

# **BUSINESS ACCOUNTING**

**For B.Com. Semester II, BHARATHIDASAN UNIVERSITY**



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**SYLLABUS**  
**SEMESTER - II**  
**BHARATHIDASAN UNIVERSITY**

**UNIT - I**

Branch accounts – (Excluding foreign branches) – Departmental accounts.

**UNIT - II**

Hire purchase accounts & Instalment purchase System

**UNIT - III**

Self balancing and sectional balancing ledgers – Royalty accounts

**UNIT - IV**

Fire insurance claims for loss of stock and profits – Accounting for sale or return.

**UNIT - V**

Insolvency accounts – Statement of Affairs – Insolvency of individual only

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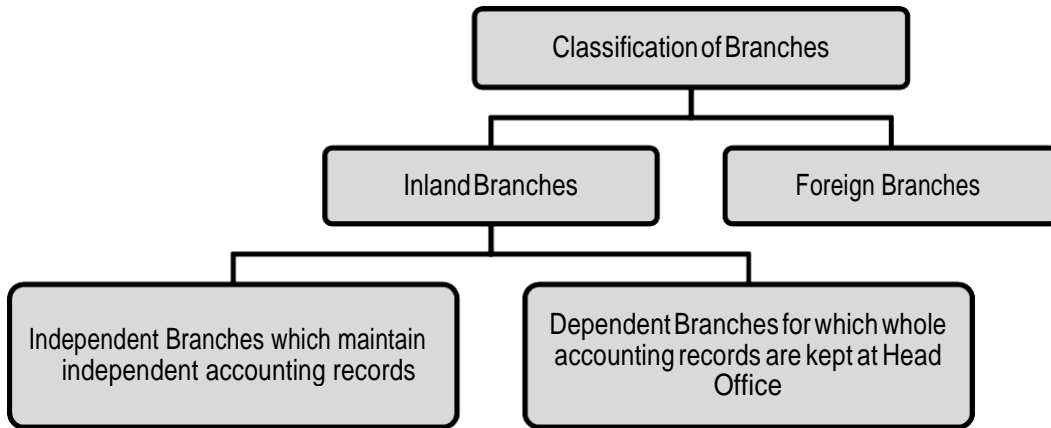
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## UNIT - I BRANCH ACCOUNT

### Introduction

A branch can be described as any establishment carrying on either the same or substantially the same activity as that carried on by head office of the company. It must also be noted that the concept of a branch means existence of a head office for there can be no branch without a head office - the principal place of business. From the accounting point of view, branches may be classified as follows:



### Distinction Between Branch Accounts And Departmental Accounts

Basis of distinction	Branch Accounts	Departmental Accounts
<b>1. Maintenance of accounts</b>	Branch accounts may be maintained either at branch or at head office.	Departmental accounts are maintained at one place only.
<b>2. Allocation of common expenses</b>	No allocation problem arises since the expenses in respect of each branch can be identified.	Common expenses are distributed among the departments concerned on some equitable basis considered suitable in the case.
<b>3. Reconciliation</b>	Reconciliation of head office and branch accounts is necessary in case of independent branches at the end of the accounting year.	No such problem arises.
<b>4. Conversion of foreign currency figures</b>	At the time of finalization of accounts, conversion of figures of foreign branch is necessary.	No such problem arises in departmental accounts.

### **Dependent Branches**

When the business policies and the administration of a branch are wholly controlled by the head office and its accounts also are maintained by it the branch is described as Dependant branch. Branch accounts, in such a case, are maintained at the head office out of reports and returns received from the branch. Some of the significant types of branches that are operated in this manner are described below:

- (a) A branch set up merely for booking orders that are executed by the head office. Such a branch only transmits orders to the head office;
- (b) A branch established at a commercial centre for the sale of goods (wholesale) supplied by the head office, and under its direction all collections are made by the H.O.; and
- (c) A branch for the retail sale of goods, supplied by the head office.

Accounting in the case of first two types is simple. Only a record of expenses incurred at the branch has to be maintained. But however a retail branch is essentially a sale agency that principally sells goods supplied by the head office for cash and, if so authorized, also on credit to approved customers. Generally, cash collected is deposited into a local bank to the credit of the head office and the head office issues cheques thereon for meeting the expenses of the branch. In addition, the Branch Manager is provided with a 'float' for petty expenses which is replenished from time to time on an imprest basis. If, however, the branch also sells certain lines of goods, directly purchased by it, the branch retains a part of the sale proceeds to pay for the goods so purchased.

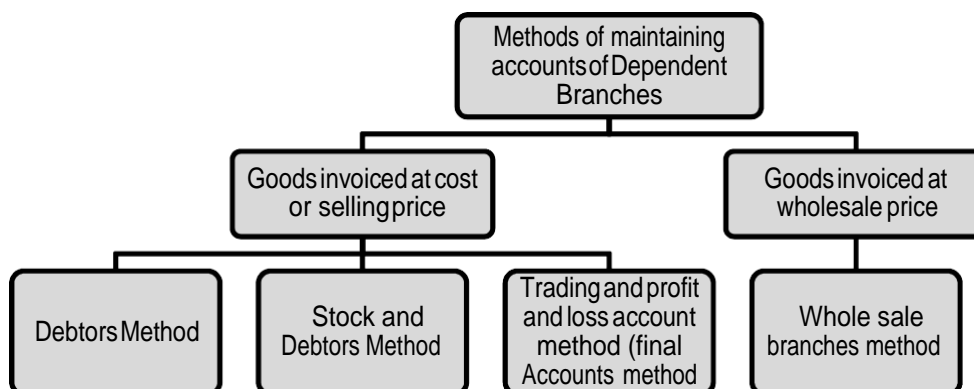
### **Methods of Charging Goods to Branches**

Goods may be invoiced to branches (1) at cost; or (2) at selling price; or (3) in case of retail branches, at wholesale price.

Selling price method is adopted where the goods would be sold at a fixed price by the branch. It is suitable for dealers in tea, petrol, vanaspati ghee, etc. In this way, greater control can be exercised over the working of a branch in as much as that the branch balance in the head office books would always be composed of the value of unsold stock at the branch and remittances or goods in transit. The arbitrary price method is usually adopted if the selling price is not known or when it is not considered desirable to disclose to the branch manager the profit made by the branch.

## Accounting for Dependent Branches

Dependent branch does not maintain a complete record of its transactions. The Head office may maintain accounts of dependent branches in any of the following methods:



**When goods are invoiced at cost:** If goods are invoiced to the branch at cost, the trading results of branch can be ascertained by following any of the three methods: (i) **Debtors Method**, (ii) **Stock and Debtors method**, (iii) **Trading and Profit and Loss Account (Final Accounts) Method**.

For finding out the trading results of branch, it is assumed that the branch is an entity separate from the head office. On the basis, a Branch Account is stated in the head office books to which the price of goods or services provided or expenses paid out are debited and correspondingly, the value of benefits and cash received from the branch are credited.

### **Debtor's method:**

This method of accounting is suitable for small sized branches. Under this method, separate branch account is maintained for each branch to compute profit or loss made by each branch. The opening balance of stock, debtors (if any), petty cash (if any), are debited to the Branch Account; the cost of goods sent to branch as well as expenses of the branch paid by the head office, *e.g.*, salaries, rent, insurance, etc., are also debited to it. Conversely, amounts remitted by the branch and the cost of goods returned by the branch are credited. At the end of the year, the value of unsold stock, the total of customers' balances outstanding and that of petty cash are brought into the branch account on the credit side and then the branch account will reveal profit or loss; Debit 'balance' will be the loss suffered by the working of the branch and *vice versa*. If the branch is allowed to make small purchases of goods locally as well as to incur expenses out of its cash receipts, it will be necessary for the branch to supply to the head office a copy of the Cash Account, showing details of cash collections and disbursements. To illustrate the various entries which are made in the Branch Account, the proforma of a Branch Account is shown below:

### Branch Account

To Balance b/d Stock Debtors		By Bank A/c (Cash remitted) By Return to H.O. By Balance c/d	
Petty Cash To Goods sent to Branch To Bank A/c Salaries Rent Sundry Expenses To Profit & Loss A/c— Profit (if credit side is larger)		Cash Debtors Petty Cash Fixed Assets Prepaid Expenses By Profit and Loss A/c— Loss (if debit side is larger)	

**Note:**

1. Having credited the Branch Account by the actual cash received from debtors, it would be wrong to debit the Branch Account, in respect of discount or allowances to debtors.
2. The accuracy of the trading results as disclosed by the Branch Account, so maintained, if considered necessary, can be proved by preparing a Memorandum Branch Trading and Profit & Loss Account, in the usual way, from the balances of various items of income and expenses contained in the Branch Account.

### Stock and Debtors method

If it is desired to exercise a more detailed control over the working of a branch, the accounts of the branch are maintained under what is described as the Stock and Debtors Method. According to this method, the following accounts are maintained by the Head Office:

Account	Purpose
1. Branch Stock Account (or Branch Trading Account)	Ascertainment of shortage or surplus
2. Branch Profit and Loss Account	Calculation of net profit or loss
3. Branch Debtors Account	Ascertainment of closing balance of debtors
4. Branch Expenses Account	Ascertainment of total expenses incurred
5. Goods sent to Branch Account	Ascertainment of cost of goods sent to branch

If the branch is also allowed to purchase goods locally and to incur expenses out of

its cash collections, it would be necessary to maintain (i) a Branch Cash Account, and (ii) an independent record of branch assets.

The manner in which entries are recorded in the above method is shown below:

	<b>Transaction</b>	<b>Account debited</b>	<b>Account credited</b>
(a)	Cost of goods sent to the Branch	Branch Stock A/c	Goods sent to Branch A/c
(b)	Remittances for expenses	Branch Cash A/c	(H.O.) Cash A/c
(c)	Any assets (e.g. furniture) provided by H.O.	Br Asset (Furniture) A/c	(i) (H.O.) Cash A/c or (ii) Creditors A/c
(d)	Cost of goods returned by the branch	Goods sent to Branch A/c	(iii) (H.O.) Furniture A/c Branch Stock A/c
(e)	Cash Sales at the Branch	Branch Cash A/c	Branch Stock A/c
(f)	Credit Sales at the Branch	Branch Debtors A/c	Branch Stock A/c
(g)	Return of goods by debtors to the Branch	Branch Stock A/c	Branch Debtors A/c
(h)	Cash paid by debtors	Branch Cash A/c	Branch Debtors A/c
(i)	Discount & allowance to debtors, bad debts	Branch Expenses A/c	Branch Debtors A/c
(j)	Remittances to H.O.	(H.O.) Cash A/c	Branch Cash A/c
(k)	Expenses met by H.O.	Branch Expenses A/c	(H.O.) Cash A/c

- (l) *Closing Stock*: Credit the Branch Stock Account with the value of closing stock at cost. It will be carried down as opening balance (debit) for the next accounting period. The Balance of the Branch Stock Account, (after adjustment therein the value of closing stock), if in credit, will represent the gross profit on sales and vice versa.

#### *Other Steps*

- (m) Transfer Balance of Branch Stock Account to the Branch Profit and Loss Account.  
 (n) Transfer Balance of Branch Expenses Account to the debit of Branch Profit & Loss Account.  
 (o) The balance in the Branch P&L A/c will be transferred to the (H.O.) Profit & Loss Account.

The credit balance in the Goods sent to Branch Account is afterwards transferred to the Head Office Purchase Account or Trading Account (in case of manufacturing concerns), it being the value of goods transferred to the Branch.

#### **Branch Trading and Profit and Loss Account (Final Accounts Method)**



In this method, Trading and Profit and Loss accounts are prepared considering each branch as a separate entity. The main advantage of this method is that, it is easy to prepare and understand. It also gives complete information of all transactions which are ignored in the other methods. It should be noted that Branch Trading and Profit and Loss account is merely a memorandum account and therefore, the entries made there in do not have double entry effect.

**When goods are invoiced at selling price:** It would be obvious that if Branch Account is debited with the sales price of goods and subsequent to the debit being raised there is a change in the sale price, the amount of debit either has to be increased or reduced on a consideration of the quantity of unsold stock that was there at the branch at the time the change took place. Such an adjustment will be necessary as often as the change in sale price occurs.

Moreover the amount of anticipatory profit, included in the value of unsold stock with the branch at the close of the year will have to be **eliminated** before the accounts of the branch are incorporated with that of the head office. This will be done by creating a reserve.

It may also be necessary to adjust the value of closing stock on account of the physical losses of stock due to either pilferage or wastages which may have occurred during the year. The last mentioned adjustments are made by debiting the cost of the goods to Goods Lost Account and the amount of loading (included in the lost goods), to the Branch Adjustment Account. The three different methods that are usually adopted for maintaining accounts on this basis are described below:

### ***Stock and Debtors Method***

Under this method, when goods are invoiced at selling price, one additional account i.e. 'Branch Adjustment account' is also prepared in addition to all the accounts which are maintained on cost basis.

When goods are invoiced at selling price, the following points should be kept in mind under this method:

#### **(i) Journal Entries:**

Transaction	Accounts debited	Accounts credited
(a) Sale price of the goods sent from H.O. to the Branch	Branch Stock A/c (at selling price)	(i) Goods sent to Branches A/c with cost of the goods sent.  (ii) Branch Adjustment A/c (with the loading i.e., Difference between the selling and cost price).

