Unit-1

CONSIGNMENT

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

Features:

1. **Two Parties:** Consignment accounting mainly involves two party's consignor and consignee.
2. **Transfer of Procession:** Procession of goods transferred from consignor to consignee.
3. **Agreement:** There is a pre-agreement between the consignor and consignee for terms and conditions of the consignment.
4. **No Transfer of Ownership:** The ownership of goods remains in the hands of the consignor until the consignee sells it. The only procession of goods is transferred to a consignee.
5. **Re-Conciliation:** At the end of the year or periodic intervals consignor sends Pro-forma invoice while consignee sends account sale details and both reconcile their accounts
6. **Separate Accounting:** There is independent accounting done of consignment account in the books of consignor and consignee. Both prepare consignment account and record the journal entries of goods through consignment account only.

Terms used in consignment a/cs

Consignor: It is the person that sends goods.

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

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

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

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

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

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

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

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

Advantages

- **Increase in Business Exposure:** Due to consignment sales increase, thereby increase in business exposure. It is a cost-effective method to expand the business.
- **Lower Inventory Cost:** Less inventory holding costs for the consignor;
- **Incentives to Consignee:** When consignee sells on behalf of the consignor, the former receives a commission and other incentives.
- **Business Growth:** Consignment benefits both consignor and consignee. Consignor gets lower inventory bearing cost, and consignee without investment earns the commission by selling on behalf of the consignor.

Disadvantages

- **Lower Profit Margin:** Due to consignment, the consignor has to pay commission to the consignee, thereby resulting in a lower profit margin in the hands of the consignor.
- **Negligence by Consignee:** Consignee's negligence may create the problem.
- **Risk of Goods Damaged:** There is a high risk of goods damaged at the consignee's place or during transport, especially perishable goods.
- **High Charges:** Sometimes, there are high maintenance charges of goods to be borne by consignee and high shipping or conveyance charges to be borne by consignor. This is the place of the consignee, and the consignor is far away from each other.

Commission

There are **three** types of commission payable to consignee on sale of the goods −

- **Simple Commission** − This is usually a fixed percentage on the total sale, calculated as per mutually agreed terms.
- **Over-riding Commission** − In case of an extra-ordinary sale of the goods, some specific amount is payable to consignee in the form of an incentive is called overriding commission. Over-riding commission is also calculated on the total sales.
- **Del-credere Commission** − "An agreement by which an agent or factor, in consideration of an additional premium or commission (called a del credere commission), engages, when he sells goods on credit, to insure, warrant, or guarantee to his principal the solvency of the purchaser, the engagement of the factor being to

pay the debt himself if it is not punctually discharged by the buyer when it becomes due."

Valuation of unsold Consignment

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

- Proportionate cost price and
- Proportionate direct expenses.

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

Invoicing Goods higher than Cost

Under this method, goods are charged at the cost + profit and the pro-forma invoice also shows this higher price of such goods. To know the actual profit, at the end of an accounting period, consignment account will be credited with excess price so charged. Value of the stock will also be adjusted to the extent of profit element. Main reason to adopt this policy by consignor is −

- To hide actual profit from consignee.
- Valuation of a stock at the consignor's warehouse is comparatively easy in this case.
- In this case, consignor usually directs consignee to sale goods on invoice price only. It prevents different sale price to different customers.

Loss of Goods

There may be two types of losses as explained below −

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

Valueofclosingstock=TotalvalueofgoodssentNetquantityreceivedbyconsignee×UnsoldquantityValueofclosingstock=TotalvalueofgoodssentNetquantityreceivedbyconsignee×Unsoldquantity

Netquantityreceived=Goodsconsignedquantity−NormallossquantityNetquantityreceived=Goodsconsignedquantity−Normallossquantity

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

Abnormal Loss and Insurance

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

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

Summary of Accounting Entries

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

Sr.No.	In the Books of Consignor	In the Books of Consignee
1	**When goods are sent to the consignee**	No need to do any Entry in this case

