partner dies, is ascertained on the date of death, (without closing the books) on the basis of average profit of past years, which is set in the Partnership Deed. Then his share of profit upto the date of death is arrived at and credited in his account. In case of death, treatment of goodwill, revaluation of assets and liabilities, distribution of reserves/profit set care done on similar lines when a partner retires. But goodwill is valued on the basis of the terms provided in the Partnership Deed in this regard. Moreover Sec.37 of the Partnership Act, is a relevant section in case of death, which says, the executors of the deceased partners would be entitled, at their choice, to interest at 6% p.a. on the amount due from the date of death to the date of payment to that portion of profit which is earned by the firm with the help of the amount due to the deceased partner. A retiring partner is also eligible for such a benefit under this section.

Another important accounting aspect in case of death of a partner is the treatment of Joint Life Policy. The firm takes a life insurance policy on the joint lives of its partners in order to pay off the executors of the deceased partner without affecting the financial position of the firm.

Accounting for Joint Life Policy is done in three different ways. They are

1. Premium paid is treated as an expense
2. Joint life policy is shown in the balance sheet at its surrender value by treating it as an asset
3. Joint life policy is treated as an asset and a reserve viz. joint life policy reserve is maintained

1. Premium paid is treated as an expense

When premium paid is treated as an expense it is written off at the end of the year, by transferring it to Profit and Loss Account. In case a partner dies, the policy amount is credited to all partners including the deceased partner in their profit sharing ratio. The relevant entries are:

When premium is paid Premium on JLP a/c Dr -

To Bank/cash -

[Payment of JLP premium]

At the end of the year the premium account is closed by transferring it to Profit & loss a/c.

a) Profit and loss account Dr -

To Premium on JLP a/c - [Profit and loss account is cleared]

On the death of a partner, the policy amount receivable is credited to all partners in their profit sharing ratio.

Insurance Co. a/c Dr -

To Partners' capital a/c (individually) -

[Policy amount receivable is distributed to all partners in their profit sharing ratio] When policy amount is received, the following entry is made:

Bank a/c Dr -

To Insurance Co. -

[Receipt of policy amount from Insurance Co.]

2. JLP is treated as an asset at its surrender value

When JLP is treated as an asset, then the following entry is passed at the time of payment of JLP premium

JLP a/c Dr -

To Bank a/c -

[Payment of premium is debited to JLP a/c and it is treated as an asset]

At the end of the year, the amount in excess of surrender value is transferred to profit and loss account. The relevant entry is

Profit and loss a/c Dr

To JLP a/c -

[Premium paid in excess of surrender value is treated as loss and transferred to profit and loss a/c]

So every year joint life policy account appears in the balance sheet at its surrender value.

On the death of a partner the policy amount in excess of the surrender value is again and is distributed to all partners in their profit sharing ratio. The relevant entries are

a) Insurance Co. a/c Dr -

To JLP a/c

[Amount due by the insurance company on the death of a partner]

b) JLP a/c Dr -

To All partners' capital a/c (individually) -

[Balance of amount in the JLP a/c is distributed to all partners in their profit sharing ratio]

c) Bank a/c Dr-

To Insurance Co. a/c

[Receipt of money from the Insurance Company]

3. Joint Life Policy is treated as an investment and a reserve viz. JLP reserve, is maintained

The relevant entries are

a) Joint life policy a/c Dr -

To Bank -

[Payment of premium]

b) Profit and loss a/c Dr-

To JLP Reserve a/c

[An amount equal to the premium paid is debited to profit and loss account and a joint life policy reserve account is created]

Then JLP account and JLP reserve account are mutually adjusted so as to leave a balance in each account equal to the surrender value of the policy. The following entry is passed for this:

Joint life policy reserve a/c Dr -

To Joint life policy account

[Mutual adjustment entry so that both the accounts show a balance which is equal to the surrender value]

The above entries are passed every year. On the death of a partner, the balance of joint life policy reserve account is closed by transferring it to Joint Life Policy Account, and the amount received as the policy amount is credited to all partners in their old profit sharing ratio and joint life policy account is also closed. The following entries are passed.

a) Joint life policy reserve account Dr-

To joint life policy account

[On the death of a partner JLP Reserve is closed by transferring it to Joint life policy account]

b) Insurance Co. a/c Dr -

To Joint life policy a/c

[Policy amount due on the death of a partner]

c) Joint life policy a/c Dr-

To all partners' capital a/c (individually) -

[Joint life policy account is closed by transferring it to all partners' capitals a/c in their profit sharing ratio]

d) Bank a/c	Dr-
To Insurance Co. a/c	—
[Receipt of policy amount from the Insurance Co.]	

Illustration 6

X, Y and Z carried on business in partnership, profits being divisible to X 1/2; Y 1/3; Z 1/6. The balance sheet on 31-12-1986 showed their capitals to be

X-Rs. 20,000; Y -Rs.15,000; Z-Rs.10,000

On 31-03-1987 X died and you are asked to prepare the executor's account of X having regard to the following facts:

1. The firm insured the partners' life severally X for Rs.10000, Y for Rs.7500 and Z for Rs.5000. The premiums have been charged to profit and loss account and the surrender value on 31-03-1987 amounted in each case to one-half of the sum assured.
2. Capitals carried interest at 6% p.a.
3. X's drawings from 01-01-1987 to the date of death were Rs.3500.
4. X's share of profits for the portion of the current financial year for which he lived was to be taken at the sum. Calculate on the average of the last three completed years and goodwill was to be raised on the basis of two years purchase of the average profits of those three years. The annual profits of last three years were Rs.7500, Rs.8000 and Rs.9000 respectively.

Workings: X's claim

(1) Joint life policies

X's policy-Rs.10000; 1/2 of 10000 =Rs.5000
Y and Z policies Surrender value = 1/2 (7500+5000)
= 1/2 x 12500
= 6250
X's share = 6250 x 1/2
= Rs.3125

(2) Interest on capital

$$\text{Rs. } 20000 \times 6 / 100 \times 3 / 12 = 300$$

(3) Share of profit

X's share of profit for 3 months on the average profits

$$\text{of last 3 years Average profit} = (7500 + 8000 + 9000) / 3$$

$$= \text{Rs. } 8167$$

$$\text{X's share} = 8167 \times 1/2 \times 1/4$$

$$= \text{Rs. } 1021$$

(4) Share of goodwill

$$\text{Average profits} \times 2 = 8167 \times 2$$

$$= 16334$$

X's share of
goodwill =

$$\text{Rs. } 8167 (16334 \times 1/2)$$

2)

Solution

Executor's Account of X

	Rupees		Rupees
March 31, 1987		March 31, 1987	
To drawings	3,500	By balance b/d	20,000
To balance c/d	24,113	By joint life policy	5,000
		By interest on capital	300
		By goodwill	8,167
		By profit and loss suspense a/c	1,021
		By Y and Z's capital a/c	3,125
		(Share of surrender value of X and Y policies)	
	37,613		37,613

A, B and C sharing profits and losses in the ratio of 5:3:2 took out a Joint life policy for Rs. 1,00,000 paying an annual premium of Rs. 5000 starting from 1st January, 1990. The surrender value of the policy was as follows:

1990 -NIL

1991 -Rs. 1000

1992 -Rs. 2500

1993 -Rs. 4000

1994 -Rs. 6000

B died on 25th May, 1994 and the policy money was received on 30th June, 1994.

Show the account relating to joint life policy under various treatments.

Solution

Case 1 When premium is written off:

Profit and Loss Account

Dr.

Cr.

1990Dec.,31	Topremium on joint lifepolicy	5000
1991Dec.,31	Topremium on joint lifepolicy	5000
1992Dec.,31	Topremium on joint lifepolicy	5000
1993Dec.,31	Topremium on joint lifepolicy	5000
1994Dec.,31	Topremium on joint lifepolicy	5000

JointLifePolicy Account

1994 June, 30		1994 June, 30	
To transfertocapitalA/cA	50,000	ByBank	1,00,000
B	30,000	(AmountreceivedfromInsuranceCo.)	
C	20,000		
	1,00,000		1,00,000

Case2Surrendervalueistreatedasanasset

	Rs.		Rs.
1990 Jan. 1		1990 Jan. 1	
ToBank	5,000	ByProfitandLossa/c	5,000
	5,000		5,000
1991 Jan. 1		1991Dec.31	
ToBank	5,000	ByProfit andLossa/c	4,000
		ByBalancec/d	1,000
	5,000		5,000
1992 Jan. 1		1992Dec.31	
ToBalanceb/d	1,000	ByProfit andLossa/c	3,500
ToBank	5,000	ByBalancec/d	2,500
	6,000		6,000
1993 Jan. 1		1993Dec.31	
ToBalanceb/d	2,500	ByProfit andLossa/c	3,500
ToBank	5,000	ByBalancec/d	4,000
	7,500		7,500
1994 Jan. 1		1994 June 30	
ToBalanceb/d	4,000	ByBank	1,00,000
ToBank	5,000	Amountreceived from	
	7,500	InsuranceCo.)	
1994 June 30			
ToTransfertocapitalaccounts			
A	45,500		
B	27,300		
C	18,200		
	1,00,000		1,00,000

Case3

PremiumtobewrittenoffthroughJointLifePolicyreserveaccountJointLifePolicyAccount

JointLifePolicy Account

	Rs.		Rs.
1990 Jan. 1		1990 Jan. 1	
ToBank	5,000	ByProfitandLossa/c	5,000
	5,000		5,000
1991 Jan. 1		1991Dec.31	
ToBank	5,000	ByJoint LifePolicyReserve	4,000
	5,000	ByBalancec/d	1,000