(b) Return of goods By the Branch to H.O.	(i) Goods sent to Branch A/c (with the cost of goods returned). (ii) Branch Adjustment A/c (with the loading)	Branch Stock A/c
(c) Cash sales at the Branch	Cash/Bank A/c	Branch Stock A/c
(d) Credit Sales at the Branch	Branch Debtors A/c	Branch Stock A/c
(e) Goods returned to Branch by customers	Branch Stock A/c	Branch Debtors A/c (at selling price)
(f) Goods lost in Transit or stolen	(i) Goods Lost in Transit A/c or Goods Stolen A/c (with cost of the goods) (ii) Branch Adjustment A/c (with the loading)	Branch Stock A/c

### (ii) Closing Stock

The balance in the Branch Stock Account at the close of the year normally should be equal to the unsold stock at the Branch valued at sale price. But quite often the value of stock actually held at the branch is either more or less than the balance of the Branch Stock Account. In that event it will be necessary that the balance in the Branch Stock Account is increased or reduced by debit or credit to Goods Lost Account (at cost price of goods) and Branch Adjustment Account (with the loading). The Stock Account at selling price, thus reveals loss of stock (or surplus) and serves as a check on the branch in this respect.

The discrepancy in the amount of balance in the Branch Stock Account and the value of stock actually in hand, valued at sale price, may be the result of one or more of the under-mentioned factors:

- An error in applying the percentage of loading.
- Goods having been sold either below or above the established selling price.
- A Commission to adjust returns or allowances.
- Physical loss of stock due to natural causes or pilferage.
- Errors in Stock-taking.

*If on the other hand, a part of the sale proceeds has been misappropriated, then the adjusting entry would be:*

		Dr.	Cr.
Loss by theft A/c	Dr.	XX	
Branch Adjustment A/c	Dr.	XX	
To Branch Stock A/c			XX

**Rebates and allowances** allowed to customers are adjusted by debiting the amounts of such allowances to Branch Adjustment Account and crediting Branch Stock Account. But, if the gross amount of sale has been debited to Branch debtors Account, this account would be credited instead of Branch Stock Account, since the last mentioned account would have already received credit for the full value.

In the Goods Sent to Branch Account, the cost of the goods sent out to a branch for sale is credited by debiting Branch Stock Account. Conversely, the cost of goods returned by the branch is debited to this account. As such the balance in the account at the end of the year will be the cost of goods sent to the branch; therefore, it will be transferred either to the Trading Account or to Purchases Account of the head office.

The amount of profit anticipated on sale of goods sent to the branch is credited to the Branch Adjustment Account and conversely, the amount of profit not realized in respect of goods returned by the branch to head office or that in respect to stock remaining unsold with the branch at the close of the year is debited. The balance in this account, at the end of year thus will consist of the amount of Gross Profit earned on sale by the branch. On that account, it will be transferred to the Branch Profit and Loss Account.

(iii) **Elimination of unrealised profit in the closing stock:** The balance in the Branch Stock account would be at the **sale price**; therefore it would be necessary to eliminate the element of profit included in such closing stock. This is done by creating a reserve against unrealised profit, by debiting the Branch Adjustment Account and crediting Stock Reserve Account with an amount equal to the difference in the cost and selling price of unsold stock. Sometimes instead of opening a separate account in respect of the reserve, the amount of the difference is credited to Branch Stock Account. In that case, the credited balance of such a reserve is also carried forward separately, along with the debit balance in the Branch Stock Account; the difference between the two would be the value of stock at cost. In either case, the credit balance will be deducted out of the value of closing stock for the purpose of disclosure in the balance sheet, so that the stock is shown at cost.

**An Alternative method:** Where the gross profit of each branch is not required to be ascertained separately, although the selling price is uniform, the amount of goods sent to the branch is recorded only in two accounts namely - Branch Stock Account and Goods Sent to Branch A/c.

In this method, at the end of the year the Branch Stock Account is closed by transfer of the balance representing the value of closing stock, at sale price, to the **Goods Sent to Branch Account**. This has the effect of altogether eliminating from the books the value of stock at the branch. The balance of Goods sent to Branch Account is afterwards transferred to the **Trading Account** representing the net sale price of goods sold at the branch. In that case, the value of closing stock at the branch at cost will be subsequently introduced in the Trading Account together with that of closing stock at the head office.

### Debtors Method

Under this method, the principal accounts that will be maintained are:

- The Branch Account;
- The Goods Sent to Branch Account; and
- The Stock Reserve Account.

Entries in these accounts will be made in the following manner:

	Transaction	Account debited	Account credited
(a)	Goods sent to Branch at selling price	Branch A/c	Goods Sent to Branch A/c
(b)	'Loading' being the difference between selling price and cost of goods	Goods Sent to Branch A/c	Branch A/c
(c)	Returns to H.O. at selling price	Branch A/c	Branch A/c
(d)	'Loading' in respect of goods returned to H.O.	Goods Sent to Branch A/c	Branch A/c
(e)	'Loading' included in the opening stock to reduce it	Stock Reserve A/c	Branch A/c
(f)	Closing stock at selling price	Branch Stock A/c	Branch A/c
(g)	'Loading' included in closing stock to reduce it to cost	Branch A/c	Stock Reserve A/c

It will be observed that entries in the Branch Account in respect of goods sent to a branch or returned by it, as well as those for the opening and closing stock, will be at selling price. In consequence, the Branch Account is maintained at selling price.

Hence the Branch Account will not correctly show the trading profit of the Branch unless these amounts are adjusted to cost. Such an adjustment is effected by making contra entries in 'Goods Sent to Branch A/c' and 'Stock Reserve Account'. In respect of closing stock at branch for the purpose of disclosure in the Balance Sheet, the credit balance in the 'Stock Reserve Account' at the end of the year will be deducted from the value of the closing stock, so as to reduce it to cost; it will be carried forward as a separate balance to the following year, for being transferred to the credit of the Branch Account.

### Goods invoiced at wholesale price to retail branches:

Under this method, the Head Office (particularly, the manufacturing concern) supplies goods to its retail branches at wholesale price which is cost plus wholesale profit. The profit attributable to such branches is the difference between the sale proceeds of goods at the shops and the wholesale price of the goods sold. For the purpose, it is assumed that the manufacturer would always be able to sell the goods on wholesale terms and thereby realizes profit equal to the difference between the

wholesale price and the cost. Many concerns, therefore, invoice goods to such shops at wholesale price and determine profit or loss on sale of goods on this basis. Accordingly, Branch Stock Account or the Trading Account is debited with:

- (a) the value of opening stock at the Branch; and
- (b) price of goods sent during the year at wholesale price. It is credited by:

- (a) sales effected at the shop; and
- (b) closing stock of goods valued at wholesale price.

The value of goods lost due to accident, theft etc. also is credited to the Branch Stock Account or Trading Account calculated at the **wholesale price**. At this stage, the Branch Stock or Trading Account will reveal the amount of gross profit (or loss). It is transferred to the Branch Profit and Loss Account. On further being debited with the expenses incurred at the shop and the wholesale price of goods lost, the Branch Profit and Loss Account will disclose the net profit (or loss) at the shop.

Since the closing stock at the branch has to be valued at wholesale price, it would be necessary to create a stock reserve equal to the difference between its wholesale price and its cost (to the head office) by debiting the amount in the *Head Office Profit and Loss Account*. This Stock Reserve is carried down to the next year and then transferred to the credit of the (Head Office) Profit and Loss Account.

### **Accounting for Independent Branches**

When the size of the business is big, it is desirable that the branch maintains complete records of its transactions. These branches are called independent branches and each independent branch maintains comprehensive account books for recording their transactions; therefore a separate trial balance of each branch can be prepared. The head office maintains one ledger account for each such branch, wherein all transactions between the head office and the branches are recorded.

Salient features of accounting system of an independent branch are as follows:

1. Branch maintains its entire books of account under double entry system.
2. Branch opens in its books a Head Office account to record all transactions that take place between Head Office and branch. The Head Office maintains a Branch account to record these transactions.
3. Branch prepares its Trial Balance, Trading and profit and loss Account at the end of the accounting period and sends copies of these statements to Head Office for incorporation.
4. After receiving the final statements from branch, Head Office reconciles between the two
  - Branch account in Head Office books and Head Office account in Branch books.
5. Head office passes necessary journal entries to incorporate branch trial balance in its books.

The Head Office Account in branch books and Branch Account in head office books are maintained respectively.

	Transactions	Head office books	Branch books
(i)	Dispatch of goods to branch by H.O.	Branch A/c Dr. To Good sent to Branch A/c	Goods received. from H.O. Dr. A/c To Head Office A/c
(ii)	When goods are returned by the Branch to H.O.	Goods sent to Branch Dr. A/c To Branch A/c	Head Office A/c Dr. To Goods recd. from H.O. A/c
(iii)	Branch Expenses are paid by the Branch	No Entry	Expenses A/c Dr. To Cash A/c
(iv)	Branch Expenses paid by H.O.	Branch A/c Dr. To Bank	Expenses A/c Dr. To Head Office A/c
(v)	Outside purchases made by the Branch	No Entry	Purchases A/c Dr. To Bank (or) Crs. A/c
(vi)	Sales effected by the Branch	No Entry	Cash or Debtors A/c Dr. To Sales
(vii)	Collection from Debtors of the Branch recd. by H.O.	Cash or Bank A/c Dr. To Branch A/c	Head office A/c Dr. To Sundry Drs. A/c
(viii)	Payment by H.O. for purchase made by Branch	Branch A/c Dr. To Bank	Purchase (or) Sundry Creditors A/c Dr. To Head Office
(ix)	Purchase of Asset by Branch	No Entry	Sundry Assets Dr. To Bank (or) Liability
(x)	Asset purchased by the Branch but Asset A/c retained at H.O. books	Branch Asset Dr. A/c To Branch A/c	Head office Dr. To Bank (or) Liability
(xi)	Depreciation on (x) above	Branch A/c Dr. To Branch Asset	Depreciation A/c Dr. To Head Office A/c
(xii)	Remittance of funds by H.O. to Branch	Branch A/c Dr. To Bank	Bank A/c Dr. To Head Office
(xiii)	Remittance of funds by Branch to H.O.	Reverse entry of (xii) above	Reverse entry of (xii) above

(xiv)	Transfer of goods from one Branch to another branch	(Recipient) A/c To Supplying Branch A/c	Branch Dr. Supplying	Supplying Branch H.O. A/c To Goods Received from H.O. A/c Recipient Branch Goods Received from H.O. A/c To Head Office A/c	Dr.    Dr.
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The final result of these adjustments will be that so far as the Head Office is concerned, the branch will be looked upon either as a debtor or creditor, as a debtor if the amount of its assets is in excess of its liabilities and as a creditor if the position is reverse.

A debit balance in the Branch Account should always be equal to the net assets at the branch. The important thing to remember, when independent sets of accounts are maintained, is that the branch and head office books are connected with each other only through the medium of the Branch and the Head Office Account which are converse of each other.; also when accounts of the branch and head office are consolidated both the Branch and Head Office Accounts will be eliminated.

### Adjustment and Reconciliation of Branch and Head Office Accounts

If the branch and the head office accounts, converse of each other, do not tally, these must be **reconciled** before the preparation of the final accounts of the concern as a whole.

However, there will be no entry in Head office books being the point where the event has been recorded in full, hence no further entries in Head office books.

**Reasons for Disagreement:** Following are the possible reasons for the disagreement between Branch A/c in Head office books and Head office A/c in Branch books on the closing date:

- Goods dispatched by the Head office not received by the branch. These goods may be in transit or loss in transit.
- Goods returned by the branch to Head Office may have been received by the H.O. Again, these goods may be in transit or lost in transit.
- Amount remitted by Head office to branch or *vice versa* remaining in transit on the closing date.
- Receipt of income or payment or expenses relating to the Branch transacted by the head office or *vice versa*, hence not recorded at the respective ends wherein they are normally to be recorded.

#### (1) Inter-Branch Transactions

Inter-branch transactions are usually adjusted as if they were entered into only with the head office. It is a very convenient method of treating such transaction especially where the number of branches are large. .

## 2) Fixed Assets

Often the accounts of fixed assets of a branch are kept in the head office books; in such a case, at the end of the year, the amount of depreciation on the assets is debited to the branch concerned by recording the following entry:

Branch Account	Dr.
To Branch Asset Account	

The branch will pass the following entry:

Depreciation Account	Dr.
To Head Office Account	

### (2) Head office Expenses charged to Branch

Usually the head office has to devote considerable time in attending to the affairs of the branch; on that account, it may decide to raise a charge against the branch in respect of the cost of such time. In such a case the amount is debited to the branch as 'Expenses' and is credited to appropriate revenue head such as Salaries Accounts, General Charges Account, Entertainment Account etc. The branch credits the H.O. Account and debits Expenses Account.

## Foreign Branches

Foreign branches generally maintain independent and complete record of business transacted by them in currency of the country in which they operate. Thus problems of incorporating balances of foreign branches relate mainly to translation of foreign currency into Indian rupees. This is because exchange rate of Indian rupee is not stable in relation to foreign currencies due to international demand and supply effects on various currencies. The accounting principles which apply to inland branches also apply to a foreign branch after converting the trial balance of the foreign branch in the Indian currency.



**Problems**

1. From the following particulars prepare branch account for the year ended 31.12.2015.

	Rs.
Stock on 31.12.2014	2300
Goods sent to branch	45000
Cash sent to branch for Rent	1800
Salaries	5000
Other expenses	1600
Cash received from the branch	60000
Stock on 31.12.2015	5800
Petty cash 31.12.2015	30

2. TVS & Co. of Madurai operates a branch at Madras. From the following particulars, prepare the branch account as it would appear in the books of Head office.

	Rs.
Stock in trade at the branch 1.1.2010	11200
Goods sent to branch	109000
Cash sent to branch:	
Rent	7200
Salaries	8600
Other expenses	2200
Cash sent by branch	172000
Stock in trade at branch on 31.12.2010	7600
Cash in hand at the branch on 31.12.2010	100

3. The following information relates to Madurai Branch

	Rs.
Stock on 1.1.94	11200
Goods sent to branch	51000
Branch debtors on 1.1.94	6300
Cash sent to branch for:	
Rent	1500
Salaries	3000
Petty cash	600
Sales at branch	
Cash	25000

Credit	39000
Cash received from debtors	41200
Stock on 31.12.94	13600

Prepare Branch Account for the year 1994.

4. Raj metal company opened a branch at Chennai as on 1.1.99. From the following particulars, prepare the Chennai Branch account for the year 2000.

	1999	2000
	Rs.	Rs.
Goods sent to branch	15000	45000
Cash sent to branch for:		
Rent	1800	1800
Salaries	3000	5000
Other expenses	1200	1600
Cash received from the branch	24000	60000
Stock on 31 <sup>st</sup> December	2300	5800
Petty cash in hand on 31 <sup>st</sup> December	40	50

5. From the following particulars relating to Hyderabad branch for the year ended 31.12.90. Prepare Branch Account in the head office books

	Rs.
Stock at the branch on 1.1.90	15000
Debtors at the branch on 1.1.90	30000
Petty cash at the branch on 1.1.90	300
Goods sent to branch during 1990	252000
Cash sales 1990	60000
Received from Debtors	210000
Credit sales during 1990	228000
Cheques sent to branch during 1990	
For salaries	9000
For rent and rates	1500
For petty cash	1100
Stock at the branch on 31.12.90	25000
Petty cash on 31.12.90	200
Goods returned by the branch	2000
Debtors on 31.12.90	48000

6. The following are the details of a dependent Kovai branch established by Salem Head

office for the year ending 31.3.2005.

	Rs.
Goods sent to BO at cost	50000
Goods returned by BO at cost	3000
Expenses paid by HO	10000
Remittances received from BO	45000
Received from debtors by the BO	42500
Cash sales	2500
Credit sales	51000
Closing stock with BO	17000
Branch debtors (31.3.2005)	7700
Discount allowed to customers by branch	1800

Prepare branch account in the books of Head office to find out profit or loss.

7. A Calcutta head office has a branch at Patna to which goods are sent at cost plus 25%. From the following particulars prepare branch account in the head office books.

	Rs.
Stock on 1.1.2009 invoice price	1250
Stock on 31.12.2009 invoice price	1500
Debtors 1.1.2009	700
Debtors 31.12.2009	900
Cash sales for the year	5400
Credit sales for the year	3500
Goods send to branch	9100
Cash received from Calcutta	
Rent	400
Wages	340
Sundry Expenses	80

8. A Namakkal head office has a branch at Erode to which goods are invoiced at cost plus 20% from the details, prepare branch a/c in the head office books.

	Rs.
Goods sent to branch	211872
Cash sales	110400
Credit sales	96000
Cash received from debtors	88000

Debtors on 1.1.2006	24000
Stock on 1.1.2006	7680
Stock on 31.12.2006	13440

9. Raga of Trichy has a branch at Madras. Goods are sent by head office at invoice price which is at the profit of 20% on cost price. All expenses of the branch are paid by head office. From the following particulars prepare branch account in the HO books. Show the goods at invoice price.

	Rs.
Opening balances:	
Stock at invoice price	11000
Debtors	1700
Petty cash	100
Goods sent to branch at invoice price	20000
Expenses paid by head office:	
Rent	600
Wages	200
Salary	900
Remittance made to head office:	
Cash sales	2650
Cash collected from debtors	21000
Goods returned by branch at invoice price	400
Balanced at end:	
Stock at invoice price	13000
Debtors	2000
Petty cash	25

10. From the following information, prepare branch account in the books of H.O. on 31.12.2005. All the expenses and goods are sent by H.O. The goods are invoiced at 25% above cost.

	Rs.
Stock on 31.12.2005	90000
Stock on 1.1.2005	60000
Debtors 1.1.2005	40000
Debtors 31.12.2005	60000
Cash sent to HO (cash sales)	150000
Cash sent to HO (Cash collected from debtors)	160000

Goods sent to branch	360000
Rent	9000
Goods returned by branch	6000
Petty cash on 1.1.2005	100
Petty cash on 31.12.2005	50
Sale of gunny bags	200

11. Tip top co., Delhi has a branch at Calcutta. It invoices goods to branch at selling price which is cost plus  $33\frac{1}{3}$ . From the following particulars prepare branch a/c. show also branch debtors account and goods sent to branch account in the books of Tip to co., Delhi.

	Rs.
Stock on 1 <sup>st</sup> January 2001 (invoice price)	15000
Debtors on 1 <sup>st</sup> Jan. 2001	11400
Goods invoiced to branch during the year at invoice price	67000
Sale at branch	
Cash	31000
Credit	37400
Cash received from debtors	40000
Discount allowed to customers	300
Cheque sent to branch	
Salaries	5000
Sundry expenses	1700
Stock on 31.12.2001 at invoice price	13400

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

	Rs.
Opening stock at the branch	15000
Goods sent to the branch	45000
Sales	60000
Salaries	5000
Other expenses	2000

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

13. The Calcutta commercial company invoice goods to its Jamshedpur Branch at cost. The head office paid all the branch expenses from its bank except petty cash expenses which

were paid by the branch. From the following details relating to the branch prepare.

- a. Branch stock A/c                      b. Branch Debtors A/c  
c. Branch Expenses A/c                 d. Branch P&L A/c

	Rs.
Stock (opening)	21000
Debtors (opening)	37800
Petty cash (opening)	600
Goods sent from HO	78000
Goods returned to HO	3000
Cash sales	52500
Advertisement	2400
Cash received from debtors	85500
Stock (closing)	19500
Discount to customers	4200
Bad debts	1800
Goods returned by customer to branch	1500
Salaries and wages	18600
Rent and rates	3600
Debtors (closing)	29400
Petty cash (closing)	300
Credit sales	85200
Allowance to customers	600

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

	Rs.		Rs.
Stock on 1.1.09 invoice price	27900	Goods returned by debtors	3600
Debtors on 1.1.09	20400	Goods returned to HO by branch	4500
Goods invoiced to the branch at invoice price	153000	Shortage of stock	1350
Cash sales	75000	Discount allowed	600
Credit sales	93000	Expenses at the branch	16200
Cash collected from debtors	91200	Bad debts	600

## DEPARTMENTAL ACCOUNTS

### Introduction

If a business consists of several independent activities, or is divided into several departments, for carrying on separate functions, its management is usually interested in finding out the working results of each department to ascertain their relative efficiencies. This can be made possible only if departmental accounts are prepared. Departmental accounts are of great help and assistance to the managements as information for controlling the business more intelligently and effectively, since thereby all types of waste either of material or of money are readily detected; also attention is drawn to inadequacies or inefficiencies in the working of departments or units into which the business may be divided.

### Advantages of Departmental Accounting

The main advantages of departmental accounting are as follows:

1. **Evaluation of performance:** The performance of each department can be evaluated separately on the basis of trading results. An endeavour may be made to push up the sales of that department which is earning maximum profit.
2. **Growth potential of each department:** The growth potential of a department as compared to others can be evaluated.
3. **Justification of capital outlay:** It helps the management to determine the justification of capital outlay in each department.
4. **Judgement of efficiency:** It helps to calculate stock turnover ratio of each department separately, and thus the efficiency of each department can be revealed.
5. **Planning and control:** Availability of separate cost and profit figures for each department facilitates better control. Thus effective planning and control can be achieved on the basis of departmental accounting information.

### Methods of Departmental Accounting

Basically, an organization usually divides the work in various departments, which is done on the principle of division of labour. This can improve efficiency of each and every department of the organization. Each department prepares its separate accounts to judge its individual performance.

There are two methods of keeping departmental accounts:

**Accounts of all departments are kept in one book only:** To prepare such accounts, it will be necessary first, for the income and expenditure of department to be separately recorded in subsidiary books and then for them to be accumulated under separate heads in a ledger or ledgers. This may be done by having columnar subsidiary books and a columnar ledger. *Under this system, the gross profit of individual department can be determined accurately.*

**Separate set of books are kept for each department:** A separate set of books may

be kept for each department, including complete stock accounts of goods received from or transferred to other departments or as also sales.

Nevertheless, even when separate sets of books are maintained for different departments, it will also be necessary to devise a basis for allocation of common expenses among the different departments, if an organisation is interested in

### Basis of Allocation of Common Expenditure among different Departments

determining the separate departmental net profit in addition to the gross profit.

Expenses should be allocated among different departments on a rational basis while preparing departmental accounts.

**Individual Identifiable Expenses:** Expenses incurred specially for a particular department are charged directly thereto, *e.g.*, insurance charges of stock held by a department.

**Common Expenses:** Common expenses, the benefit of which is shared by all the departments and which are capable of precise allocation are distributed among the departments concerned on some equitable basis considered suitable

#### Allocation of Expenses

S.No.	Expenses	Basis
1.	Rent, rates and taxes, repairs and maintenance, insurance of building	Floor area occupied by each department (if given) other wise on time basis
2.	Lighting and Heating expenses (eg. energy expenses)	Consumption of energy by each department
3.	Selling expenses, <i>e.g.</i> , discount, bad debts, selling commission, freight outward, travelling sales manager's salary and other costs	Sales of each department
4.	Carriage inward/ Discount received	Purchases of each department
5.	Wages/Salaries	Time devoted to each department
6.	Depreciation, insurance , repairs and maintenance of capital assets	Value of assets of each department otherwise on time basis
7.	Administrative and other expenses, <i>e.g.</i> , salaries of managers, directors, common advertisement expenses, etc.	Time basis or equally among all departments
8.	Labour welfare expenses	Number of employees in each department
9.	PF/ESI contributions	Wages and salaries of each department



## Types of Departments

There are two types of departments.

**Independent Departments:** Departments which work independently of each other and have negligible inter department transfer are called Independent Departments.

**Dependent Departments:** Departments which transfer goods from one department to another department for further processing are called dependent departments. Here, the output of one department becomes the input for the other department. These transfers may be done at cost or some pre-decided selling price. The price at which this is done is known as transfer price. In these departments unloading is required if the transfer price is having profit element.

## Inter-departmental Transfers

Whenever goods or services are provided by one department to another, their cost should be separately recorded and charged to the department benefiting thereby and credited to that providing it. The totals of such benefits should be disclosed in the departmental Profit and Loss Accounts, to distinguish them from other items of expenditure.

**Basis of Inter-Departmental Transfers:** Goods and services may be charged by one department to another usually on either of the following three bases:

- (i) Cost,
- (ii) Ruling market price,
- (iii) Cost *plus* agreed percentage of profit.

**Elimination of Unrealized Profit:** When profit is added in the inter-departmental transfers the loading included in the unsold stock at the end of the year is to be excluded before final accounts are prepared so as to eliminate any anticipatory profit included therein.

**Stock Reserve:** Unrealized profit included in unsold inventory at the end of accounting period is eliminated by creating an appropriate stock reserve by debiting the combined Profit and Loss Account. The amount of stock reserve will be calculated as:

$$\frac{\text{Transfer price of unsold stock} * \text{Profit included in}}{\text{transfer price} \quad \text{Transfer price}}$$

**Journal Entry:** At the end of the accounting year, the following journal entry will be passed for elimination of unrealized profit (creation of stock reserve):

Profit and Loss Account                      Dr.  
     To Stock Reserve

(Being a provision made for unrealized profit included in closing inventory)

In the beginning of the next accounting year, the aforesaid journal entry will be reversed as under:

Stock Reserve Dr.  
 To Profit and Loss Account

(Being provision for unrealized profit reversed.)

**Disclosure in Balance Sheet:** The unsold closing inventory acquired from another department will appear on the assets side of the balance sheet as under:

(An extract of the assets side of the balance sheet)

Current assets	xxx
Inventory	xxx
Less: Stock reserve	<u>xxx</u>
	<u>xxx</u>

**7. Memorandum Stock and Memorandum Mark up Account Method**

Under this method, goods supplied to each department are debited to a Memorandum Departmental Stock account at cost plus a 'mark up' (loading) to give the normal selling price of the goods. The sale proceeds of the department are credited in Memorandum Departmental Stock account and amount of 'Mark up' is credited to the Departmental Mark up Account. When it is necessary to reduce the selling price below the normal selling price, i.e., cost plus mark up, the reduction (mark down) is entered in the Memorandum Stock account as well as in the Mark up account. This method helps to achieve effective control of stock movements of various departments.

**Problems**

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

	Dept. A	Dept. B
	Rs.	Rs.
Opening stock	9000	8400
Total purchases	27000	21600
Total sales	42000	36000
Closing Stock	10800	4800
Credit purchases	17000	10600
Credit sales	5000	6000

2. Prepare departmental trading, profit and loss account for the year ended 31.12.2014.

	Dept. A Rs.	Dept. B Rs.
Stock (January)	40000	-
Purchases from outside	200000	20000
Wages	10000	1000
Transfer from department A	-	50000
Stock at cost to department (December)	30000	10000
Sales to outsiders	200000	71000

The stock of B represents goods sent by a at 25% on above cost. Administrative expenses Rs.15000 is to be should among departments as per ratio 4:1.

3. A firm has two departments A and B. B department purchased all goods from A at its selling price. From the following information, prepare trading and profit and loss account for the year ended 31.12.2005

	Dept. A Rs.	Dept. B Rs.
Stock as on 1.1.2015	100000	25000
Purchases	1000000	7500
Sales	11000000	225000
Transfer to B department	-	30000
Stock as on 31.12.2015	100000	3000
Expenses:		
Manufacturing	-	
Selling	10000	3000

The stock on B department consists 75% stock on A . The gross profit of A department in 2004 is the same rates for 2004 is the same rate for 2005 also. General expenses for 2005 is Rs.45000

4. From the following, prepare departmental trading and profit and loss account for the year ended 31<sup>st</sup> December 2000, apportioning expenses on a suitable basis.