1992 Jan. 1		1992Dec.31	
ToBalanceb/d	1,000	ByJointLifePolicyReserve	3,500
ToBank	5,000	ByBalancec/d	2,500
	6,000		6,000
1993 Jan. 1		1993Dec.31	
ToBalanceb/d	2,500	ByJointlifepolicyreserve	3,500
ToBank	5,000	ByBalancec/d	4,000
	7,500		7,500
1994 Jan. 1		1994 June 30	
ToBalanceb/d	4,000	ByBank	1,00,000
ToBank	5,000	ByJointlifepolicyreserve	9,000
	7,500		
1994 June 30			
ToTransfertocapitalaccounts			
A	50,000		
B	30,000		
C	20,000		
	1,09,000		1,09,000

JointLifePolicyReserveAccount

	Rs.		Rs.
1990Dec.31		1990 Jan. 1	
To Joint Life Policy a/c	5,000	By Profit and Loss a/c	5,000
	5,000		5,000
1991 Dec. 1		1991 Dec. 31	
To Joint Life Policy a/c	4,000	By Profit and Loss a/c	5,000
To Balance c/d	1,000		
	5,000		5,000
1992 Dec. 31		1992 Dec. 31	
To Joint Life Policy a/c	3,500	By balance c/d	1,000
To Balance c/d	2,500	By Profit and Loss a/c	5,000
	6,000		6,000
1993 Dec. 31		1993 Dec. 31	
To Joint Life Policy a/c	3,500	By Balance b/d	2,500
To Balance c/d	4,000	By Profit and Loss a/c	5,000
	7,500		7,500
1994 Dec. 31		1994 June 30	
To Joint Life Policy a/c	9,000	By Balance b/d	4,000
		By Profit and Loss a/c	5,000
	9,000		9,000

UNIT- 4 DISSOLUTION OF A FIRM

Dissolution of a firm means the dissolution of partnership between all the partners in the firm. In case of admission, retirement or death of a partner, the partnership is dissolved, but the remaining partners continue the business after entering into a new agreement. When a firm is dissolved there will not be any business afterwards. The assets are disposed off, liabilities are paid and all accounts are closed, by settling the partners' capital accounts.

Dissolution of a firm takes place in the following cases:

1. Dissolution by Agreement.

A firm is dissolved in case

- a) when all partners give consent for its dissolution, or
- b) as per the terms of agreement.

2. Compulsory Dissolution:

A firm is compulsorily dissolved on the following grounds:

- a) When all the partners or all excepting one partner becomes insolvent
- b) When all partners excepting one decide to retire from the firm
- c) When all the partners or all excepting one partner dies
- d) When the business becomes illegal.

3. Dissolution on the happening of a certain event:

- a) Expiry of the period for which the firm was formed

4. When the venture or project is completed

Dissolution by court: A court may order a partnership firm to be dissolved on a suit filed by a partner in the following cases.

- a) Where a partner becomes insane.
- b) Where a partner becomes permanently incapable of doing business.
- c) Where a partner willfully and consistently commits breach of agreement relating to the management of the firm.

- d) Where a partner's conduct is likely to adversely affect the business to the firm.
- e) Where a partner transfers all his share to a third party.
- f) Where the business of the firm can't be carried out except at a loss.
- g) On any other grounds which the court thinks just and equitable.

Settlement

of

Accounts Ru

les

In case of dissolution, business ceases to exist, and as such, assets are to be disposed of and after settlement of all its claims, accounts are to be closed. As per Sec. 48 of the Indian Partnership Act, the following rules are to be observed:

1. Losses are to be paid first out of profits, next out of capital, and lastly by the partners, individually, in proportion to their profit sharing ratios.
2. The assets of the firm, including the contribution made by the partners to make up the deficiency of capital are to be applied in the following order:
 - a) to pay debts of the firm to third parties.
 - b) to pay partners' loans and advances.
 - c) to pay capital accounts of the partners.

In case after paying all the above claims, if any surplus is there, it should be distributed among the partners in their profit sharing ratios.

Payment of firm's debts and personal debts

The assets of the firm are applied to pay the debts of the firm first and if any surplus is left it is used to pay the personal debts. Likewise, personal asset of a partner is applied to pay personal debts and if any surplus is left it will be applied to pay the debts of the firm.

Accounting Treatment

When a firm is dissolved all accounts are to be closed. For this purpose a new account called 'Realization Account' is opened. All assets except cash is transferred to this account. Similarly all outside liabilities are transferred and closed. When assets are realized it is passed through this account, likewise when liabilities are paid it is passed through the books. Profit or loss on realization of assets and settlement of liabilities shown in the account are distributed to all partners in their profit sharing ratio. Partners' loan account is settled separately and closed. Reserves and profit and loss accounts are transferred to capital account of all partners in their profit sharing ratio and

closed. Then capital accounts of partners are balanced and paid off. Cash Account is automatically closed when all the entries affecting the cash account are posted. **Journal Entries**

- To transfer all assets (except cash and bank) at their book values

Realization a/c	Dr	
To Assets account (individually)–		

[Note: If there is a provision for bad debts, Debtors Account should be transferred at gross amount. Provision for bad debts is to be treated like an outsider liability]

- To transfer outsiders liability at their

book value		
Outsiders liability a/c	Dr	-
To Realization a/c		

- When assets are sold

Cash/Bank a/c	Dr	-
To Realization a/c		

- When a partner takes over an asset

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

- When liabilities are paid

Realization a/c	Dr	-
To Bank/cash a/c		

- When a liability is taken over by a partner

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

- For any unrecorded assets sold

Bank/cash a/c	Dr	
To Realization a/c		

- For any unrecorded liability paid by firm

Realization a/c	Dr	
To Bank/cash a/c		

- For expenses of realization

Realization a/c	Dr	
To Bank/cash a/c		

- If

a partner pays the realization expenses on beha

[Cash/Bank account will get automatically closed
if all entries effecting cash/bank are posted]

ILLUSTRATION

P and Q are partners sharing profits and losses in the ratio of 3:1.

Their balance sheet as on 31-12-1992 is given below.

Balance Sheet of M/s P and Q as on 31-12-92

Liabilities		Assets	
Sundry creditors	35,000	Cash at bank	10,000
Mrs. P's loan	12,000	Stock in trade	8,000
Q's loan	18,000	Sundry debtors	25,000
Reserve fund	6,000	Less Provision	1,000
P's capital	10,000	Fixtures and fittings	2,000
Q's capital	5,000	Machinery and plant	25,000
		Investments	9,000
		Profit and loss account	8,000
	86,000		86,000

The firm was dissolved on 31-12-1992 and the following was the results.

(a) P took over investments at an agreed value of Rs. 10,000 and agreed to pay off the loan to Mrs. P.

(b) The assets realized the following:-

Stock Rs. 7,000

Debtors Rs. 22,000
Fixtures and fittings Rs. 1,000
Machinery

(c) Expenses of realization amounted to Rs. 875

(d) The sundry creditors were paid off less 2 1/2% discount.

Journalize the entries to be made on the dissolution and show Realisation account, Bank account and Partner's capital accounts.

Solution:

Journal entries

1992 Dec. 31

1. Realization a/c	Dr	69,000
To stock-in-trade a/c		8,000
To sundry debtors		25,000
To furniture and fittings		2,000
To machinery and plant		25,000
To investments		9,000

[Various assets transferred to realisation account and closed on dissolution]

2. Sundry Creditors	Dr	35,000
Mrs. P's Loan	Dr	12,000

Provisionfordoubtful debts	Dr	1000	
ToRealisation a/c		48000	

[Variouscirculationsand provisionfordoubtfuldebtstransferredtorealizationaccount closed]

3. Reservefund a/c	Dr	6000	
ToP's capitala/c		4500	
ToQ'scapital a/c		1500	

[Thereservefundtransferred topartners'capital accountsintheir profitsharingratioandclosed]

3.P'scapitala/c	Dr.	6000	
Toprofit and lossa/c		2000	2000

[Profitandloss accountisclosed bytransferringtothecapital accountofPandQ]

4. Banka/c	Dr	53000	
Torealisation a/c		53000	

(Amountrealizedfromsaleofassets)

5. P'scapitala/c	Dr	10000	
Torealization a/c		10000	

[Investments takenoverbyPat an agreed valueofRs.10000]

6.Realization a/c	Dr	875	
ToBank		875	

[Expensesonrealisation]

7.Realizationa/c	Dr	34125	
Tobank		34125	

[Sundrycreditors paid less1/2 discount]

8.Realization a/c	Dr	12000	
ToP's capital a/c		12000	

[Mrs.P'sloan agreed tobe paid byP]

9. P'scapitala/c	Dr	3750	
Q's capitala/c	Dr	1250	
Torealization a/c		5000	

[Loanonrealizationtransferredtopartners'capitalaccountintheircapitalratio]1992Dec.31

Q'sloan a/c	Dr	18000	
Tobank a/c			18000

[PaymentofQ'sloan]

P'scapitala/c	Dr	6750	
Q's capitala/c	Dr	3250	
Tobanka/c			10000

[Finalpaymentofpartnersondissolution]

Realization Account

1992Dec.31	Rs.	1992Dec.31	Rupees
ToStock-in-trade	8,000	BySundrycreditors	35,000
ToSundrydebtors	25,000	ByMrs. P's loan	12,000
ToFurniture & fittings	2,000	ByProvisionforbad debts	1,000
ToMachinery&plant	25,000	ByBank (assetsrealization)	53,000
ToInvestments	9,000	ByP's Capital (Investments)	10,000
ToBank	34,125	By P's Capital a/c	5,000
ToBank (expenses)	875	3750By Q's capital a/c	
ToP'scapital (Mrs.P'sloan)	12,000	1250(Lossonrealization)	
	1,16,000		1,16,000

Capital Accounts

	P. (Rs.)	Q. (Rs.)		P. (Rs.)	Q. (Rs.)
Dec.31,1992			Dec.31,1992		
ToProfit andlossa/c	6,000	2,000	ByBalanceb/d	10,000	5,000
ToRealization a/c (investmenttaken)	10,000	---	ByReservefund	4,500	1,500
ToRealization(loss)	3,750	1,250	ByRealization a/c (Mrs.P'sloan)	12,000	---
ToBank	6,750	3,250			
	26,500	6,500		26,500	6,500

Q'sloan account

1992Dec.31	Rs.	1992Dec.31	Rupees
ToBank	18,000	ByBalanceb/d	18,000
	18,000		18,000

Bank Account

1992Dec.31	Rs.	1992Dec.31	Rupees
ToBalance	10,000	ByRealization	34,125
ToRealization (assetsrealization)	53,000	ByRealization(expenses)	875
		ByQ's loan	18,000
		ByP'scapitala/c	6,750
		ByQ's capital a/c	3,250
	63,000		63,000

Capital Accounts**Dissolution -Insolvencyofa partner**

If at the time of dissolution, a partner of a firm having debit balance in his capital account becomes insolvent and could not pay the deficiency in his capital account, then the firm suffers a loss. This loss (due to insolvency of a partner) is a special loss and has to be shared by the solvent partners in the ratio of their capitals. The above principle was laid down in the famous case *Garner Vs Murray*.