Stock on 1.1.2000	: Dept. A -5400,	Dept. B - 4900
Purchases	: Dept. A - 9800	Dept. B - 7350
Sales	: Dept. A - 16200	Dept. B - 13250
Closing stock	: Dept. A - 2748	Dept. B - 2401
Wages	: Dept. A - 1340	Dept. B - 240
Carriage inward	: Rs.469	
Discount allowed	: Rs. 441	
Discount Received	: Rs.133	
Advertisement	: Rs.783	

5. The following purchases were made by a business house having three

departments.

Dept. A	-	1000 units	} at a total cost of Rs.1,00,000
Dept. B	-	2000 units	
Dept. C	-	2400 units	

Stock on 1<sup>st</sup> January were:

Dept. A	-	120 units
Dept. B	-	80 units
Dept. C	-	152 units

Sales were:

Dept. A	-	1020 units at Rs.20 each
Dept. B	-	1920 units at Rs.22.50 each
Dept. C	-	2496 units at Rs.25 each

The rate of gross profit is same of each case. Prepare departmental trading accounts.

6. The following purchases were made by a business house having three departments.

Dept. A	-	200 units	} at a total cost of Rs.1500
Dept. B	-	1400 units	
Dept. C	-	400 units	

Stock in the beginning

Dept. A	-	100 units
Dept. B	-	400 units
Dept. C	-	60 units

Sales were:

Dept. A	-	180 units at Rs.15 each
Dept. B	-	1500 units at Rs.18 each
Dept. C	-	450 units at Rs.6 each

The rate of gross profit is same of each case. Prepare departmental trading accounts.

7. A firm had two departments, cloth and readymade garments. The garments were made by the firm itself out of cloth supplied by the cloth department at its usual selling price. From the following figures, prepare departmental trading and profit and loss account for the year ended 31.3.2004.

	Cloth Dept.	Readymade Dept.
Opening stock on 1.4.2003	300000	50000
Purchases	2000000	15000
Sales	2200000	450000
Transfer to readymade garments dept	300000	-
Expenses	-	60000
Selling	20000	6000
Stock on 31.3.2004	200000	60000

The stock in the readymade garments departments may be considered as consisting of 75% cloth and 25% other expenses. The cloth department

earned gross profit @ 15% in 1992-93. General expenses of the business as a whole came to Rs.110000.

8. Prepare departmental Trading and profit and loss account.

	Cloth Dept. Rs.	Readymade Dept. Rs.
Opening stock	121600	86400
Purchases	592000	552000
Wages expenses	2000	8000
Sales	800000	640000
Closing stock	142400	124800
		Rs.
Carriage inwards		22880
General Expenses		92800
Rent		48000
Advertising		64800
Selling expenses		57600
Discount Received		11400

Other information:

1. Goods transferred from cloth department to readymade department Rs.40000
  2. Area of the two departments are in the ratio of 3:2
  3. General expenses are to be divided equally between the 2 departments.
9. The Trading and profit and loss account of a concern having three departments is as follows for the year ending 31.3.2013

	Rs.		Rs.
Purchases:		Sales:	
Television (A)	140700	Televisions (A)	150000
Radios (B)	90600	Radios (B)	100000
Spare parts for Service (C)	64400	Receipts for servicing (C)	25000
Salaries and wages	48000	Closing Stock:	
Rent	10800	Televisions (A)	60100
Sundry Expenses	11000	Radios (B)	20300
Profit	34500	Spare parts (C)	44600
	400000		400000

Prepare departmental accounts for the departments A, B and C taking into accounts the following information:

- a) TV and Radio are sold in the shop and servicing is done in the workshop.
- b) Salaries and wages comprise the following  
Shop -  $\frac{3}{4}$  ; Workshop  $\frac{1}{4}$   
It was decided to allocate shop salaries, wages in the ratio 1:2 between A and B
- c) Workshop rent is Rs.500 per month. Rent of the shop is divided equally

between A and B

- d) Sundry expenses are to be distributed on the basis of turnover of the each department.

10. ABC firm has two departments, X and Y. Y department manufactured out of goods supplied by the X Department at its usual selling price. From the following, prepare departmental trading, profit and loss account for the year ending 31.12.91.

	X Dept.	Y Dept.
Opening stock	360000	60000
Purchases	2900000	20000
Sales	3500000	700000
Transfer to Y dept	450000	-
Manufacturing Expenses	-	140000
Closing Stock	100000	48000

General expenses for both the departments were Rs.120000. The stock in the Y Department may be considered as consisting of  $66\frac{2}{3}\%$  of X department goods and  $33\frac{1}{3}\%$  of other expenses. The X department earned profit @18% in 1990.

## UNIT - 2 HIRE PURCHASE AND INSTALMENT

### Introduction

With an increasing demand for better life, the consumption of goods has been on the expanding scale, but, this has not been backed up by adequate purchasing power, transform in to effectual demand, i.e., actual sale at set or settled prices. This has created the market for what is called hire purchase.

### Nature of Hire Purchase

Under the hire purchase system the hire purchaser gets possession of the goods at the outset and can use it, while buying for it in instalments over a specific period of time as per the agreement. However, the ownership of the goods remains with the hire vendor until the hire purchaser has paid all the instalments. Each installment paid by the hire purchaser is treated as hire charges for using an asset. In case he fails to pay any of the instalments the hire vendor will take back his goods without compensating the buyer, i.e., the hire vendor is not going to pay back a part or whole of the amount received through instalments till the date of default from the buyer.

### Special Features of Hire Purchase

1. **Possession:** The hire vendor transfers only possession of the goods to the hire purchaser immediately after the contract for hire purchase is made.
2. **Instalments:** The goods are delivered by the hire vendor on the condition that a hire purchaser should pay the amount in periodical instalments.
3. **Down Payment:** The hire purchaser generally makes a down payment i.e., an amount on signing the agreement.
4. **Constituents of Hire purchase instalments:** Each installment consists partly of a finance charge (interest) and partly of a capital payment.
5. **Ownership:** The property in goods is to pass to the hire purchaser on the payment of the last installment and exercising the option conferred upon him under the agreement.
6. **Repossession:** In case of default in respect of payment of even the last installment, the hire vendor has the right to take the goods back without making any compensation.

### Terms used in Hire Purchase

1. **Hire Vendor:** Hire vendor is a person who delivers the goods along with its possession to the hire purchaser under an hire purchase agreement.
2. **Hire Purchaser:** Hire purchaser is a person who obtains the goods and rights

to use the same from hire vendor under an hire purchase agreement.

3. **Cash Price:** Cash price is the amount to be paid by the buyer on outright purchase in cash.
4. **Down Payment:** Down payment is the initial payment made to the hire vendor by the hire purchaser at the time of entering in to hire purchase agreement.
5. **Hire Purchase Installment:** Hire purchase installment is the amount which the hire purchaser has to pay after a regular interval up to certain period as specified in the agreement to obtain the ownership of the asset purchased under a hire purchase agreement. It comprises of principal amount and the interest on the unpaid amount.
6. **Hire purchase price:** It means the total sum pay able by the hire purchaser to obtain the ownership of the asset purchased under hire purchase agreement. It comprises of cash price and interest on outstanding balances.

### Distinction between hire purchase and instalment system

Basis	Hire purchase system	Instalment system
Nature of agreement	It is an agreement of hiring with option to buy	It is an agreement of sale
Transfer of ownership	Ownership is transferred on payment of final installment	Ownership is transferred on signing of the agreement
Names of the parties	The buyer is called hirer and sellers as owner or hire vendor	The parties involved are called buyer and seller
Relationship	The relationship of hirer and hire vendor is that at bailor and bailee	The relationship between the buyer and seller is that of a debtor and creditor till last instalment is paid.
Repossession of goods	The hire vendor can repossess the goods if installment is not paid	Seller cannot repossess the goods.
Termination of agreement	The hirer can terminate the agreement by returning the goods	The agreement cannot be terminated.



## Accounting Record

	Transactions	Buyer books	Vendor books
(i)	When an asset is purchase on HP	Asset account To Hire vendor	Dr. Hire Purchaser A/c To hire sales a/c
(ii)	For cash down payment on delivery	Hire vendor a/c To cash/Bank a/c	Dr. Cash/Bank a/c To Hire purchaser a/c
(iii)	For interest Due at the end of the year	Interest a/c To Hire Vendor a/c	Dr. Hire Purchaser's a/c To interest a/c
(iv)	For the payment of First installment	Hire vendor a/c To Bank a/c	Dr. Cash/Bank a/c To Hire Purchaser's a/c
(v)	For Depreciation charge	Depreciation a/c To Asset a/c	Dr. No Entry
(vi)	For transfer of interest and depreciation to profit and loss a/c	Profit and Loss a/c To Interest a/c To Depreciation a/c	Dr. Interest a/c To Profit and Loss a/c

Note: 1. Entries (iii),(iv), (v) and (vi) will be replaced in subsequent years in Buyers books.

2. Entries (iii) to (v) will be replaced in subsequent years in vendors books.

## Default and Repossession

**Default:** If the hire purchaser fails to make payment of any installment, it is called default. Unless he regularizes the matter, the hire vendor can take back the goods into his possession after default.

**Repossession:** The hire vendor has the right to take away the goods sold on hire purchase in the event of default made by the hire purchaser. The hire vendor can repair or recondition the reposed goods and sell them to anyone else.

### Type of repossession

- Complete repossession: The hire vendor may take away all the goods on which there is default of interest.
- Partial repossession: The hire vendor may take away only a portion of the goods on which there is a default of instalments.

### Calculation of interest:

- When the rate of interest, the cash price and the instalments are given.**

Under this method, the interest is to be calculated on the outstanding balance of the cash price at the stipulated rate. When interest is component is deducted from installment, the balance represents the amount paid in reduction of cash.

**b. When total cash price and instalments are given but rate of interest is not given.**

When the rate of interest is not given, the interest included in each installment will be calculated on the basis of the hire purchase price outstanding in the beginning of each year.

**c. When rate of interest and instalments are given, but total cash price is not given.**

When the amount of each installment which includes interest is given and rate of interest is also given, cash price is found out in the following manner.

a. First of all find out cash price of the last installment.

Amount of installment X Rate of interest/100+Rate of interest

b. Cash price of the last installment + amount of Prior installment)

X Rate of interest/100+Rate of interest

c. The same process may be repeated for earlier instalments.

**d. When rate of interest and total cash price are given but the installment price is not given.**

In this method is also, the interest is to be calculated on the outstanding balance of the cash price at the stipulated rate. Then cash price paid is deducted from the total cash price and interest is calculated for the next period falling between the dates payment of first installment and second installment.

**e. Calculation of cash price by annuity method:**

When in place of cash price, hire purchase price and annuity rate are given, the cash price is calculated by multiplying the amount of installment with the annuity factor given and adding down payment to the product.

## **Installment purchase system**

### **Meaning**

Under installment purchase system, the property in goods passes to the purchaser immediately on signing the contract. In short, sale is outright but payment is made by different instalments. The amount of installment and the interest payable are determined at the time of signing the contract.

### **Problems:**

1. 'S' purchased a machine on 1.1.14 on hire purchase system. The cash price of the machine is Rs.22350, payable Rs.6000 on signing the agreement and the balance in three equal annual instalments of Rs.6000 at the end of each year. Vendor charges interest at 5% p.a. You are

required to calculate the interest included in each installment.

2. On 1.1.08, X purchased machinery on Hire purchase system. The payment is to be made Rs.4000 down and Rs.4000 annually for three years. The cash price of the machinery is Rs.14900 and the rate of interest is 5%. Calculate the interest in each year's instalment.
3. Kannan purchases a vehicle from X company on 1.1.98 paying Rs.10000 as advance and agrees to pay Rs.10000 every year for three years. The cash price is Rs.37250. X company charged interest @5% p.a. Calculate the interest in each year's instalment.
4. X purchased a typewriter on hire purchase system. As per terms, he is required to pay Rs.800 down; Rs.400 at the end of the first year, Rs.300 at the end of the second year and Rs.700 at the end of the third year. Interest is charged 5% p.a. Calculate the total cash price of the typewriter and the amount of interest payable on each instalments.
5. Mr. Ravi purchased 4 cars on hire purchase system paying Rs.15,000 down payment. The balance to be paid on 3 equal instalments of Rs.15000 plus interest. Interest on due is 5% p.a. cash price was Rs.60,000. Calculate interest for the year.
6. X purchases a car on hire purchase system. The total cost price of the car is Rs.15980 payable Rs.4000 down and three instalments of Rs.6000, Rs.5000 and Rs.2000 payable at the end of first, second and third year respectively. Interest is charged at 5% p.a. You are required to calculate interest paid by the buyer.
7. On 1.1.2006, Govind purchased machinery under hire purchase system. The down payment was Rs.60,000 and the balance is payable in three annual instalments of Rs.60,000 each. Interest is charged at 10% p.a. Calculate cash price.
8. Mr. M purchases a car under HP system. The terms of assessment were: Cash down Rs.12000; Five annual instalments of Rs.7700 each, the first to commence at the end of twelve months from date of cash down payment; interest at 10% p.a. is charged by the seller. You are required to calculate interest paid by the buyer to the seller each year and also the cash price of the car.
9. X purchase a radiogram on hire purchase system. He agreed to pay Rs.800 down. Rs.400 at the end of 1<sup>st</sup> year. Rs.300 at the end of second year and Rs.700 at the end of third year. Interest is charges at 5% p.a. calculate the cash price of the radiogram and interest paid with each instalment.
10. Mr.N purchased a VCR on hire purchase system on April 1, 1999. As per the terms, he is required to pay Rs.8000 down; i.e., on April 1, 1999, Rs.7000 on March 31,2000; Rs.7000 on March 31, 2001 and Rs.6000 on

March 31,2002. Interest is charged at 20% per annum. You are required to calculate total cash price of the VCR and interest paid with cash instalment.

11. Mr. X purchased a machine on hire purchase system Rs.3000 being paid on delivery and the balance in five instalments of Rs.6000 each, payable annually on 31<sup>st</sup> December. The cash price of the machine was Rs.30,000. Calculate the amount of interest for each year.
12. On 1.1.12. Mr. H bought some trucks under hire purchase system for Rs.51000 payable by three equal instalments combining principal and interest. The latter being a normal rate of 5% per annum. Calculate the cash price. (The Present value of an annuity of one rupee for three years at 5% is Rs.2.72325).
13. A purchase a machine under hire purchase system by annual instalment of Rs.10000 over a period of 5 years . The seller charges interest at 4% p.a. on yearly balances. Calculate the cash price as per annuity table value Re.1 for 5 year at 4% is 4.45818.
14. The Madras company purchased a machine from Bombay company on instalment system on 1.1.92. paying cash Rs.6000 and agreeing to pay three further instalments of Rs.6000 each on 31<sup>st</sup> December of every year. The cash price of machinery is Rs.22350. Bombay company charges interest @ 5% p.a. and Madras company writes of depreciation @ 10% p.a. on reducing balance method. Show ledger accounts in the books of Madras Company.
15. Mr. P. purchased 4 car of Rs.14,000 each on 1.1.2012 under hire purchase system. The hire purchase price for all the 4 cars was Rs.60,000 to be paid as Rs.15,000 down payment and 3 equal instalments of Rs.15000 each at the end of each year interest is charged at 5% p.a.. The buyer depreciates the car at 10% p.a. on straight line method. From the above particulars show the ledger accounts in the books of hire vendor a/c.
16. On 1.1.2012 D & Co., purchased a machine on hire purchases basis. The total amount payable being Rs.42700. payment was to be made Rs.12,000 on that date and balance in three half yearly instalment of Rs.11400, Rs.10900 and Rs.8400 commencing from 30<sup>th</sup> June 2012. The vendor charged interest @10% p.a. calculate on half yearly rests. D & Co., close their books annually on 30<sup>th</sup> June and provide depreciation @ 10% p.a. on reducing balance method. Determine the cash price of the machine and show the relevant accounts in the books of D & Co.
17. K purchased a truck for Rs.160000 under hire purchase system. The spot cash was Rs.40,000 and the annual end instalments were I Rs.46000; II Rs.44000 and III Rs.42000. Interest was charged @5%. K depreciates the truck @ 10% p.a. on diminishing balance method. K

having paid down payment and I instalment could not pay the second instalment. The seller took possession of truck and after spending Rs.4000 on repairs, sold it Rs.91500. show the ledger accounts of both parties.

18. Delhi Transport Ltd purchased 3 trucks costing Rs.40,000 each from Bombay motors under hire purchase system. Payment to be made Rs.30,000 down and the balance in three equal instalments together with interest at 5%. Delhi transport writes off depreciation at 20% diminishing balance method. It paid the first instalment but could not pay the next. Give the ledger accounts of both parties, if the vendor took over all the assets back. It paid Rs.5,800 for renovation and sold for Rs.70000.
19. On 1.1.90 National Transport Company purchased from Metro motors five trucks costing Rs.40000 each on hire purchase system. It was agreed that Rs.50000 should be paid immediately and the balance in three instalments of Rs.60000 each at the end of each year. The Metro Motor charges interest @ 10% p.a. The buyer depreciates trucks at 20% on the diminishing balance method. The buyer has paid cash down and two instalments but failed to pay the last instalment. Consequently, the Methro Motors repossessed three trucks against the amount due. The trucks repossessed were valued on the basis of 30% written down value. The trucks repossessed were sold by Metro Motors for Rs.60000 after necessary repairs amounting to Rs.10000. Open the necessary ledger account in the books of both the parties.
20. Transport Ltd., purchases 3 buses costing Rs.75000 each. Under hire purchase system, payment was to be made as Rs.45000 down and the balance as 3 equal instalments together with interest 12% p.a. Transport ltd wrote off depreciation @ 20% on written down value method if paid the first instalment but could not pay the next. The seller, therefore left one bus and taking the remaining after charging depreciation at 30% on straight line method. Show the necessary ledger accounts of both parties.
21. Mr. Palani purchased 4 cars of Rs.14000 each by hire purchase system. The HP price for all the 4 cars was Rs.60000 to be paid Rs.15000 down payment and three instalments of Rs.15000 each at the end of each year. Interest is charged at 5% p.a. Buyer depreciates cars at 10% p.a. on the Straight line method.

After having paid the down payment and the first instalment, the buyer could not pay the second instalment and the seller took possession of three cars at an agreed value to be calculated after depreciating cars at 20% p.a. on WDV method. One car was left with the buyer. Seller, after spending Rs.1200 on repairs sold all the 3 cars to X for Rs.35000. Open ledger accounts in the books of both parties.

## UNIT - III

# SELF BALANCING LEDGERS

### MEANING

Self Balancing Ledger System implies a system of ledger keeping which classifies ledgers as per nature of transactions, namely, Sales ledger, Bought ledger, General ledger, etc. and also makes them to balance independently. With rise in the number of transactions the size of the ledger becomes hefty due to large number of accounts. This creates problem in detection of errors. To overcome this, the system of multiple ledgers is deployed. It involves splitting of single ledger. Generally three ledgers, namely debtor ledger, creditor ledger and main ledger (containing remaining accounts) are prepared. In this Unit we shall discuss the self balancing ledger system and its advantages. Also we shall illustrate system.

### **Advantages of Self Balancing System**

When a number of ledgers are kept by a concern and if their balances do not tally, the accountant would have to face great difficulty in tracing book-keeping errors, responsible for the non-agreement of the Trial Balance. In order to reduce to a minimum the trouble and time involved in locating the errors, sometimes the system of self-balancing or sectional balancing of ledger is employed.

Quite often the debit and credit entries relating to a transaction are posted in different ledgers e.g. when goods are sold on credit, the Sales Account will be credited in the General Ledger but the corresponding debit will be made in the customer's account in the Personal Ledger. In such a case for ascertaining the correctness of the posting in either of the ledgers it will be necessary to take out balances in both the ledgers; thus a mistake in one ledger will require checking of the balances in the others as well.

Such a position would be avoided if every ledger is made independent of the other by the converse aspect of entries in each ledger being posted in totals to the Control Account set up in the ledger itself. If this is done the correctness of individual balances in each ledger would be verified extracting its balances and agreeing them with the balances of the Control Account. A ledger that has a Control Account set up in it, is referred to as a self balancing ledger. It connotes that it is capable of being balanced independently, the balance in the Control Account being equal to that of the individual balance.

### **The advantages of this system are:**

- (i) It fixes the responsibility of the ledger keeper, as to the balancing of the ledger or ledger under his/her charge and the person responsible for the mistake can be called upon to work overtime to locate it. Errors are localised.

- (ii) It enables preparation of interim accounts without personal ledgers having to be balanced.
- (iii) The figures of total debtors or creditors is readily available.
- (iv) It is instrumental in strengthening the internal check.

### **Sectional Balancing**

A really simple way to prove the accuracy of say, the Sales Ledger would be to maintain a Total Debtors account in the General Ledger. It would mean that whereas accounts of Individual customer would be maintained in the Sales Ledger, in the General Ledger the Total Debtors account would be posted by the (monthly) totals of various transactions with total credit sales, total amount received from credit customers, total discount allowed to them, total returns inwards, total bills receivable received; etc. The balance in the Total Debtors Account should be equal to the total of balances shown by the accounts of individual customers. If it is so, the Total Debtors Account as well as individual customers' account may be taken as correct. A difference would show that there is some error somewhere.

In the same way, the accuracy of individual supplier account may be checked by comparing total of their balances with the balance in the Total Creditors Account. The double entry would be complete in the General Ledger itself. For instance, for credit sales– Total Debtors Account would be debited and Sales Account credited. For goods returned to suppliers– Total Creditors Account would be debited and Return Outward Account credited.

The "total accounts" are also known as adjustment accounts or control accounts since they prove the accuracy of the subsidiary (Sales or Bought) ledgers.

### **Various Ledgers to be Maintained in Self-balancing Ledger System**

In the Sales or Bought ledgers double entry is not completed as in the system outlined above, a separate trial balance cannot be taken out from these ledgers. If these ledgers are maintained in such a way as to offer separate trial balances, the system would be known as "Self-balancing". In such a case "General Ledger Adjustment Account" is prepared in each of the subsidiary ledgers. The General ledger would have:

- (i) Bought Ledger Adjustment Account  
(in reality, Total Creditors Account) and
- (ii) Sales Ledger Adjustment Account (in reality, Total Debtors Account)

These accounts are known as Control Accounts. The system on which entries are made in the adjustment account is described below:

## **Bought Ledger**

For recording a purchase it will be observed that the initial entry made is to the debit of the Purchases Account in the General Ledger and to credit the Supplier's Account in the Bought Ledger. If it is desired to make the General and Bought Ledger self-balancing a further entry would be made debiting the General Ledger Adjustment account in the Bought Ledger, and crediting the Bought Ledger Adjustment Account in the General Ledger with the total of purchases.

Again, if part of the materials purchased is returned and the balance due is paid the entries made would be; debit the personal account of the Supplier in the Bought Ledger with the value of goods returned as well as the amount paid and credit Return Outwards Account in the General Ledger with the value of goods returned and Bank Account with the amount paid. Further, in consonance with the system of self-balancing an additional entry should be made crediting the General Ledger Adjustment Account in the Bought Ledger and debiting the Bought Ledger Adjustment Account in the General Ledger with the aforementioned amount.

Similarly entries can be made in case of bills payable, discount in price etc. It should be particularly noted that the balance in the Bought Ledger Adjustment Account in the General Ledger will be equal to that in the General Ledger Adjustment Account in the Bought Ledger but on the opposite side. Also, the Bought Ledger Adjustment Account shall self-balance the General Ledger.

If there are several Bought Ledgers in use each such ledger will have a General Ledger Adjustment Account and, in the General Ledger there will be Bought Ledger Adjustment Account separately for each of these ledgers.

## **Sales Ledger**

For recording a credit sale, it will be observed that the original entry made is to debit the customer's account in the Sales Ledger and to credit the Sales Account in the General Ledger. But to self-balance the General and Sales Ledgers a further entry is made, debiting the Sales Ledgers Adjustment A/c in the General Ledger and crediting the General Ledger Adjustment Account in the Sales Ledger with the total of sales.

Again, when a part of the goods sold is received back and the balance realised, the entries made are to debit the Sales Return account with the value of goods returned as well as Bank Account with the amount collected, and credit their total to personal account of the customer in the Sales Ledger. Further to self-balance the ledgers an additional entry is made to debit the General Ledger Adjustment Account in the Sales Ledger and credit the Sales Ledger Adjustment Account in the General Ledger with the aforementioned amounts.



### **General Ledger**

As stated above, each time an entry is made in the Bought and Sales Ledger for self-balancing, the contra effect of the entries is shown in the Bought Ledger or Sales Ledger Adjustment Account set up in the General Ledger. The accounts represent the Total Debtors and Creditors Accounts in a summarised form and thus serve to self-balance the General Ledger. As a result no additional entries are required to make the General Ledger self-balancing.

It may be mentioned that in regard to several other accounts, which do not relate either to customers or suppliers, no additional entry is necessary under the self-balancing scheme since, both aspects of every transaction already exist in one or other of the accounts contained in the General Ledger such as cash sales, discounting of bills, recovery of bad debts written off, creating provision for bad debts etc.

### **Rectification of Errors under Sectional Balancing System**

#### **Rectification of errors before opening Suspense Account**

If the error affects the accounts of Debtors or Creditors without affecting their total, it is rectified by adjusting the accounts of Debtors or Creditors itself. However, if it affects the totals of Debtors or Creditors, the additional entries are to be made in the main ledger through Total Debtors and Total Creditors Account. The same is discussed with the following examples:

1. If goods sold to X and wrongly posted in the account of Y, The trial balance of main ledger will tally. This error can be rectified in Debtors' ledgers by debiting X's account and crediting Y's account.
2. If goods sold to X are not recorded in the Sales Book, it means under reporting of Sales. It means sectional balancing entry will be passed with lower amount of sales and Total debtors. The error can be rectified by debiting the total debtors account and crediting the sales account in the main ledger.
3. If goods sold to X are omitted to be recorded in his account only in the debtors ledger, main ledger will tally. This error is rectified by debiting X's account by writing "to error in omitting to record sales".
4. If goods sold to X are recorded in the debtors ledger and sales account is properly credited at the end of the period, but omitted to debit the total debtors account. The error can be rectified by writing in debit side of total debtors account "To error in omitting to record sales".