Sec.48 (b) (ii) of the Indian Partnership Act, expresses the same view as far as sharing the loss due to insolvency of a partner is concerned. The above rule laid down in *Garner Vs Murray* is applicable only if the Partnership Deed is silent

as to the mode of sharing the loss due to insolvency of a partner.

The method of distributing the loss (using Garner Vs Murray rule) due to the insolvency of a partner to the solvent partners depends on the method of keeping the capital accounts of the partners.

In case capital accounts of the partners are kept under fixed capital method, the loss is to be distributed to the solvent partners in the ratio of their fixed capitals.

In case the capital accounts of partners are kept under fluctuating capital method, then the loss due to insolvency of a partner is to be distributed to solvent partners in the ratio of their capital accounts after distributing profits/reserves appearing in the balance sheet but before adjusting the profit or loss on realization. So, in case realization loss is distributed to partner then the solvent partners have to bring in cash equivalent to their share of realization loss.

Illustration 10

X, Y and Z are partners sharing profits and losses in the ratio of 4/9, 2/9 and 1/3. On 1st January 1981, 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
Sundry debtors	9,000	Stock	19,400
Loan from X	4,000	Debtors	31,000
Capital accounts		Investments	24,000
X 3000		Bills receivable	5,600
Y 46000		Cash at bank	6,500
Z 68000	1,17,000	Cash at hand	1,000
	1,51,200		1,51,200

The assets realised investments Rs. 20,400; Bills receivable and debtors Rs. 28,200; stock Rs. 14,500; Furniture Rs. 2,050. Machinery Rs. 8,600; Buildings Rs. 26,450; All the liabilities were paid off. The cost of realization was Rs. 600. Z has become bankrupt and Rs. 10,24 only was recovered from estate once and for all. Partners were finally paid off. Show the realization account, the bank account and the capital accounts of the partners (i) when the capitals are fixed (ii) when the capitals are fluctuating.

Solution**Realization Account**

1981 Jan. 1	Rupees	1981 Jan. 1	Rupees
To Buildings	45,000	By Bills payable	4,100
To Machinery	15,000	By Sundry creditors	9,000
To Furniture	3,700	By Bank (assets realized)	1,00,200
To Stock	19,400	By X's Capital a/c 19,600	
To Debtors	31,000	By Y's Capital a/c 9,800	
To Investments	24,000	By Z's Capital a/c 14,700	44,100
To Bills receivable	5,600	(realization loss)	
To Bank (creditors and B/P paid off)	13,100		
To Bank (expense on realization)	600		
	1,57,400		1,57,400

(a) When capital accounts are fixed**Capital Accounts**

	X (Rs.)	Y (Rs.)	Z (Rs.)		X (Rs.)	Y (Rs.)	Z (Rs.)
To Realization	19,600	9,800	14,700	By Balance b/d	68,000	46,000	3,000
To Z's capital a/c	2,968	2,008	----	By Profit & loss	2,000	1,000	1,500
(Z's deficiency distributed to X and Y)				By Reserve fund	5,600	2,800	4,200
To Bank a/c	72,632	47,792	----	By Bank a/c (realization loss brought in by solvent partners)	19,600	9,800	----
				By Bank a/c	----	----	1,000
				By X's capital a/c (Z's deficiency in the ratio 34/53)	----	----	2,968
				By Y's capital a/c (Z's deficiency in the ratio 23/53)	----	----	2,008

Bank Account

1981 Jan. 1	Rupees	1981 Jan. 1	Rupees
To Balance b/d	6,500	By Realization a/c (payment to creditors and bills payable)	13,100
To Cash in hand	1,000	By Realization a/c (cost of realization)	600
To Realization a/c (assets realized)	1,00,200	By X's loan a/c	4,000
To X's Capital a/c (realization loss brought in)	19,600	By X's capital a/c	72,632
To Y's Capital a/c (realization loss brought in)	9,800	By Y's capital a/c	47,792

To Z's Capital a/c	1,024		
	1,38,124		1,38,124

X's Loan Account

1981 Jan. 1	Rupees	1981 Jan. 1	Rupees
To Bank	4,000	By Balance b/d	4,000
	4,000		4,000

(b) When capital accounts are fluctuating:

Capital Accounts

	X (Rs.)	Y (Rs.)	Z (Rs.)		X (Rs.)	Y (Rs.)	Z (Rs.)
To Realization	19,600	9,800	14,700	By Balance b/d	68,000	46,000	3,000
To Z's Capital a/c	3,000	1,976	----	By Profit & loss	2,000	1,000	1,500
(Rs. 4976 in the ratio of 75600:49300)				By Reserve fund	5,600	2,800	4,200
To Bank a/c	72,600	47,824	----	By Bank a/c (realization loss brought in)	19,600	9,800	----
				By Bank a/c	----	----	1,024
(Rs. 4976 in the ratio of 75600:49300)				By Reserve fund	5,600	2,800	3,000
				By Y's Capital a/c	----	----	1,976
To Bank a/c	95,200	59,600	14,700	By Bank a/c (realization loss brought in)	95,200	59,800	14,700
				By Bank a/c	----	----	1,024
				By X's Capital a/c	----	----	3,000
				By Y's Capital a/c	----	----	1,976
	95,200	59,600	14,700		95,200	59,600	14,700

Bank Account

1981 Jan. 1	Rupees	1981 Jan. 1	Rupees
To Balance b/d	6,500	By Realization a/c	13,100
To Cash in hand	1,000	By Realization a/c	600
To Realization a/c	1,00,200	By X's Loan a/c	4,000
To X's Capital a/c	19,600	By X's Capital a/c	72,632
To Y's Capital a/c	9,800	By Y's Capital a/c	47,792
To Z's Capital a/c	1,024		
	1,38,124		1,38,124

X's Loan Account

1981 Jan. 1	Rs.	1981 Jan. 1	Rs.
To Bank	4,000	By Balance b/d	4,000
	4,000		4,000

Insolvency of all partners

In case all partners became insolvent it is not possible to pay the liabilities of the firm in full. Usually creditors, are not transferred to realization account on dissolution. Cash realized from sale of assets and surpluses from private assets of partners are used to pay off the liabilities to the extent possible. Liabilities unpaid

are a gain for the firm and are transferred to a newly opened account viz 'Deficiency Account'. Then capital accounts of partners are closed after adjusting for realization profit/loss, receipts from private estates etc, by transferring the balances in the capital accounts to deficiency account. The deficiency account is then automatically closed.

Illustration 11

Arun and Anand were equal partners whose firm was dissolved on December 31, 1982.

Balance Sheet as on December 31, 1982

Liabilities	Rs.	Assets	Rs.
Creditors	3,200	Machinery	1,200
Arun's capital a/c	400	Furniture	300
		Debtors	500
		Stock	400
		Cash	100
		Anand's capital a/c	1,020
	3,600		3,600

Assets realized the following: Machinery Rs.600; Furniture Rs.100; Debtors Rs.400; Stock Rs.300; realization expenses were Rs.140. Arun was declared insolvent. Anand's private estate yielded a surplus of Rs.140 only. Give necessary accounts to close the books of the figure.

Solution

Realization Account

Dec.31,1982	Rs.	Dec.31,1982	Rs.
To Machinery	1,200	By cash	1,400
To Furniture	300	(Assets realized)	
To Debtors	500	By Arun's Capital a/c	570
To Stock	400	By Anand's Capital a/c	570
To Cash		(realization loss)	
(realization expense)	140		
	2,540		2,540

Capital Accounts

(Fig. in Rupees)

	Arun	Anand		Arun	Anand
Dec.31,1982			Dec.31,1982		
To Balance b/d	----	1,020	By Balance c/d	400	----
To Realization a/c	570	570	By Cash	----	140
			By Deficiency	170	1,450
			(Balancing figure)		
	570	1,590		570	1,590

Creditors Account

Dec.31,1982	Rs.	Dec.31,1982	Rs.
-------------	-----	-------------	-----

ToCash	1,580	ByBalance b/d	3,200
ToDeficiencya/c	1,620		
(Balancingfigure)			
	3,200		3,200

CashAccount

Dec.31,1982	Rs.	Dec.31,1982	Rs.
ToBalanceb/d	180	ByRealizationa/c	140
ToRealizationa/c	1,400	(realizationexp.)	
(Assetsrealized)		ByCreditors	1,580
ToAnandan's Capitala/c	140	(Balancingfig)	
	1,720		1,720

DeficiencyAccount

Dec.31,1982	Rs.	Dec.31,1982	Rs.
ToArun'sCapitala/c	170	ByCreditors	1,620
ToAnand'sCapitala/c	1,450		
	1,620		1,620

Gradualrealizationofassets -Piecemeal Distribution

When a firm is dissolved and its assets are realized and liabilities are paid off. In case any surplus is left after payment of liabilities, it is used to pay partners' capital accounts. Assets are sold gradually and so payments to various parties is also made gradually. While making payments, first outside liabilities are paid and after paying outside liabilities in full, partners' loan accounts are paid. If any surplus is left after payment to partners' loan accounts, partner's capital balances are paid.