#### **Rectification of errors under Self Balancing system**

The rectification of errors will be done in the usual manner as in single ledger system but there is one difference that is, whenever the totals of

Debtors or Creditors are affected, rectification will be done by making additional self balancing entries. In this case, rectification of errors in the above examples will be done as follows:

1. For rectification of errors in Debtors ledger - X's account will be debited and Y's account will be credited.
2. The rectification of error will be made by crediting sales account by writing 'By error in omitting the sales' and additional entry of self balancing with the same amount will be made, namely,
 

Debtor Ledger Adjustment A/c	Dr	(In main ledger)
To General Ledger Adjustment A/c		(In debtors ledger)
3. The error is rectified by debiting X's account by writing 'To error in omitting to record sales.'
4. This can be rectified by self balancing entry with the same amount, namely, Debtor Ledger Adjustment A/c Dr (In main ledger)
 

To General Ledger Adjustment A/c		(In debtors ledger)
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**Rectification of errors after opening suspense account**

The method of rectification of error will be same under sectional and self balancing system, with the exception that the entries which were corrected unilaterally will be corrected through suspense account. In the above examples rectification of error will be done as follows :

**Under Sectional Balancing System-**

1. Same as above
2. Same as above
3. Same as above
4. Total Debtors A/c Dr. (In main ledger)
 

To Suspense A/c		(In main ledger)
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**Under Self Balancing system-**

1. Same as above
2. (a) Suspense A/c Dr. (In Debtors ledger)
 

To Sales A/c		
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- (b) Debtors ledger Adjustment A/c Dr. (In main ledger)
 

To General Ledger Adjustment A/c		(In Debtors Ledger)
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3. X's A/c	Dr.	(In Debtors Ledger)
To Suspense A/c		(In Debtors Ledger)
4. (a) Debtors ledger Adjustment A/c	Dr.	(In main ledger)
To Suspense A/c		(In main ledger)
(b) Suspense A/c	Dr.	(In Debtors ledger)

### **Ruling of Subsidiary Books**

Whenever there are several Bought or Sales Ledgers in use, various books of original entry, e.g., Purchases Books, Sales Books, Cash Book and Journal are suitably ruled in a manner that they readily show the monthly total of the transactions posted in various ledgers, on the basis of which the self-balancing entries, can be recorded.

### **Secret Account**

At time it may be considered necessary to keep the operation of certain accounts, e.g., partners' capitals, loans, deposits etc., secret from members of the staff except the senior officials. In such a case, these accounts would be segregated into a Private Ledger and posting will be made in the ledger by a confidential clerk, under the direct supervision of the Chief Accountant. Also a General Ledger Adjustment Account will be set up in the Private Ledger and a Private Ledger Adjustment Account in the General Ledger. In this way, though the individual entries in the accounts kept in the Private Ledger will be revealed to the accounting staff, their total effect will be kept secret. In case individual accounts also are desired to be kept secret separate Cash Book and Bank Account would be maintained; this would ensure complete secrecy.

When such a system is first started, the assets and other debit balances are transferred to the Private Ledger by crediting the respective accounts in the General Ledger and the Private Ledger Adjustment Account is debited with their total. The opposite are the entries made when credit balances are transferred. Also, if it is desired to transfer a part of the Bank Balance to Private Bank Account, Bank Account is credited and the Private Ledger Adjustment Account is debited. From the Private Bank Account, partners will be able to draw amounts required by them and to pay interest on deposits and loans at whatever rates they may please without the fact being disclosed to the staff.

When accounts are closed at the end of the year, the revenue accounts are closed off by transfer of the Private Ledger Adjustment Account and corresponding entries are made in the Private Ledger by debit or credit to

the General Ledger Adjustment Account. Afterwards all the balances so transferred, along with those already in the Private Ledger, are transferred to the Profit & Loss Account in the Private Ledger. In this way, complete secrecy is maintained regarding the operation of accounts in the Private Ledger; also the amount of profit made by the concern is not disclosed to the staff.

### PROBLEMS

1. Dinesh & Co. have three ledgers in use viz, a Debtors Ledger, a Creditors Ledger and a Normal Ledger which are all kept on the system of self-balancing. From the following particulars prepare the adjustments account that would appear in each of these ledgers.

2011		Rs.
Jan. 1	Balance of Sundry Debtors	16,000
	Balance of Sundry Creditors	18,500
Jan. 31	Credit Purchases	4,500
	Credit Sales	9,800
	Cash Sales	1,500
	Paid to Creditors	9,875
	Discount allowed by them	325
	Cash received from debtors	7,800
	Allowed them discount	200
	Bills payable accepted	1,500
	Bills receivable received	3,000
	Returns inwards	875
	Returns outwards	600
	Rebates allowed to debtors	275
	Rebates allowed to creditors	150
	Provision for Doubtful Debts	320
	Bad Debts	450
	Bills Receivable dishonoured	375

2. From the following particulars as extracted from the books of Messrs Kulkarni Brothers, who keep a Debtors' Ledger, a Creditors Ledger and a General Ledger on the self-balancing system, show how the General Ledger Adjustment Account will appear in the Debtor's Ledger and the creditors' Ledger.

	Rs.
Debtors' Balance on 1st January, 2010	91,500
Creditors, Balance on 1st January, 2010	1,09,800
Transactions for the year 2010 :	
Credit purchases	41,000
Credit sales	45,400
Returns Inwards	800
Returns Outwards	1,200
Cash received from customers	51,000
Discount allowed to customers	900

Cash paid to creditors	61,400
Discount received	1,340
Acceptances received	17,000
Acceptances given	24,000
Bills Receivable dishonoured	2,400
Bills Payable dishonoured	6,000
Bad debts written off	5,000
Sundry charges debited to customers	690
Allowances from creditors	550
Transfer from Debtors Ledger	1,290

3. M. Govind keeps self-balancing ledgers. Record the following transactions in the General Ledger Adjustment Account in the Sales Ledger :

1.4.2010 Received Rs. 475 from Mr. X in full settlement. He was allowed a discount of Rs.25.

2.4.2010 Received Rs.2,000 from Mr. Y towards his dues in full.

3.4.2010 Goods supplied to Mr. T. Rs.700 and received Rs.300 after adjustment of the advance of Rs.400.

4.4.2010 Bad debts recovered from Mr. Q ` 1,000.

5.4.2010 Goods sold to the following :

Mr. A Rs. 1,000

Mr. B Rs.1,500

Mr. C Rs. 2,000

15.4.2010 Mr. P paid ` 750 towards dues. Balance thereafter due was ` 250.

25.4.2010 Amount received from the following :

Mr. A Rs. 750

Mr. B Rs. 1,000

Mr. C Rs. 2,000

30.4.2010 Advance received from Mr. R for supply Rs. 2,000.

4. From the following particulars, prepare the relevant adjustment account as would appear in the General Ledger of Mr. Vasu for the month of March, 2011:

1 Purchase from Mr. X Rs. 2,000

2 Paid Rs.1,600 after adjusting the initial advance in full to Mr. X.

3 Paid Rs.1,000 to Mr. R towards the purchases made in February in full.

13 Paid advance to Mr. Y Rs.3,000

14 Purchased goods from Mr. A Rs.4,000

25 Returned goods worth Rs.500 to Mr. A.

26 Settled the balance due to A at a discount of 10 per cent.

27 Goods purchased from Mr. Y Rs.2,500 against advance paid on 13th.

- 28 Received at bank the advance from Mr. P paid on 28 February, 2011, Rs. 2,000.
- 29 Purchased from B Rs.2,000.
- 30 Goods returned to Q Rs.750. The goods were originally purchased for cash in February..

**5. The following particulars are obtained from books of a Self Ltd. for the year ended 31st March, 2011.** You are required to prepare the Total Debtors Account and Total Creditors Account.

			Rs.
Cash Sales	25,000	Bills Receivable dishonoured	2,500
Credit Purchases	2,80,000	Return Inward	8,500
Collection from Debtors	4,25,000	Payments to creditors	1,62,000
Bills Receivable drawn	20,000	Discount allowed	3,000
Discount Received	2,500	Debtors' cheque returned dishonoured	7,500
Cash Purchases	12,000	Credit Sales	4,90,000
Bills Payable paid	6,500	Bills Receivables collected	10,000
Recovery of Bad Debts	1,500	Return outward	3,700
Bills Receivable discounted with Bank	8,000	Bills Receivable endorsed to creditors	7,900
Interest charged on overdue	1,200	Overpayments refunded by suppliers	600
Customer's Accounts			
Endorsed Bills Receivable dishonoured (noting charges Rs.75)	5,500	Bad Debts	1,000
Bills Payable accepted	16,000	Opening Balances	
		Sundry Debtors	78,000
		Sundry Creditors	85,000

## ROYALTY ACCOUNTS

### Meaning:

Royalty is an amount payable by one person to another for the use of an asset or right or monopoly. It is periodical payment in the nature of rent made to a person for the right to use certain property such as mine, patent, copy right.

When an person (Lessor) having an exclusive right of some kind, surrenders it to another person (Lessee) in exchange for a certain amount calculated with reference to output or units produced or sold, such an amount is known as royalty.

### Minimum rent or Dead rent or Fixed Rent

This is guaranteed minimum amount payable by the lessees to the landlord irrespective of the actual output or sales of the lessee. It is the minimum amount which the lessee had to pay each period even when the mine is not worked at all or when the output for the period is below a certain quantity provided for in the agreement.

### Shortworkings

Excess of minimum rent over actual rent royalty paid to the landlord is known as shortworkings.

### Recoupment of shortworkings

The landlord permits the tenant to recoup the shortworkings in a specific period in future only out of the surplus royalties. The right over to recover short working as per agreed terms is known as recoupment of shortworkings.

### Method of recoupment

The right of recoupment can be fixed or flexible.

- a) **Fixed recoupment:** In this type of recoupment, the lessee may be allowed the privilege within a fixed number of years initially.
- b) **Flexible recoupment:** In this method of recoupment, any particular year's shortworkings may be allowed to be recovered in the subsequent two or three years.

### Shortworkings lapsed or written off

This is the amount of shortworkings unrecovered by the lessee within the agreed period of recoupment. It is a loss to the lessee and gain to the lessor.

**Journal entries:****In the books of Lessee or Tenant**

<b>Particulars</b>	<b>Debit</b>	<b>Credit</b>
<b>I. For royalty payable</b>		
<b>a. When there are no shortworkings</b>		
Royalty A/c	Dr.	
To Landlord's A/c		
<b>b. When there are shortworkings:</b>		
<b>i) If minimum rent account need not be shown:</b>		
Royalty A/c	Dr.	
Shortworkings A/c	Dr.	
To Landlord's A/c		
<b>ii) If minimum rent account is required:</b>		
Minimum Rent A/c	Dr.	
To Landlord's A/c		
Royalty A/c	Dr.	
Shortworkings A/c	Dr.	
To Landlord's A/c		
<b>II. For payment of cash:</b>		
<b>a. When there is no recoupment of shortworkings:</b>		
Landlord's A/c	Dr.	
To cash A/c		
<b>b. When there is recoupment of shortworkings:</b>		
Landlord's A/c	Dr.	
To cash A/c		
<b>III. For transferring royalty at the end of the year</b>		
Production or Profit and loss A/c	Dr.	
To Royalty A/c		





**Problems**

1. A company leased a colliery on 1.1.2002 with a minimum rent of Rs.20000. the royalty was at Rs.1.50 per ton, with a power to recoup the shortworing over first 3 years. The output were 2002 – 9000 tones, 2003 – 12000 tones, 2004 – 16000 tones, 2005 – 20000 tones. Pass the journal entries of lessee.
2. K ltd., took from P ltd., a lease of a colliery for a period of 25 years from 01.04.2006 on a royalty of Rs.25 per tone of coal extracted with a dead rent of Rs.220000 a year which power to recoup short workings during the first five years of the lease. The company close its books of account on 31<sup>st</sup> March every year. The output in the first five years of the lease was as follows:

Year	I	II	III	IV	V
Output (ton)	2000	3600	9000	15000	20000

Pass journal entries for the transactions relating to royalties for the 5 years in the books of K ltd.

3. Ram tiles ltd., leased a land on 1.1.2012 for 4 years the details are:  
 Minimum rent Rs.20,000  
 Royalty rate – Rs.1.50 per ton  
 Recovery of short working – the first three years of lease  
 Output: 2012 – 9000 tons; 12000 tons, 16000 tons, and 20000 tons.  
 Prepare ledger account of Ram ltd.
4. Akilan took a lease of mine for a period of 20 years. Royalty payable is Re.1 per ton subject to a minimum rent of Rs.12000 p.a. The shortworkings are recoupable during the first three years of the lease. The output was 1994-nil; 1995 – 4000 ton, 1996 – 20000 ton and 1997 - 40000 ton. Prepare an analytical table and necessary ledger accounts of Akilan.
5. Kovai Mine Company took from Akila a lease of a mine for a period of 25 years from 1.1.2000 on a royalty of Rs.5 per ton of mineral got with a minimum rent of Rs.20000 and power to recoup short worings during the first five years of the lease. The annual outputs were as follows.  
 2000 – 2000 tons; 2001 – 3000 tons; 2002 – 4000 tons; 2003 – 4500 tons; 2004 – 5000 tons.  
 Pass journal entries in the books of Kovai Mines Company.
6. Udaya tiles ltd., leased a land on 1.1.2002 for 4 years the details are:  
 Minimum rent Rs.8000 p.a. Royalty rate – Rs.0.50 per ton  
 Recovery of short working – next year only

Year	2002	2003	2004	2005
Output (tons)	2000	10000	20000	32000

Prepare ledger account of udaya ltd.

7. A owned the patent of a safety lock. B acquired the right to manufacture and sell locks for seven years on the following terms.

B to pay Raja a royalty of Rs.5 for each lock sold with a minimum annual payment of Rs.50000. Accounts are to settled on 31<sup>st</sup> December.

Year	2010	2011	2012	2013
Numbers	8000	9000	11000	18000

You are required to prepare necessary ledger accounts in the books of B which are closed annually on 31<sup>st</sup> December.

8. A colliery worked coal under a lease which provided for the payment of royalties at 50 paise per tone with a minimum rent of Rs.17000 per annum. Each year's excess of minimum rent over the actual royalties were recoverable during the subsequent three years.