When paying outsiders' liabilities, if two or more creditors are there and the account available is not sufficient to pay them in full, then they are paid in proportion to their dues. Likewise while paying partners' loan accounts the same procedure is followed. Then lastly partners' capital accounts are returned.

Partners' capital accounts are paid gradually as and when assets are realized. There are two methods available for the payment of cash to partners for the return of their capitals.

1. Proportionate Capital Method
2. Maximum Loss Method

Whatever method is used for payment of cash to partners' capital accounts, the unpaid balance of capital accounts, after making final payments to partners, must be in the ratio of profit sharing.

1. Proportionate Capital Method

Under this method the partner who is having excess capital in relation to

his profitsharing ratio is paid first by the excess amount only. This process will continue till the capital accounts of all the partners are in proportion to their profit sharing ratios. Thereafter realized amounts are paid to partners in the ratio of their profit sharing.

2. Maximum Loss method

Under this method, every realization is assumed as the final realization and accordingly the loss to partners is arrived at. The loss is transferred to all partners in their profit sharing ratio. Then from the respective capital accounts of partners, the distributed share of loss is deducted, if the balance amount shows a positive amount then it represents the amount paid to each partner. Sometimes a partner's capital account is less than the amount of loss distributed. In such a case his balance amount will show a negative amount. This amount represents loss due to insolvency of the partner and the other solvent partners have to share this amount in the ratio of their capital accounts. The balance left in the capital accounts of solvent partners represents the amount paid to them. This process is continued to all subsequent realizations.

Piecemeal Distribution

Illustration

A, B and C share profits and losses in the proportion of $\frac{1}{2}$, $\frac{1}{3}$ and $\frac{1}{6}$. Their Balance Sheet on 31-12-1994, is as follows.

	Rs.		Rs.
Creditors	50,000	Land and Buildings	70,000
A's loan	10,000	Plant and 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:

	Rs.
1st realization	40,000
2nd realization	30,000
3rd realization	54,000
4th realization	7,000

Prepare a statement how the distribution is to be made.

Solution**Proportionate Capital Method**

		Creditors	A's loan a/c	A's capital	B's capital	C's capital
Amount due		50,000	10,000	50,000	10,000	40,000
Cash in hand paid to creditors		5,000	---	---	---	---
Balance due		45,000	10,000	50,000	10,000	40,000
Amount of 1st realization paid to creditors		40,000	---	---	---	---
Balance due		5,000	10,000	50,000	10,000	40,000
Amount of 2nd realization	30,000					
Paid to creditors	5,000	5,000	---	---	---	---
	25,000	NIL				
Paid A's loan a/c	10,000		10,000			
	15,000	---	---	50,000	10,000	40,000
Paid to C	15,000	---	---	---	---	15,000
Amount due				50,000	10,000	25,000
Amount of 3rd realization	54,000					
Paid to C	8,333					8,333
	45,667			50,000	10,000	16,667
Paid to A and C	45,667			34,250	---	11,417
Amount due				15,750	10,000	5,250
Amount of 4th realization	7,000					
(-) Paid to A and C	1,000			750	---	250
	6,000			15,000	10,000	5,000
(-) Paid to A, B and C	6,000			3,000	2,000	1,000
Balance unpaid or loss on realization	----			12,000	8,000	4,000

Working Notes**Capital Account**

Capital Balances (Rs.)	(a)	50,000	10,000	40,000
Profit sharing ratios		3	2	1
Proportionate capitals (Rs)	(b)	15,000	10,000	5,000
(taking B's capital as the basis)				

Excess capital (Rs.) (a- b)		35,000	----	35,000
Proportionate capital as between	(c)	50,000	----	16,667
A and C, taking A's capital as the basis				
Excess capital (a- c)		----	----	24,333

Therefore C is to be paid first by Rs.24,333. Next A and C are to be paid their profit sharing ratio till the capital balances of all the partners are in proportionate to their profit sharing ratio. Then all partners are to be paid in proportion to their profit sharing ratios.

Illustration 13

A, B and C were partners sharing profits and losses as in the ratios of 5:3:2. On December 31, 1985, their Balance Sheet was as follows:

	Rs.		Rs.
Sundry creditors	20,000	Cash at bank	2,000
A's loan	10,000	Stock	28,000
B's loan	4,000	Sundry debtors	30,000
Capitals		Furniture and fittings	4,000
A 15,000			
B 12,000			
C 3,000	30,000		
	64,000		64,000

The firm was dissolved on the 1st January, 1986. The assets realized were as follows:

	Stock	Debtors	Furniture's	Expenses
January, 31	5,000	6,000	1,500	500
February, 28	7,000	4,000	----	800
March, 31	10,000	15,000	----	1,500
April, 30	4,000	3,000	2,000	500

Cash received was paid to the rightful claimants. Give accounts to clear the books of the firms.

Working Notes

The cash available each month is as follows:

	Stock	Debtors	Furniture's	Expenses	Cash available

January, 31	5000	+	6000	+	1500	-	500	=	12000
February, 28	7000	+	4000	+	---	-	800	=	10800
March,31	10000	+	15000	+	---	-	1500	=	23500
April,30	4000	+	3000	+	2000	-	500	=	8500

Distribution of Cash

(Fig.inRupees)

		Creditors	A'sloan a/c	B'sloan a/c	A's capital	B's capital	C's capital
Balancedue		20,000	10,000	4,000	15,000	12,000	3,000
Cashinhand paidto creditors		2,000	---		---	---	---
Balancedue		18,000	10,000	4,000	15,000	12,000	3,000
January,31-Net realization Rs.15000 paidtocreditors		12,000	---	---	---	---	---
Balancedue		6,000	10,000	4,000	15,000	12,000	3,000
February28 – Net realization	10200						
Paidtocreditors	6,000 4,200	6,000	---		---	---	---
Rs. 4200 paid to A's andB'sloanintheratiooftheir loans		---	3,000	1,200			
March31,Netrealization Rs.23,500		---	7,000	2,800	15,000	12,000	3,000
		----	7,000	2,800	---	---	---
A's loan and B's loan paid 9800							
Balance due (a)		----	----	----	15,000	12,000	3,000
Cash available for partners 13700							
Maximum less distributed		----	----	----	8,150	4,890	3,260

Rs.16300 (30000 - 13700) to A, B and C in the profit sharing ratio							
Amount at credit		----	----	----	6,850	7,110	-260
Deficiency of C shared by A and B in their capital ratios of 15:12		----	----	----	-144	116	+260
Amount at credit and available cash paid 13700 (b)		----	----	----	6,706	6,994	----
Balance of capitals (a - b)		----	----	----	8,294	5,006	3,000
April 30 - Net realization Rs.8500							
Maximum loss distributed to A,B and C (16300 - 8500) = 7800		----	----	----	3,900	2,340	1,560
Amount at credit and available cash paid Rs.8500		----	----	----	4,394	2,666	1,440

Realization Account

(Fig.inRupees)

1986, Jan. 1		1986, Jan. 1	
To Stock	28,000	By Creditors	20,000
To Sundry debtors	30,000	By Cash - Assets realized	
To Furniture & fittings	4,000	Stock -5000	
		Debtors-6000	
		Furniture-1500	12,500
To Cash-creditors paid	2,000	1986, Feb. 28	
To Cash -creditors & expenses	12,500	By cash-Assets realized	
		Stock- 7000	11,000
		Debtors-4000	
1986, Feb. 28	6,800	1986, March 31	
To Cash - creditors & expenses	1,500	By Cash - Assets realized	
		Stock- 10000	25,000
		Debtors-15000	
1986, March 31		1986, April 30	
To Cash - expenses	500	By Cash - Assets realized	
		Stock- 4000	
		Debtors-3000	9,000
		Furniture -2000	

		By Loss	
		transferred A's capital 3900	7,800
		B's capital 2340	
		C's capital 1560	
	85,300		85,300

Cash Account

(Fig. in Rupees)

1985, Jan. 1		1986, Jan. 1	
To Balance b/d	2,000	By Creditors	2,000
1985, Jan. 31		1985, Jan. 31	
To Realization a/c assets realized	12,500	By Realization a/c creditors & expenses	12,500
1985, Feb 28	11,000	1985, Feb 28	
To Realization a/c assets realized		By Realization a/c creditors & expenses	6,800
1985, Feb 31		1985, March 31	
To Realization a/c assets realized	25,000	By A's loan 3,000	3,000
1985, Feb 31		By B's loan	1,200
To Realization a/c assets realized		By Realization a/c expenses	1,500
		By A's loan	7,000
		By B's loan	2,800
		By A's Capital	6,706
		By B's Capital	6,994
1985, April 30		1985, April 30	
To Realization a/c assets realized	9,000	By Realization expense	500
		By A's Capital a/c	4,394
		By B's Capital a/c	2,666
		By C's Capital a/c	1,440
	59,500		59,500

March 31	To Cash	2,800	
		4,000	4,000

Capital Account

(Fig. in Rupees)

1986March31				1986Jan. 1			
To Cash	6,706	6,994		Bybalanceb/d	15,000	12,000	3,000
1986Apr,30							
To Cash	4,394	2,666	1,440				
	15,000	12,000	3,000		15,000	12,000	3,000

Illustration 14.A, Band C share profits in the proportion of 1/2, 1/3 and 1/6.

Their Balance Sheet is as follows:

Liabilities	Rs.	Assets	Rs.
Capital Accounts		Assets less liabilities	80,000
A 30,000			
B 30,000			
C 20,000	80,000		
	80,000		80,000

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

Rs.

First realization 10,000

Second realization 15,000

Third realization 25,000

Prepare statements showing how the distributions should be made applying Garner Vs.

Murray principle.