The lease however stipulated that if in any year the normal rent was not attained due to strike, the minimum rent was to be regarded as have been reduced proportionately having regard the length of the stoppage.

The output was as follows

Year	2001	2002	2003	2004	2005	2006
Output (ton)	4000	28000	38000	46000	30000	50000

During the year 2005, there were stoppages due to strike lasting three months. Give necessary ledger accounts in the books of the colliery for each of the above years.

9. Raj took a colliery on lease. The dead rent was Rs.1500 a year, merging into a royalty for 35 paise per tone of caol raised, which the right to recover shortworkings out of royalties of two subsequent years from the period in which the shortworkings arose. The output realized was:

Year	I	II	III	IV	V
Output (ton)	2000	3000	5000	3000	2000

Give necessary ledger accounts for each of the five years in the books of Raj.

10. Ravi took a colliery on lease. The dead rent was Rs.750 a year, merging into a royalty of 35 paise per tone of coal raised with the right to recover

shortworkings out of royalties of two subsequent years from the period in which the short working arose. The output raised were

Year	I	II	III	IV	V
Output (ton)	1000	1500	2500	1500	1000

Give the necessary ledger accounts for each of the five years in the books of Ravi.

11. A company took a lease of mine from the company for a period 30 years from 1<sup>st</sup> January 1990 upon the terms of royalty of 50 paise per tone upon the output with a minimum rent of Rs.10000 in the first year and then increase every year by Rs.1000, till it reaches Rs.13,000, when it becomes fixed for all the coming years. A company was granted the right of recouping shortworkings of any 3 years in the subsequent years and not afterwards. The following was the production of the first 5 years.

Year	2011	2012	2013	2014	2015
Output (ton)	3000	18000	24000	30000	32000

Show journal entries in the books of A company. Assume there is no minimum rent.

## UNIT - 4

### FIRE INSURANCE CLAIM FOR LOSS OF STOCK AND LOSS OF PROFIT

#### Meaning of Fire

For purposes of insurance, fire means:

1. Fire (whether resulting from explosion or otherwise) not occasioned or happening through:
  - (a) Its own spontaneous fomentation or heating or its undergoing any process involving the application of heat;
  - (b) Earthquake, subterranean fire, riot, civil commotion, war, invasion act of foreign enemy, hostilities (whether war be declared or not), civil war, rebellion, revolution, insurrection, military or usurped power.
2. Lightning.
3. Explosion, not occasioned or happening through any of the perils specified in 1 (a) above.
  - (i) of boilers used for domestic purposes only;
  - (ii) of any other boilers or economisers on the premises;
  - (iii) in a building not being any part of any gas works or gas for domestic purposes or used for lighting or heating the building.

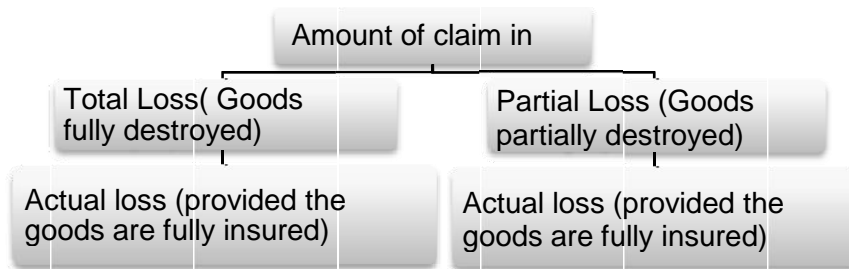
#### Claim for Loss of Stock

Fire insurance being a contract of indemnity, a claim can be lodged only for the actual amount of the loss, not exceeding the insured value. In dealing with problems requiring determination of the claim the following point must be noted:

- a. **Total Loss:** If the goods are totally destroyed, the amount of claim is equal to the actual loss, provided the goods are fully insured. However, in case of under insurance (i.e. insurable value of stock insured is more than the sum insured), the amount of claim is restricted to the policy amount.
- b. **Partial Loss:** If the goods are partially destroyed, the amount of claim is equal to the actual loss provided the goods are fully insured. However in case of under insurance, the amount of claim will depend upon the nature of insurance policy as follows:
  - I) Without Average clause:- Claim is equal to the lower of actual loss or the sum insured.
  - II) With Average Clause:- Amount of claim for loss of stock is

proportionately Reduced, considering the ratio of policy amount (i.e. insured amount) to the value of stock as on the date of fire (i.e. insurable amount) as shown below:

Amount of claim = Loss of stock x sum insured / Insurable amount (Total Cost)



Relevant points

- (i) Where stock records are maintained and such records are not destroyed by fire, the value of the stock as at the date of the fire can be easily arrived at.
- (ii) Where either stock records are not available or where they are destroyed by the fire the value of stock at the date of the fire has to be estimated. The usual method of arriving at this value is to build up a Trading Account as from the date of last accounting year. After allowing for the usual gross profit, the figure of closing stock on the date of the fire can be ascertained as the balancing item.

Memorandum trading account

Particulars	Amount	Particulars	Amount
To opening stock	xxx	By sales	xxx
To purchase	xxx	By stock on the date of fire (BF)	xxx
To Gross profit (sales X GP ratio)	xxx		
	xxx		xxx

Gross profit (GP) Ratio = Gross profit /sales \*100

- (iii) Where books of account are destroyed, the task of building up the Trading Account becomes difficult. In that case information is obtained from the customers and suppliers have to be circularised to ascertain the amount of sales and purchases.
- (iv) After the insurance company makes payment for total loss, it has the same right which the insured had over the damaged stock. .
- (v) Frequently salvaged stock can be made saleable after it is reconditioned. In that case, the cost of such stock must be credited to the Trading Account and debited to a salvaged

(vi) stock account. The expenses on reconditioning must be debited and the sales credited to this account, the final balance being transferred to the Profit & Loss Account.

(vii)

Loss of Stock	
Amount of loss of stock is calculated as under:	
Value of stock on the date of fire	XXX
Less:- Value of Salvaged stock	XXX
Amount of loss of stock	XXXX

**Claim for Loss of Profit**

When a fire occurs, apart from the direct loss on account of stock or other assets destroyed, there is also a consequential loss because, for some time, the business is disorganized or has to be discontinued, and during that period, the standing expenses of the business like rent, salaries etc. continue. Moreover, there is loss of profits which the business would have earned during the period. This loss can be insured against by a "Loss of Profit" or "Consequential Loss" policy; there must be a separate policy in respect of the consequential loss but claim will be admitted in respect of the policy unless the claim on account of fire is also admitted under other policies.

The Loss of Profit Policy normally covers the following items:

- (1) Loss of net profit
- (2) Standing charges.
- (3) Any increased cost of working e.g., renting of temporary premises.

In every business, there is some standard by which its activity or progress can be accurately judged: it may be sales affected or the quantity of goods (or services) produced. To measure the loss suffered by a firm due to fire, it is necessary to set up some standard expressed in such units to represents the volume of work. There should be a direct relation between the amount of standard and the amount of profit raised. A comparison between the amount of the standard before and after the fire will give a reliable indication of the loss of profit sustained. The most satisfactory unit of measuring the prosperity (and therefore profits) is usually turnover:

A claim for loss of profits can be established only if :

- (i) the insured's premises, or the property therein, are destroyed or damaged by the peril defined in the policy; and
- (ii) the insured's business carried on the premises is interrupted or

interfered with as a result of such damage.

A claim for loss of profits cannot arise if the claim for loss of property as a result of the fire is not also admitted. This is very convenient as it avoids independent investigation into loss of property for purposes of loss of profits policy. It is possible that the business of the insured may suffer because of fire in the neighbourhood, not causing damage to the property of the insured, say by closing the street for some time. Such eventualities may be covered by agreement with the insurer on payment of extra premium. If fire does not affect the volume of business, there can be no claim for loss of profits.

Also, it does not follow that if there is a large property claim, there will be necessarily a large claim for loss of profit or vice versa.

### **Terms Defined**

The following terms should be noted:

**Gross Profit** is the sum produced by adding to the Net Profit the amount of the Insured Standing Charges, or, if there be no Net profit, the amount of the Insured Standing Charges less such a proportion of any net trading loss as the amount of the Insured Standing Charges bears to all the standing charges of the business.

**Net Profit** is the net trading profit (exclusive of all capital) receipts and accretion and all outlay properly (chargeable to capital) resulting from the business of the Insured at the premises after due provision has been made for all standing and other charges including depreciation.

**Insured Standing Charges:** Interest on Debentures, Mortgage Loans and Bank Overdrafts, Rent, Rates and Taxes (other than taxes which form part of net profit) Salaries of Permanent Staff and Wages to Skilled Employees, Boarding and Lodging of resident Directors and/or Manager, Directors' Fees, Unspecified Standing Charges [not exceeding 5% (five per cent) of the amount recoverable in respect of Specified Standing Charges].

### **Conditions included in a Loss of Profit Insurance Policy**

Insurance policies covering loss of profit contain the following conditions usually:

**Rate of Gross Profit:** The rate of Gross Profit earned on turnover during the financial year immediately before the date of damage.

**Annual Turnover:** The turnover during the twelve months immediately before the damage.

**Standard Turnover:** The turnover during that period in the twelve months immediately before the date of damage which corresponds with the Indemnity Period.

To which such adjustment shall be made as may be necessary to provide



for the trend of the business and for variations in or special circumstances affecting the business either before or after the damage or which would have affected the business had the damage not occurred, so that the figures thus adjusted shall represent, as nearly as may be reasonably practicable the results which but for the damage would have been obtained during the relative period after damage.

**Indemnity Period:** The period beginning with the occurrence of the damage and ending not later than twelve months thereafter during which the results of the business shall be affected in consequence of the damage.

**Memo 1:** If during the indemnity period goods shall be sold or services shall be rendered elsewhere than at the premises for the benefit of the business either by the insured or by others on the Insured's behalf, the money paid or payable in respect of such sales or service shall be brought into account in arriving at the turnover during the indemnity period.

**Memo 2:** If any standing charges of the business be not insured by this policy then in computing the amount recoverable hereunder as increase in cost of workings that proportion only of the additional expenditure shall be brought into account which the sum of the Net Profit and the insured Standing Charges bear to the sum of the Net Profit and all standing charges.

**Memo 3:** This insurance does not cover loss occasioned by or happening through or in consequence of destruction of or damage to a dynamo motor, transformer, rectifier or any part of an electrical installation resulting from electric currents however arising.

- (i) The word 'turnover' used above may be replaced by any other term denoting the basis for arriving at the loss of profit e.g., output.
- (ii) Insured standing charges may include additional items, by agreement with the insurer.
- (iii) Net profit means profit before income tax based on profit.
- (iv) Depending upon the nature of business, the indemnity period may extend beyond 12 months (it may be as long as 6 years). Indemnity period shall not be confused with the period of insurance which cannot be more than one year.

The insurance for Loss of Profit is limited to loss of gross profit due to :

- (i) Reduction in turnover, and
- (ii) Increase in the cost of working.

**Computation of claims for loss of profits:****Step : 1 Claim for reduction in turnover:**

	Rs.
Standard turnover	xxx
Add: Increase for trend Or Less: decrease for trend	xxx
	xxx
Less: Affected period turnover	xxx
Short sales	xxx
Gross profit ratio = $\frac{\text{Net profit} + \text{Insured Standing Charges}}{\text{Accounting year turnover}} \times 100$	

Claim for reduction in Turnover = Short sales x GP ratio

**Step - 2 Claim for increased cost of working**

	Rs.
a) Actual increased cost of working	xxx
b) if all standing charges are not insured:	
$\frac{\text{Net profit} + \text{Insured charges}}{\text{Accounting year turnover}} \times 100$	xxx
NP + all insurable standing charges	
c) saved turnover x GP ration	xxx
Amount to be claimed for increased cost of working (lowest of A, B, and C)	xxx

**Step - 3 Total claims for loss of profits**

	Rs.
Claims for reduction in Turnover (Step - 1)	xxx
Add: Claim for increased cost of working (Step - 2)	xxx
	xxx
Less: saving in standing charges	xxx
Total claim for loss of profits	xxx

**Step - 4**

	Rs.
Annual turnover	xxx
Add: increase for trend or Less: decrease for trend	xxx
Adjusted annual turnover	xxx

**Claim to be made:** Total claim X Policy amount / GP on adj. annual sales  
**ACCOUNT FOR SALE OR RETURN**

### Meaning

The transactions which involve customers' approval for rejection of goods after physical delivery are called sale on approval or sale or return transactions.

### Purpose

1. Traders can increase their turnover, particularly in the case of slow moving goods.
2. Valued customers or bulk buyers can be provided with the opportunity of inspecting the goods at their own place conveniently before approval or rejection.

### Method of recoding or sale or return transactions

#### I. When the transaction are few and rare:

##### a. When goods are sent on approval:

Customer's A/c	Dr
To Sales A/c	

##### b. When customer intimate approval:

No further entry in needed

##### c. When customer returns the goods, fully or partly, for the goods returned.

Sales A/c	Dr
To Customer's A/c	

##### d. At the end of the accounting year (regarding goods sent for which specified time is not yet finished)

##### i. For reversing the original entry:

Sales A/c	Dr
To Customer's A/c	

##### ii. For taking goods with the customers into stock at their cost.

Stock with customer's A/c	Dr
To Trading A/c	

#### II. When the transactions are frequent:

##### a. A sale or return day book is opened on memorandum basis to show the goods sent, approval, rejected and balance.

##### b. When goods are sent, they are recorded sales value in the goods sent column, because actual sale has not resulted

- c. When goods are approved, the sales value of the goods is recorded in the goods approved column. Immediately customers' accounts are debited in the regular ledger.
- d. When goods are rejected the sale value of the goods is recorded in the goods returned column.
- e. Balance of goods is recorded in the balance column. This column shows the sale value of goods with customers.