Note: Maximum Loss Method is used to distribute cash to capital accounts when Garner

Vs Murray principle is to be followed.

Solution

		A	B	C
Balance of capital	(a)	30,000	30,000	20,000
First Realization Rs. 1,00,000				
Maximum loss (80,000 - 10,000) 70,000 distributed to partners in their profit sharing ratios	(b)	35,000	23,333	11,667
Amount at credit	(c)	-5,000	6,667	8,333
A's loss shared by B and C in their capital ratios 3:2	(d)	+5,000	-3,000	-2,000
Amount at credit and available cash paid	(e)	-	3,667	6,333
Balance of capital (a - e)	(f)	30,000	26,333	13,667
Second Realization Rs. 15,000				

Maximum balance distributed (70000 - 15000) = 55000	(g)	27,500	18,333	9,167
Amount at credit and available cash paid	(h)	2,500	8,000	4,500
Balance of capital (f - h)	(i)	27,500	18,333	9,167
Third Realization Rs.25000				
Maximum possible loss distributed (55000 - 25000) = 30000	(j)	15,000	10,000	5,000
Amount at credit and available cash paid (i - j)	(k)	12,500	8,333	4,167
Balance in capital account left unpaid and hence loss (i-k)		15,000	10,000	5,000

A's Loan Account

1986			1986	
Feb.28	To Cash	3,000	Jan.1 ByBalanceb/d	10,000
March31	To Cash	7,000		
		10,000		10,000

B's Loan Account

(Fig.in Rupees)

1986			1986	
Feb.28	To Cash	1,200	Jan. 1Bybalanceb/d	4,000

UNIT- 5 ACCOUNTING STANDARD FOR FINANCIAL REPORTING

Robert Anthony once stated that accounting is a language of business. The primary function of a language is to serve as a means of communication. It is through accounting that a business communicates with the outside world. Thus, accounting is a living language.

At the end of each accounting year, every business enterprise is curious to know whether it has earned a profit or suffered a loss during an accounting period. Similarly, it also wants to know its financial position. It is for these purposes, financial statements are prepared.

Meaning of financial statement

Financial statements are the final product of the accounting process. They are statements containing financial information of a business enterprise. The basic purpose of preparing financial statements is to convey information about the financial position of the enterprise to owners, creditors and the investors.

Nature of financial statement

The following characteristics of financial statements indicate their nature.

1. Recorded fact: the term recorded facts refers to the data drawn from accounting records. Only those facts which have been recorded in the books are shown in the financial statements.
2. Periodical report: financial statements are prepared usually at the end of each year to show the result of business operation and financial position of a firm.
3. Accounting principles: in the preparation of financial statements, certain accounting principles, concepts and conventions are followed. For example, the principle of cost price or market price whichever is less is followed.
4. Assumptions: business transactions are recorded on certain assumptions. For example, in preparing financial statements, the accountants make many assumptions like that the value of money remains constant, going concern concept etc..
5. Personal judgement: the financial statements are affected by the personal judgement of an accountant.

Objective of financial statement

The significant objectives of financial statements are:

1. They provide necessary information about the financial activities to the interested parties.

2. They provide necessary information about the efficiency or otherwise of the management, regarding the proper utilization of the scarce resources.
3. They provide necessary information for predictions (financial forecasting).
4. They help to evaluate the earning capacity of the firm by supplying a statement of financial position, a statement of periodical earnings together with a statement of financial activities to the various interested persons.
5. They facilitate decisions regarding the changes in the manner of acquisition, utilization, reservation and distribution of the scarce resources.
6. They facilitate decisions regarding replacement of fixed assets and expansion of the firm.
7. They provide necessary data to the government for taking proper decisions relating to duties, taxes and price control, etc. and for some legal and control purposes.
8. They devise remedial measures for the deviations between the actual and budgeted performances.
9. They also provide necessary data and information to the managers for internal reporting and formulation of overall policies.
10. They also help to safeguard the interest of shareholders who are not allowed to go through the day-to-day affairs of the firm.
11. They help to settle disputes arising from High Court, Supreme Court, Arbitrator etc.
12. They help the credit rating agencies to determine the rating of the Company.

Uses (Utility) of financial statements for users

1. Owners and investors

Stockholders of corporations need financial information to help them make decisions on what to do with their investments (shares of stock), i.e. hold, sell, or buy more.

Prospective investors need information to assess the company's potential for success and profitability. In the same way, small business owners need financial information to determine if the business is profitable and whether to continue, improve or drop it.

2. Management

In small businesses, management may include the owners. In huge organizations, however, management is usually made up of hired professionals who are entrusted with the responsibility of operating the business or a part of the business. They act as agents of the owners.

3. Lenders

Lenders of funds such as banks and other financial institutions are interested in the company's ability to pay liabilities upon maturity (*solvency*).

4. Trade creditors or suppliers

Like lenders, trade creditors or suppliers are interested in the company's ability to pay obligations when they become due. They are nonetheless especially interested in the company's *liquidity* – its ability to pay *short-term* obligations.

5. Government

Governing bodies of the state, especially the tax authorities, are interested in an entity's financial information for taxation and regulatory purposes. Taxes are computed based on the results of operations and other tax bases. In general, the state would like to know how much the taxpayer makes to determine the tax due thereon.

6. Employees

Employees are interested in the company's profitability and stability. They are after the ability of the company to pay salaries and provide employee benefits. They may also be interested in its financial position and performance to assess company expansion possibilities and career development opportunities.

7. Customers

When there is a long-term involvement or contract between the company and its customers, the customers become interested in the company's ability to continue its existence and maintain stability of operations. This need is also heightened in cases where the customers depend upon the entity.

8. General Public

Anyone outside the company such as researchers, students, analysts and others are interested in the financial statements of a company for some valid reason.

ACCOUNTING STANDARDS

When different firms used different methods of recording the transactions, comparison becomes difficult. In the absence of a uniform set of rules, there will be a lot of problems. Thus, there is a need for uniform rules and principles. This will make the preparation and presentation of financial statements easy, relevant, reliable, understandable and comparable. This is sought to be achieved by developing accounting standards.

Meaning of Accounting Standards:

Accounting standards are the written statements consisting of rules and guidelines, issued by the accounting institutions, for the preparation of uniform and consistent financial statements and also for other disclosures affecting the different users of accounting information.

Accounting standards lay down the terms and conditions of accounting policies and practices by way of codes, guidelines and adjustments for making the interpretation of the items appearing in the financial statements easy and even their treatment in the books of account.

Definition

Kohler defines accounting standards as, "a mode of conduct imposed on accountants by law, custom or professional body"

Objective of accounting standard

The main objective of accounting standard is to standardize the diverse accounting policies and practices.

1. **To provide information:** one of the major objectives of accounting standard is to provide information to the users.
2. **To harmonize different accounting processes:** accounting standards are evolved to bridge the gap between various accounting procedures to harmonize different accounting processes.
3. **To enhance the content:** another objective of accounting standard is to enhance the credibility and comparability of the financial statements.
4. **To communicate uniform results:** another objective of accounting standard is to communicate uniform results to external users as well as internal users for decision making.
5. **To facilitate comparison:** accounting standards aim at facilitating inter-firm comparison and intra-firm comparison.
6. **To improve the quality of financial statement:** another important objective of accounting standard is to make the financial statements more reliable, comparable, relevant and understandable.

Role and importance of accounting standards

Accounting standard plays an important role in facilitating uniform preparation and reporting of general purpose financial statement. These are very useful for investors and other external groups in assessing the progress and prospects of alternative investments in different companies in different countries.

In an era of globalization it is essential to adopt transparent accounting norms in valuation of fixed assets, revenue recognition, valuation of inventories, classification and valuation of investment, foreign currency translation etc... accounting standard play an important role in strengthening financial regulation and supervision. In short, accounting standards improve transparency, consistency, adequacy, accuracy and comparability of financial statement.

Advantages of accounting standards

1. **Credibility and reliability of financial statements:** the accounting standards create a sense of confidence amongst the users of the accounting information by providing a definite structure of uniform guidelines.
2. **Uniformity:** the accounting information disclosed in financial statement cannot be interpreted in any manner other than the purpose it is intended for.
3. **Elimination of ambiguity:** as the general principle of disclosure and valuation have been developed on uniform basis, there would be no ambiguity in interpretation.
4. **Comparison:** as the same methodology is being followed in all cases comparison between the results of different organizations has become easier.
5. **Determination of managerial accountability:** accounting standards are useful in measuring the efficiency of the management regarding the profitability, liquidity, solvency and general progress of the enterprise.

6. **Useful to the shareholders, investors, researchers etc.:** accounting standards help the investor to take decision regarding investments. The government officials can make effective use of accounting data for planning etc.
7. **Raises the standards of auditing:** accounting standards raise the standards of auditing itself in its task of reporting on the financial statement.

Accounting standard board of India (ASB)

ASB was setup in India on 21st April 1977 with a view to harmonise the diverse accounting policies and practices in India. It was set up by the Council of ICAI. ICAI is one of the members of IASC. Hence, while formulating the accounting standards, ASB gives much weight to standardize issued by the IASC. ICAI tries to incorporate those international standards in India, in the light of the condition and practices prevailing in India.

Objectives of accounting standard board of India

1. To conceive of and suggest areas in which Accounting Standards need to be developed.
2. To formulate Accounting Standards with a view to assisting the Council of the ICAI in evolving and establishing Accounting Standards in India.
3. To examine how far the relevant International Financial Reporting Standards can be adapted while formulating the Accounting Standard and to adapt the same.
4. To review, at regular intervals, the Accounting Standards from the point of view of acceptance or changed conditions, and, if necessary, revise the same.
5. To provide, from time to time, interpretations and guidance on Accounting Standards.
6. To proactively participate with the national and international bodies engaged in the Standard-setting process, such as, sending comments on various consultative papers such as Exposure Drafts, Discussion Papers etc., issued by International Accounting Standards Board and various other international bodies such as Asian-Oceanian Standard-Setters Group (AOSSG).
7. To carry out such other functions relating to Accounting and Accounting Standards.

Accounting standards in India

AS 1 Disclosure of Accounting

Policies AS 2 Valuation of Inventories

(amended) AS 3 Cash Flow Statements

AS 4 Contingencies and Events Occurring after the Balance Sheet Date

AS 5 Net Profit or Loss for the period, Prior Period Items and Changes in Accounting Policies AS 6

Depreciation Accounting (withdrawn)

AS 7 Construction Contracts (revised 2002)

AS 8 Accounting for Research and Development (withdrawn for AS

26) AS 9 Revenue Recognition

AS 10 Accounting for Fixed Assets (amended)

AS 11 The Effect of Changes in Foreign Exchange Rates (revised 2003)

AS 12 Accounting for Government Grants AS 13
 Accounting for Investments (amended)
 AS 14 Accounting for Amalgamations
 (amended) AS 15 Employee Benefits (revised 2005)
 AS 16 Borrowing
 Costs AS 17 Segment Reporting
 AS 18 Related Party Disclosures AS
 19 Leases
 AS 20 Earnings Per Share
 AS 21 Consolidated Financial Statements
 (amended) AS 22 Accounting for Taxes on Income
 AS 23 Accounting for Investments in Associates in Consolidated Financial
 Statements AS 24 Discontinuing Operations
 AS 25 Interim Financial
 Reporting AS 26 Intangible Assets
 AS 27 Financial Reporting of Interests in Joint
 Ventures AS 28 Impairment of Assets
 AS 29 Provisions, Contingent Liabilities and Contingent Assets
 (amended) AS 30 Financial Instrument – recognition and measurement
 AS 31 Financial instrument –
 presentation AS 32 Financial instrument-
 disclosures **International accounting st
 andards**

The main purpose of accounting is to provide information to internal and external users. For this purpose, financial statements are prepared. If different accounting procedures and practices are followed by accountants, there would be a lot of difficulties. So the accountants all over the world have developed certain rules, procedures and conventions. These accounting procedures and practices are known as Generally Accepted Accounting principles. But the generally accepted accounting principles permit a number of alternative treatments for the same item. Therefore, there was a need to harmonize and standardize the diverse accounting policies and practices. However, there was hesitation in doing so and making it mandatory. The great depression of 1929 forced the accounting professionals to rethink about accounting rules. USA took the lead in this direction followed by UK, Australia, Canada, and other developed countries. In USA, the American Institute of Certified public accountants was given the responsibilities to codify accounting standards. Later on International Accounting Standards Committee was also established for formulating International Accounting Standards. These are formulated to convey the accounting language to all people in the world. In fact, the concept of development and establishment of International Accounting Standards emerged initially in the first International Congress Accountants held at St. Louis in 1904.

Institutions engaged in Accounting Harmonization at Global level

These are some institutions engaged in accounting harmonization at global level. Important among them are United Nations, European Union, international Accounting Standards Foundation, International Accounting Standards Board (IASB), Financial Accounting Standards Board (FASB) etc. of these, the most important are IASB and FASB.

International Accounting Standards Committee (IASC)

Due to the increase in malpractices in accounting, and increase in failure of business units, there was a great demand for standardized accounting practices. This resulted in the formation of "Accountants International Study group" in 1967. For the purpose of maintaining uniformity in accounting principles throughout the world, IASC came into force on 29th June 1973. IASC is the outcome of the 1972 world Accounting Congress after the informal meeting between representatives of the Institute of Chartered Accountants of England and Wales and the American Institute of Certified Public Accountants.

The IASC Foundation is an independent body, not controlled by any particular Government or professional organization. Its main purpose is to oversee the IASB in setting the accounting principles which are used by business and other organizations around the world concerned with financial reporting.

The IASC was formed in 1973 through an agreement made by professional accountancy bodies from Australia, Canada, France, Germany, Ireland, Japan, Mexico, the Netherlands, the UK and the USA

International Accounting Standard Committee has issued certain standards. A list of such standards is given below.

- IAS.1 Presentation of financial statement
- IAS.2 Inventories
- IAS.3 It is replaced by IAS.27 & 28
- IAS.4 Withdrawn and replaced by IAS 16, 22 & 38
- IAS.5 Replaced by IAS 15
- IAS.6 Replaced by IAS 15
- IAS.7 Cash flow statement
Profit and loss account for the period, fundamental errors and changes in accounting policies
- IAS.8 Research for development costs will be superseded by IAS 38 with effect from 1/7/1999
- IAS.9
- IAS.10 Events after the balance sheet date
- IAS.11 Construction contracts
- IAS.12 Income taxes
- IAS.13 Replaced by IAS 11
- IAS.14 Segment reporting

- IAS.15 Information reflecting the effect of changing prices
- IAS.16 Property, plant equipment
- IAS.17 Leases I
- AS.18 Revenue
- IAS.19 Employment benefits
- IAS.20 Accounting for government grants and disclosure of government assistance
- 21 The effect of changes in foreign exchange rates
- IAS.22 Business combinations
- IAS.23 Borrowing costs
- IAS.24 Related party disclosures
- IAS.25 Accounting for investment
- IAS.26 Accounting and reporting by retirement benefit plans
- IAS.27 Consolidated financial statements and accounting for investment in subsidiaries
- 28 Accounting for investment in associates
- IAS.29 Financial reporting in hyperinflationary economies
- IAS.30 Disclosures in financial statements of banks and similar financial institutions
- 31 Financial reporting on interest in joint ventures
- IAS.32 Financial instruments: disclosure and presentation I
- AS.33 Earnings per share
- IAS.34 Interim financial reporting
- IAS.35 Discounting operations
- IAS.36 Impairment of assets
- IAS.37 Provisions, contingent liabilities, and contingent assets I
- S.38 Intangible assets
- IAS.39 Financial instruments: recognition and measurement I
- AS.40 Investment property
- IAS.41 Agriculture

International Accounting Standard Board

The IASB (International Accounting Standards Board) is the independent standard-setting body of the IFRS Foundation. All meetings of the IASB are held in public and webcast. In fulfilling its standard setting duties the IASB follows a thorough, open and transparent due process. This process leads to publication of consultative documents, such as Discussion Papers and Exposure Drafts, for public comment. The IASB engages closely with stakeholders around the world, including investors, analysts, regulators, business leaders, accounting standard-setters and

the accountancy profession.

Role of IASB in Developing IFRS

1. **Setting the agenda:** The IASB, by developing high quality financial reporting standards, seeks to address a demand for better quality information that is of value to those users of financial reports. When deciding whether a proposed agenda item will address users' needs the IASB considers: The relevance to users of the information and the reliability of information that could be provided, Existing guidance available, The possibility of increasing convergence, The quality of the



IFRS to be developed, Resource constraints. To help the IASB in considering its future agenda, its staff is asked to identify, review and raise issues that might warrant the IASB's attention. New issues may also arise from a change in the IASB's Conceptual Framework for Financial Reporting.

2. **Planning the project:** When adding an item to its active agenda, the IASB decides whether to conduct the project alone or jointly with another standard-setter. Similar due process is followed under both approaches. When considering whether to add an item to its active agenda, the IASB may determine that it meets the criteria to be included in the annual improvements process. The IASB assesses the issue against criteria such as Clarifying, Correcting, Well defined and sufficiently narrow in scope that the consequences of the proposed change have been considered, Completed on a timely basis, All criteria must be met to qualify for inclusion in annual improvements. Once this assessment is made, the amendments included in the annual improvements process will follow the same due process as other IASB projects. The primary objective of the annual improvements process is to enhance the quality of IFRSs by amending existing IFRSs to clarify guidance and wording, or correcting for relatively minor unintended consequences, conflicts or oversights. After considering the nature of the issues and the level of interest among constituents, the IASB may establish a working group at this stage and a project team for the project will be selected. The project manager draws up a project plan under the supervision of the directors of the technical staff and the project team may also include members of staff from other accounting standard-setters, as deemed appropriate by the IASB.
3. **Developing and publishing the discussion paper:** A discussion paper is not a mandatory step in the IASB's due process. Normally the IASB publishes a discussion paper as its first publication on any major new topic as a vehicle to explain the issue and solicit early comment from constituents. If the IASB decides to omit this step, it will state its reasons. Typically, a discussion paper includes a comprehensive overview of the issue, possible approaches in addressing the issue, the preliminary views of its authors or the IASB, and an invitation to comment. This approach may differ if another accounting standard-setter develops the research paper. Discussion papers may result either from a research project being conducted by another accounting standard-setter or as the first stage of an active agenda project carried out by the IASB. If research has been performed by another accounting standard-setter, issues related to the discussion paper are discussed in IASB meetings, and publication of such a paper requires a simple majority vote by the IASB. If the discussion paper includes the preliminary views of other authors, the IASB reviews the draft discussion paper to ensure that its analysis is an appropriate basis on which to invite public comments. For discussion papers on agenda items that are under the IASB's direction, or include the IASB's preliminary views, the IASB develops the paper or its views on the basis of analysis drawn from staff research and recommendations, as well as suggestions

made by the IFRS Advisory Council, working groups and accounting standard-setters and presentations from invited parties. All discussions of technical issues related to the draft paper take place in public sessions. When the draft is completed and the IASB has approved it for publication the discussion paper is published to invite public comment.