**Problems:**

1. A fire occurred at the premises of a trader on 31.5.2014 destroying a great part of his goods. His stock at 1.1.2014 was Rs.60000, the value of stock salvaged was Rs.13500. The gross profit on sale was 30% and sales amounted to Rs.153000 from January to date of Fire. While for the same period the purchases amounted to Rs.103500. prepare a statement of claim.
2. Fire occurred on 8.9.2010 in the godown of Mr.Akilan. Ascertain the claim to be lodged.

	Rs.
Stock 1.9.2010	220000
From 1.9.2010 to the date of fire	
Purchases	182000
Other expenses	18000
Sales	240000
Rate of Gross profit is 25% on cost.	

3. A fire occurred on Sep.30,2016 in the godown of Mr.Anand. From the following figures ascertain the claim to be lodged.

	Rs.
Stock 1.1.2016	17000
Purchased from 1.1.16 to date of fire	170000
Wages	17000
Sales from 1.1.2016 to date of fire	200000
The rate of Gross Profit is 25% on cost	
The salvaged stock was value at	4000

4. Fire occurred in the premises of ABC on 10<sup>th</sup> May 2016. In order to make to claim on their fire policies in respect of the stock, they ask your advice and you are able to obtain the following information.

	2013	2014	2015	2016
	Rs.	Rs.	Rs.	Rs.
Opening Stock	16000	15000	16000	18000

Purchases	41000	47200	56600	78000
Sales	60000	66000	78000	99000
Closing stock	15000	16000	18000	?

The stock salvaged was Rs.3800 compute the amount of claim.

5. A fire occurred in the premises of Mr. D on 15<sup>th</sup> August 2015. A large part of the stock was destroyed and Rs.7,500 was realized for the salvage. For the period from 1<sup>st</sup> Jan 2015 to 15<sup>th</sup> August 2015. The following information is available.
- Purchase amounted to Rs.42500
  - Sales amounted to Rs.45000
  - Stock on hand on 1<sup>st</sup> January 2015 was Rs.20000 at cost price
  - Goods costing Rs.2500 were taken by D for his personal use.

The previous accounts reveal that the rate of gross profit was 33  $\frac{1}{3}$ % on sale. The insurance policy was Rs.25000 and included an average clause. Prepare the statement of claim to be made on the insurance company.

6. Fire occurred in the premises on 1.1.2005 and the books and records were showed. From the following information, calculate the insurance claim.

	Rs.
Purchases for the year ending 30.6.2004	60000
Sales for the year ending 30.6.2004	90000
Purchases from 1.7.2004 to 31.12.2004	35000
Sales from 1.7.2004 to 31.12.2004	50000
Stock as on 30.6.2004	28000
Stock as on 30.6.2003	40000

7. A fire occurred in the business premises of Raja on 19.7.2005. From the following particulars ascertain the loss of stock and prepare a claim for insurance.

	Rs.
Stock on 1.1.2005	36720
Stock on 31.12.2005	32400
Sales for 2005	216000
Purchases for 2005	146400
Purchases from 1.1.2005 to 19.7.2005	176400
Sales from 1.1.2005 to 19.7.2005	180000

The stock was always undervalued at 10% of cost. The stock saved from fire was worth Rs.21600. The amount of the policy was Rs.75600. There was an average clause in the policy.

8. From the following particulars, prepare a claim for loss of profit under the consequential loss policy.

Date of fire – 30<sup>th</sup> June 2002

Period of indemnity six months

	Rs.
Sum insured	40000
Turnover for the year ended 30 <sup>th</sup> June 2002	200000
Net profit for the amounting year ending 31 <sup>st</sup> March	12500
Standing charges for the accounting year ending 31 <sup>st</sup> March 2002	28500
Turnover for the year ending 31 <sup>st</sup> March 2002	198000
Turnover for the indemnity period from 1.7.2002 to 31.12.2002	56000

The turnover of the year 2002-2003 had shown a tendency of increase of 10% over the turnover of the preceding year.

9. From the following particulars. Prepare loss of profit claim under consequential loss policy.

Date of fire - 30.6.1991

Period of indemnity - 6 months

Sum assured - Rs.40000

Sales upto 30.6.91 -Rs. 200000

Net profit for the accounting period ending 31.3.1991 Rs.12500; standing charges for the same period Rs.28500 and sales Rs.198000.

Sales 1.7.91 to 31.12.91 - Rs.56000

Sales 1.7.90 to 31.12.90 - Rs.110000

Sales forecast is 10% higher than the previous year.

## UNIT - 5

### INSOLVENCY ACCOUNTS

#### Meaning of insolvent:

Insolvent is one who is not able to pay his debts as and when they are due.

#### Insolvency accounts

Upon being adjudicated the insolvent has to submit

1. Statement of Affairs
2. A Deficiency account

#### Statement of affairs

The form of the statement of affairs prescribed by rule made under the Presidency Towns Insolvency Act.

#### Specimen of Statement of Affairs

Gross liabilities (Rs.)	Liabilities	Expected to rank	Assets	Estimated to produce
xxx	Un secured creditors as per list - A		Property as per list - E	xxx
xxx	Fully secured creditors as per List - B	xxx	Cash in hand	
	Less: Estimated value of security	<u>xxx</u>	Cash at bank	
	Less: Amount carried down to list - C	xxx	Investments	
	Surplus as per Contra	<u>xxx</u>	Stock	
			Machinery	
			Book Debts as per List - F:	xxx
			Good	
			Doubtful	
			Bad	
			Bills of Exchange as per List - G	xxx
			Surplus from securities in the hands of secured creditors as per contra	xxx
xxx	Partly secured creditors as per List - C	xxx	Deficiency as explained in List - H (B.F.)	xxx
	Less: Estimated value of security	<u>xxx</u>		
		<u>xxx</u>		
xxx	Preferential creditors as per list D	xxx		
	Less: Deducted as per Contra	<u>xxx</u>		
		<u>xxx</u>		
		xxx		xxx

**Deficiency Account - list H**

<b>Particulars</b>	<b>Rs.</b>	<b>Rs.</b>	<b>Particulars</b>	<b>Rs.</b>	<b>Rs.</b>
Excess of assets over liabilities (Capital)		xxx	Excess of liabilities over assets on		xxx
Net profit from carrying from – to --- after deducting usual trade expenses		xxx	Net loss from carrying on business from – to the date of adjudication		xxx
Income or profit from other sources		xxx	Bad debts as per list – F		xxx
Deficiency as per Statement of Affairs		xxx	Expenses incurred since----- other than usual business expenses		xxx
			Other losses (Loss on realization of assets)		xxx
		xxx			xxx

**Unsecured creditors:** All creditors who have no specific asset as security are shown under this list. They include the following:

1. Sundry creditors, bills payable, bank overdraft.
2. Wife's loan
3. Private liabilities
4. Contingent liabilities
5. Outstanding expenses

**Fully secured creditors:**

These creditors have securities whose realizable value is more than the loan and outstanding interest.

**Partly secured creditors**

The creditors whose loan is more than the realizable value of their security are termed as partly secured. The balance of their loan is shown in the second column.

**Preferential creditors**

These are creditors who must be fully paid, though they have no specific security.

**The following are the preferential creditors**

<b>Creditors</b>	<b>Presidency Towns insolvency Act, 1909</b>	<b>Provincial Insolvency Act 1920</b>
Amount due to Government, State, Central, Local, etc.,	Fully preferential	Fully preferential
Salaries	4 months salary or Rs.300	Rs.20 flat for each



	whichever is less for each person is preferential	person is preferential
Wages	4 months wages or Rs.100 whichever is less for each person is preferential	Rs.20 flat for each person is preferential
Rent payable	One month's rent whatever is the amount is preferential	-

### Difference between statement of affairs and balance sheet

1. A balance sheet shows assets at book values, while statement of affairs shows assets at book values, as well as realizable value.
2. A balance sheet shows fictitious assets such as goodwill, prepaid expenses while a statement of affairs does not show such items.
3. A balance sheet gives information about capital, profit or loss, drawings and interest on capital whereas statement of affairs excluded all such items.
4. A statement of affairs shows the amount which the insolvent debtor is not able to pay to his creditors while a balance sheet does not show such a figure.
5. In a statement of affairs, creditors are classified as unsecured, fully secured, partly secured and preferential creditors. No such classification is usually found in a balance sheet.
6. A balance sheet shows assets and liabilities of a business as a going concern whereas statement of affairs is prepared on the liquidation of the business of an insolvent.

### Problems:

1. What are the preferential creditors in the following liabilities of insolvent B according to Presidency Towns Insolvency Act and Provincial Insolvency Act?

	Rs.
3 month's salary for 10 clerks	3600
One month wages for 12 labourers	1600
Sales tax	400
3 months rent of landlord	600
Income tax	1000
Wages of four servants	1400
Salaries	1000
Municipal tax	400

Wages	6000
-------	------

2. Compare the provincial insolvency act from the following:

	Rs.
Salary of clerk	200
Wages of labours	240
Sales tax	400
Salaries	1000
Income tax	1000
Wages of servants	80
Municipal tax	400
Wages	6000

3. What are the preferential creditors in the following liabilities of insolvent Gobal according to Presidency Towns Insolvency Act and Provincial Insolvency Act? Also mark the preferential creditors.

	Rs.
Salaries	1000
Sales tax	300
One month wage of 10 labourers	1200
Income tax	700
Rent for 3 months	900
Municipal tax	250
4 clerks 2 months salaries	1500
Wages of 3 servants	900

4. From the following details, prepare statement of affairs and deficiency account of X as on 31.3.2011.

	Rs.
Cash	2300
Stock in trade	10000
Debtors – good	70000
Debtors – doubtful	18000
Debtors – bad	15000
Furniture	5640
Investment in share	5000
Unsecured creditors (including Rs.10000 of his wife)	130000

Secured creditors	25000
Value of securities held by secured creditors	35000
Preferential creditors for rent taxes	1900

Assume, stock in trade realize – Rs.6660; furniture – Rs.2820; Investment in shares the book value; and bad and doubtful debts – Rs.6000.

5. Mr. X is insolvent. He supplies to you the following information as on 31.12.2002.

	Rs.
Cash in hand	1000
Creditors for goods	525000
Salary due to clerks	7000
Taxes due to government	21000
Bank loan secured by lien on stock of the book value of Rs..350000	175000
Furniture (Expected to realize Rs.35000)	70000
Stock (Expected to realize 60%)	525000
Book debts (good)	70000
Book debts (doubtful, expected to realize 40%)	175000
Bills receivable (Rs.52500 bad)	87500
Bills discounted (Rs.35000 bad)	105000
Loan from Mrs.X	175000

Mr. X started business six years ago with a capital of Rs.437500. He drew Rs.87500 each year for private purposes but did not maintain proper books of accounts. Mrs. X gave up her jewellery value at Rs.70000 to the receiver.

---

### **2 marks and 5 marks**

1. What is meant by head office?
2. State any four advantages of departmental accounting.
3. Define instalment system
4. What is cash price?
5. Write a note on creditor's ledger
6. What are the methods of sectional balancing system?
7. Calculation of amount of Claim. A) stock on the date of fire Rs.36625 B)

Stock salvages stock Rs.5000

8. What is meant by royalty?
9. Who are preferential creditors?
10. What is the meaning of insolvent?
11. State the important terms used in Royalty accounts. (5)
12. What are the procedure of sale or return transaction? (5)
13. What are the points to note for preparation of statement of affairs? (5)
14. What you mean by dependent branch?
15. Write note on invoice price.
16. Comment on short workings
17. What is the formula for amount of claim?
18. Define average clause.
19. What are allocations of departmental expenses? (5)
20. What is hire purchase system? Briefly, explain the some important terms in the hire purchase system. (10)
21. What is meant by independent branch?
22. What are the types of expenses?
23. Write a short on cash price and down payment.
24. What is meant by minimum rent?
25. What is meant by insolvency?
26. What are the bases for the allocation of expenses to different departments of an organization? (5)
27. What is average clause? Explain its significance (5)
28. What are the purposes of branch account?
29. What is sub-lease?
30. What is statement of affairs?
31. Explain the meaning of "Landlord" and "Lease" (5)
32. Briefly explain the different types of branches (10)
33. Give short note on cash in transit
34. State the differences between hire purchase and installment purchase. (10)
35. What is the importance of fire insurance?
36. Write a short note on affected period in fire insurance
37. What are the objectives of branch accounts? (5)

38. What is instalment purchase system? What are its characteristics? (5)
39. What are the types of insurance policies? (5)
40. Explain the procedure to ascertain stock on the date of fire. (10)
41. What is branch?
42. What is hire purchase price?
43. Write short note on indemnity period in fire insurance.
44. Explain the features of Hire purchase system. (5)
45. What are the difference between branches and departments (5)
46. Explain the importance of fire insurance (5)
47. What is retail sale branch?
48. What are departmental accounts?
49. What do you mean by recoument of short workings?
50. What do you mean by short sales?
51. What is statement of affairs?
52. What is wholesale branch?
53. What is partial repossession?
54. What do you mean by deficiency account?
55. What are incorporation entries of independent branch?
56. What is list H under insolvency account?
57. What is sectional balancing?
58. What is general ledger adjustment account?
59. Explain the advantages of self balancing ledger system (5)
60. What is transfer?
61. What is sectional balancing? How does it differ from self balancing system (10)
62. What is sale or return?
63. Explain the features of a sale or return transactions
64. What are the purposes of sending goods on approval basis to customers? (5)
65. Explain the different methods of recording the transactions of goods sent on sale or return basis. (10)