4. **Developing and publishing the exposure draft:** Publication of an exposure draft is a mandatory step in due process. An exposure draft is the IASB's main vehicle for consulting the public. Unlike a discussion paper, an exposure draft sets out a specific proposal in the form of a proposed IFRS (or an amendment to an IFRS). The development of an exposure draft begins with the IASB considering issues on the basis of staff research and recommendations, as well as comments received on any discussion paper, and suggestions made by the IFRS Advisory Council, working groups and accounting standard-setters and arising from public education sessions. After resolving issues at its meetings, the IASB instructs the staff to draft the exposure draft. When the draft has been completed, and the IASB has balloted on it, with a minimum of nine votes necessary to publish an exposure draft, the IASB publishes it for public comment. An exposure draft contains an invitation to comment on a draft IFRS, or a draft amendment to an IFRS, that proposes requirements on recognition, measurement and disclosures. The draft may also include mandatory application guidance and implementation guidance, and will be accompanied by a basis for conclusions on the proposals and the alternative views of dissenting IASB members (if any).
5. **Developing and publishing the standard:** The development of an IFRS is carried out during IASB meetings, when the IASB considers the comments received on the exposure draft. Changes from the exposure draft are posted on the website. After resolving issues arising from the exposure draft, the IASB considers whether it should expose its revised proposals for public comment, for example by publishing a second exposure draft. If the IASB decides that re-exposure is necessary, the due process to be followed is the same as for the first exposure draft. As it moves towards completing a new IFRS or a major amendment to an IFRS, the IASB prepares a project summary and feedback statement. These give direct feedback to those who submitted comments on the exposure draft, identify the most significant matters raised in the comment process and explain how the IASB responded to those matters. At the same time, the IASB prepares an analysis of the likely effects of the forthcoming IFRS or major amendment. The analysis will therefore attempt to assess the likely effects of the new IFRS on: The financial statements of those applying IFRSs, The possible compliance costs for preparers, The costs of analysis for users (including the costs of extracting data, Identifying how the data have been measured and adjusting data for the purposes of including them in, for example, a valuation model, The comparability of financial information between reporting periods for an individual entity and between different entities in a particular reporting period, and The quality of the financial information and its usefulness in assessing the future cash flows of an entity. When the IASB is satisfied that it has

reached a conclusion on the issues arising from the exposure draft, it instructs the staff to draft the IFRS.

Financial Accounting Standard Board

Established in 1973, the Financial Accounting Standards Board (FASB) is the independent, private-sector, not-for-profit organization based in Norwalk, Connecticut, that establishes financial accounting and reporting standards for public and private companies and not-for-profit organizations that follow GAAP. The FASB is recognized by the Securities and Exchange Commission as the designated accounting standard setter for public companies. FASB standards are recognized as authoritative by many other organizations, including state Boards of Accountancy and the American Institute of CPAs (AICPA). The FASB develops and issues financial accounting standards through a transparent and inclusive process intended to promote financial reporting that provides useful information to investors and others who use financial reports.

Functions of the FASB

- Establish Reporting Standards
- Improve Existing Standards
- Ensure Investors Receive Information
- Establish Accounting Principles
- Ensure an Understanding of Principles

Role of FASB in Developing Accounting Standards and GAAPs

FASB has a tremendous role in developing accounting standards and GAAPs, it develops high quality accounting standards. Besides, it monitors their effective implementation. It is engaged in educating stakeholders, helping preparers and practitioners in interpreting the standards and making necessary clarifications to the standards.

FASB has a unique position in the financial reporting process. Its main goal is to provide leadership for public companies in establishing and improving the accounting methods used to prepare financial statements.

IFRS (International Financial Reporting Standards)

International Financial Reporting Standards (IFRS) are designed as a common global language for business affairs so that company accounts are understandable and comparable across international boundaries. They are a consequence of growing international shareholding and trade and are particularly important for companies that have dealings in several countries. They are progressively replacing the many different national accounting standards. They are the rules to be followed by accountants to maintain books of accounts which are comparable, understandable, reliable and relevant as per the users' internal or external.

International Financial Reporting Standards (IFRS) is a set of accounting standards developed by an independent, not-for-profit organization called the International Accounting Standards Board (IASB).

IFRS Adoption/IFRS Convergence

1. Voluntary adoption

Companies can voluntarily adopt Ind AS for accounting periods beginning on or after 1 April 2015 with comparatives for period ending 31 March 2015 or thereafter. However, once they have chosen this path, they cannot switch back.

2. Mandatory Applicability Phase I

Ind AS will be mandatorily applicable to the following companies for periods beginning on or after **1 April 2016**, with comparatives for the period ending **31 March 2016** or thereafter:

1. Companies whose equity and/or debt securities are listed or are in the process of listing on any stock exchange in India or outside India and having net worth of 500 crore INR or more.
2. Companies having net worth of 500 crore INR or more other than those covered above.
3. Holding, subsidiary, joint venture or associate companies of companies covered above.

Phase II

Ind AS will be mandatorily applicable to the following companies for periods beginning on or after **1 April 2017**, with comparatives for the period ending **31 March 2017** or thereafter:

1. Companies whose equity and/or debt securities are listed or are in the process of being listed on any stock exchange in India or outside India and having net worth of less than rupees 500 crore.
2. Unlisted companies other than those covered in Phase I and Phase II whose net worth is more than 250 crore INR but less than 500 crore INR.
3. Holding, subsidiary, joint venture or associate companies of above companies.

Need for IFRS Convergence

The need for IFRS Convergence has arisen due to the following developments:

1. Financial globalization
2. Multinational corporations
3. Accounting profession
4. Govt. and revenue authorities

Benefits of adopting IFRS

1. Improved financial reporting and tax planning: Under IFRS, companies will produce a standardized and consistent set of accounting and financial reports for complying with local statutory and consolidated requirements. This will help improve the analysis of financial reporting and tax planning processes.
2. Improved day-to-day operations: Businesses will get faster access to more in-depth financial performance information to use in analysing and making better decisions about day-to-day operations.
3. Better managed resources: By standardizing processes and accounting, companies will be able to standardize and streamline accounting systems across the enterprise and reduce the cost of auditing and statutory reporting.
4. Improved financial controls: By standardizing the approach and control over statutory reporting, businesses will reduce the risk of penalties and compliance problems enterprise-wide and in individual countries.
5. Lowered cost of capital: Increased insight into financial results and adherence to high-quality financial standards, as specified by IFRS, can benefit both companies and their investors with reduced cost of capital.

Challenges of IFRS

1. It increases cost
2. Unlike several other countries the accounting framework in India is deeply affected by laws and regulations.
3. If IFRS has to be uniformly understood and consistently applied, all stakeholder employees, auditors, regulators, tax authorities etc. would need to be trained.
4. The industry would be able to raise capital.
5. It would provide professional opportunities to serve international clients.
6. Entity would need to incur additional cost for modifying their IT systems.
7. Difference between GAAP and IFRS may affect business decision.
8. Limited pool of trained resource and person having expert knowledge on IFRS.
9. Everybody is reluctant to change
10. There are practical difficulties for implementing certain IFRS.

Roadmap for implementation of Ind AS (or Convergence with IFRS) for scheduled Commercial banks (Excluding RRBs), insurance Companies and NBFCs

1. Scheduled commercial Banks and Insurance Companies
 - a. Scheduled commercial bank (excluding RRBs), All India Term Lending Refinancing Institutions (Like Exim Bank, NABARD, NHB and SIDBI) and insurance Companies.
 - b. Holding, subsidiary, joint venture or associate companies of Scheduled Commercial banks (Excluding IFRS)
 - i. Comparatives for these financial statements will be periods ending 31st March 2018, or thereafter.
 - ii. Ind AS will be applicable to both consolidated and individual financial statement.
2. Non Banking Finance Companies (NBFCs)

Phase I: 1st April 2018 onwards

- a. NBFC having net worth of Rs. 500 crores or more
- b. Holding, subsidiary, joint venture or associate companies of companies covered under (a) above, other than those companies already covered under corporate roadmap announced by the MCA.
 - Comparative for these financial statements will be periods ending 31st March 2018 or thereafter.
 - Ind AS will be applicable to both consolidated and individual financial statement.

Phase II: 1st April 2019 onwards

- a) NBFCs whose entity and / or debt securities are listed or are in the process of listing on any stock exchange in India or outside India having net worth less than Rs. 500 crore.
- b) NBFCs other than those covered under phase I (a) and Phase II (a) above, that are unlisted companies having net worth of Rs. 250 crores or more but less than Rs. 500 crores.
- c) Holding, subsidiary, joint venture or associate companies of companies covered under (a) above, other than those companies already covered under corporate roadmap announced by the MCA.

List of IAS/IFRS with corresponding Indian As (before convergence) and Ind-AS

IAS NO	TITLE	Corresponding Indian GAAP	Corresponding covered in Ind AS
IAS.1	Presentation of financial statement	AS1	IND-AS1
IAS.2	Inventories	AS2	IND-AS2
IAS.7	Cash flow statement	AS3	INDAS7
IAS.8	Accounting policies, changes in accounting estimate and errors	AS5	INDAS8
IAS.10	Events after the balance sheet date	AS4	INDAS10
IAS.11	Construction contracts	AS7	INDAS11
IAS12	Income taxes	AS22	INDAS12
IAS.16	Property, plant and equipment	AS10 & AS6	INDAS16
IAS.17	Leases	AS19	INDAS17
IAS.18	Revenue	AS9	INDAS18
IAS.19	Employee benefits	AS15	INDAS19
IAS.20	Accounting for govt. grants and disclosure of govt assistance	AS12	INDAS20
IAS.21	The effect of changes in foreign exchange rate	AS11	INDAS21
IAS.23	Borrowing cost	AS16	INDAS23
IAS.24	Related party disclosures	AS18	INDAS24
IAS.26	Accounting and reporting by retirement benefits plan	-	-
IAS.27	Separate financial statements	-	-
IAS.28	Investments in associate and joint ventures	AS23	INDAS28

IAS.29	Financial reporting in Hyperinflationary Economics	-	INDAS29
IAS.32	Financial instruments: presentation	AS31	INDAS32
IAS.33	Earnings per share	AS20	INDAS33
IAS.34	Interim financial reporting	AS25	INDAS34
IAS.36	Impairment of assets	AS28	INDAS36
IAS.37	Provisions, contingent liabilities and contingent assets	AS29	INDAS37
IAS.38	Intangible asset	AS26	INDAS38
IAS.39	Financial instrument: recognition and measurement	AS30	INDAS39
IAS40	Investment property	-	INDAS40
IAS41	agriculture		INDAS41

IAS 3, 4, 5, 6, 9, 13, 14, 15, 22, 25, 30, 31, and 35 have been superseded. AS-8 & issued by ICAI is withdrawn after the issue of AS 26

IFRS NO	TITLE	Corresponding Indian AS	Corresponding Covered Indian AS
IFRS1	First time adoption of IFRS	Not relevant	INDAS101
IFRS2	Share based payment	Guidance note	INDAS102
IFRS3	Business combinations	AS14	INDAS103
IFRS4	Insurance contract	-	INDAS104
IFRS5	Noncurrent asset held for sale and discontinued operation	Partly covered by AS-24	INDAS105
IFRS6	exploration for and evaluation of mineral resources	-	INDAS106
IFRS7	Financial instrument: disclosure	AS32	INDAS107
IFRS8	Operating segment	AS32	INDAS108
IFRS9	Financial instrument	AS17	INDAS109
IFRS10	Consolidated financial statements (exposed draft issued for IFRS 10)	--	INDAS110
IFRS11	Joint agreement	AS27	INDAS111
IFRS12	Disclosure of interest in other entities	---	INDAS112
IFRS13	Fair value measurement	---	INDAS113
IFRS14	Regulatory deferral account	---	INDAS114
IFRS15+	Revenue from contract with customers	--	INDAS115

title of this standard is first time adoption of Indian accounting standards.

General difference between IFRS and IAS

1. IFRS is based on fair value concept. But, Indian accounting standards are based on historical cost.

2. Financial statements under IFRS and Indian accounting standards differ in form and substance.
3. Under IFRS past errors are incorporated in the accounts of the years it pertains to, even if audited and adopted by shareholders. But, these are treated as adjustments in the current year under Indian accounting standards.
4. Depreciation on revalued assets needs to be routed through income statements under IFRS. But Indian Accounting standards disallow such a treatment.
5. Certain Indian standards offer accounting policy choices. These are not available under IFRS, eg., use of pooling of interest method in accounting for amalgamation.
6. Indian accounting standard defines assets by classes which can be depreciated at given rates, whereas IFRS promotes the concept of components of fixed assets based on their usefulness.
7. Under IFRS, prior period items will be given retrospective effect in opening equity. Under Indian AS, it is not so.
8. Proposed dividend is not required to be reflected in financial statements under IFRS. But this is required to be reflected in financial statement under Indian AS.
9. Under IFRS, EPS has to be disclosed separately for continuing and discontinuing operations. This is not required under Indian AS.
10. Under IFRS, provision made for dismantling of assets or for site closure can be capitalized. But under IAS, this cannot be capitalized.

Standard wise differences between IFRS/IAS and Ind

AS Significant differences between IFRS/IAS-1 and Ind AS-1

1. With regard to preparation of statement of profit and loss, IFRS/AS I provides an option either to follow the single statement approach or to follow the two statement approach. But Ind AS-1 allows only the single statement approach.
2. Another difference lies in the terminology used. For example, in Ind AS-1 the term Balance sheet is used, while in IFRS/IAS-1 the term 'statement of financial position' is used. Similarly, in IAS 1, the term 'statement of profit or loss' is used, but in IFRS/IAS-1, the term "statement of profit and loss and other comprehensive income" is used.
3. IFRS/IAS-1 gives the option to individual entities to follow different terminology for the titles of financial statement. On the other hand, Ind AS-1 gives only one terminology to be used by all entities.
4. IFRS/IAS-1 permits the periodicity of 52 weeks for preparation of financial statements. Ind AS-1 does not permit it.

Significant differences between IFRS/AS-2 and Ind AS-

2 There is no significant difference

Significant differences between IFRS/AS-7 and Ind AS-7

1. In case of other financial entities, IFRS/AS -7 gives an option to classify the interest paid and interest and dividend received as items of operating cash flows. Ind AS-7 does not provide such an option. It requires these items to be classified as items of financing activity and investing activity respectively.
2. IFRS/IAS 7 gives an option to classify the dividend paid as an item of operating activity. However, Ind AS 7 requires it to be classified as a part of financing activity only.
3. IFRS/AS 7 does not require disclosure of extraordinary items, as there is no concept of extraordinary item, whereas Ind AS 3 requires so.
4. Ind AS 7 does not make explicit distinction between bank borrowings and bank overdraft, whereas IFRS/IAS 7 makes so.

Conceptual framework for IFRS

Accounting needs a conceptual framework. There is also a framework for the preparation and presentation of financial statements.

Meaning of conceptual framework

A framework is the foundation of accounting standards. A conceptual framework acts as a constitution for the standard setting process. Concepts are the groundwork, the basis, the foundation upon which the superstructure of standard can be created.

Elements of conceptual framework

1. Objective: - the objective of financial statement is to provide information about the financial position, performance and changes in financial position of an enterprise that is useful to a wider range of users in making economic decision.
2. Users:- investors, employees, lenders, suppliers, and other traders, customers, government and their agencies, public, management and others.
3. Underlying assumptions:- accrual basis and going concern.
4. Qualitative characteristics:- understandability, relevance, materiality, reliability, faithful representation, substance over form, neutrality, prudence, completeness and comparability.
5. Elements of financial statement:- Assets, liabilities, equity, income and expenses.
6. Concepts of capital maintenance:- both financial and physical concepts of capital have been listed.

Requirements of IFRS/IASs

1. Statement of financial position
2. Statement of comprehensive income.
3. Statement of changes in equity.
4. Cash flow statement
5. Comparative information required for the prior reporting period.

6. Present all non owners changes in equity (ie comprehensive income) either in onestatementofcomprehensiveincomeorintwostatement(aseparateincomestatementand a statement of comprehensive income).
7. Present a statement of financial position(balance sheet) as at the beginning of theearliest comparative period in a complete set of financial statements when the entityappliesthenewstandard.
8. Presentastatementof cashflow.
9. Makenecessarydisclosure bywayof a note.

Financialelements

Financial elements are the important parts of conceptual framework. Some elementsare directly related ot the measurement of the financial position. Other elements are directlyrelatedto themeasurement offinancial performance.

Meaningoffinancialstatement

Financial elements are simply means the elements of financial statements. In otherwords,financialelementsaretheelementsfromwhichfinancialstatementandotherformoffinancial reports aretobeconstructed.

Definitionsoffinancialstatement

Assets:- Assets are the resources controlled by an entity as a result of past events and fromwhichfutureeconomicbenefits areexpected to flowto theentity.

Liabilities :-liabilities are the present obligations of an entity arising from past events, thesettlementofwhichisexpectedtoresultinanoutflowfromtheentityofresourcesembodyingeconomicbenefits.

Equity:- equity is the residual interest in the assets of an entity after deducting all of itsliabilities.Equityis otherwiseknown as shareholders fund.

Income:- income is the increase in economic benefits during the accounting period in theform of inflow or enhancements of assets,or decrease of liabilities that result in an increaseinequity.

Expenses:- expenses are decreases in economic benefits during the accounting period in theform of outflows or depletion of assets, or incurrence of liabilities that result in decreases inequity.

Recognition

Recognition is the process of incorporating in the statement of financial position orstatement of comprehensive income an item that meets the definition of an element andsatisfiesthecriteriaforrecognition.

Recognition criteria of assets

In order for an asset to be recognized in the financial statements, it must meet the definition laid down in the IASB framework. The definition is “resources controlled by the entity as a result of past events and from which future economic benefits are expected to flow to the entity.”

Apart from meeting the above definition, the framework has advised the following recognition criteria that ought to be met before an asset is recognized in the financial statements:

1. The inflow of economic benefits to the entity is probable.
2. The cost/value can be measured reliably.

Recognition criteria of liabilities

In order for a liability to be recognized in the financial statement, it must meet the following definition provided by the framework.

“Liabilities is a present obligation of the enterprise arising from past events, the settlement of which is expected to result in an outflow from the enterprise of resources embodying economic benefits”

Revenue recognition criteria

1. Economic benefit increases and thereby equity increases (in the form of inflow)
2. Assets increase or liability decreases, resulting in increase in equity (ie, economic benefits increase)

Expense recognition criteria

1. Economic benefits decrease as a result of decrease in an asset.
2. Economic benefits decrease as a result of increase of a

liability. Measurement

Measurement simply refers to valuation. The term measurement is used to describe the process for determining which numbers to present or disclose in the financial statements.

Bases of measurement

1. Historical cost
2. Current cost
3. Realizable cost
4. Present value

Measurement criteria

Type of asset	Measurement at initial recognition
1. Financial instruments	Fair value
2. Property, plant and equipment	Purchase cost + construction cost + cost to bring to the location and condition necessary to be capable of operating in the manner intended by the management.
3. Intangible asset	Purchase cost + development cost + cost to bring to the location and condition necessary to be capable of operating as intended by the management.
4. Investment properties	Costs including transaction cost accounting policy choice: fair value
5. Biological assets and agricultural produce at the point of harvest.	Measured at fair value less cost to sell. Changes in fair value less cost to sell are represented in profit or loss.
6. Assets held for disposal	Fair value
7. Inventory	cost

Principles of presentation

1. Fair presentation and compliance with IFRS
2. Consistency of presentation
3. Materiality and aggregation
4. Offsetting
5. Comparative information
6. Structure of statement of financial position (balance sheet)
7. Line items
8. Format of statement of financial position
9. Statement of profit or loss and other comprehensive income.
10. Choice in presentation and basic requirements
11. Profit or loss section or statement
12. Other comprehensive income section
13. Statement of changes in equity
14. Notes to the financial

statements Principles of disclosures in financial statements

Principles of disclosures in financial statements

1. Materiality
2. Summary of accounting policies
3. Share capital and reserves
4. Dividends
5. Capital disclosures
6. Other information