	Consignment A/cDr To Goods Sent on Consignment A/c (Being Goods Sent on Consignment)	
2	**Expenses Incurred by Consignor** Consignment A/cDr To Cash/Bank A/c (Being Expenses incurred on consignment)	Not Applicable
3	**Advance given by consignee** Cash/Bank A/cDr To Consignee's A/c (Being advance received from consignee)	Consigner A/cDr To Bank/Cash A/c (Being Advance amount paid to Consignor)
4	**Expenses Incurred by Consignee** Consignment A/cDr To Consignee's A/c (Being Expenses incurred by consignee)	Consigner A/cDr To Bank/Cash A/c (Being Expenses incurred on goods received on consignment)
5	**Sale by Consignee** Consignee's A/cDr To Consignment A/c (Being Expenses incurred by consignee)	Cash (for cash sale) A/cDr Debtors (for Credit Sale) A/c Dr To Consignor A/c (Being goods sold)
6	**Commission to Consignee** Consignment A/cDr To Consignee's A/c (Being Commission on sale due to consignee)	Consigner A/cDr To Commission A/c (Being Commission earned)
7	**Remittance from Consignee** Cash/Bank A/cDr To Consignee's A/c (Being due amount received from consignee)	Consigner A/cDr To Bank/Cash A/c (Being Balance due Payment made to consignor)

8	**Entry for Profit on Consignment** Profit & Loss A/cDr To Consignment A/c (Being Profit earned on consignment)	Not Applicable
9	**Loss on Consignment** Consignment A/cDr To Profit & Loss A/c (Being Loss incurred on Consignment transferred to the profit & Loss Account)	Not Applicable

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

UNIT-2

SINGLE ENTRY SYSTEM

Introduction: Single Entry System is the oldest and most straightforward method of keeping records of financial transactions which does not exactly follow the principles of double entry system. They only maintain essential records. Under this method usually the personal accounts of the debtors and creditors are maintained and impersonal accounts may not be maintained in the books of accounts.

A single entry is a method in which each transaction is recorded only once. In other words, only one account is given debit or credit for each transaction. It is an incomplete double entry system, which does not give the complete picture of every transaction and thus it is also called
accounts from incomplete records. There are two types of single entry:

Pure Single Entry System: In this method, only the personal accounts are maintained and there is no information present, concerning the sales and purchases, cash in hand, and bank balance.
Simple Single Entry System: In a simple single entry system, cash book is maintained along with the personal accounts .

Quasi Single Entry System: In this system, subsidiary books such as sales book, purchases book, bills receivable book and bills payable book are maintained in addition to cash book and personal accounts.

Single Entry System is simple and easy to maintain as it does not need any professional accountant to keep the records up to date. And so this system is quite helpful for small businesses and trades operated solely by individuals. Further, the system is quite economical.

Definition of Single Entry system
According to R.N. Carter, Single Entry cannot be termed as a system, and it is net based on any scientific system like Double Entry System. For this purpose, Single Entry is now-a-days known as preparation of accounts from incomplete records.

Characteristics of Single Entry System

1. **Suitability**: The system is appropriate for small businesses, like sole proprietorship business and partnership firms, as they maintain records of cash and credit transactions only.

2. **Profit or Loss**: Profit earned or loss sustained is estimated, out of the information available and so exact profits are not ascertained.
3. **Maintenance of Cash Book**: Cash Book is prepared and maintained, in which both business and personal transactions are included.

4. **Personal Accounts**: Only personal accounts are created and maintained, whereas the real and nominal accounts are not given due weight, in this system.

5. Final Accounts: In Single Entry System, it is quite difficult to prepare final accounts, due to unavailability of nominal and real accounts

Advantages of Single Entry System:
(i) Since this system is very simple, anyone can maintain it without any adequate knowledge of accounting.
(ii) Limited accounts are to be opened under this system since the transactions relating to personal accounts are recognized only and not the Real and Nominal accounts.
(iii) Since the number of books is limited, expenses related to the keeping of records are also very nominal.
(iv) In the case of accounting for an event, i.e., household, social and festival etc., it is very helpful **Disadvantages of Single Entry System**:
(i) Arithmetical accuracy of the books of account is not possible since the Trial Balance cannot be prepared under this system.
(ii) It is also not possible to ascertain the correct amount of profit or loss of the firm i.e., results from operation since the nominal accounts are not maintained under this system.
(iii) Similarly, Balance Sheet cannot be prepared since the real accounts are not recognized. Therefore, the real financial position cannot be known at the end of the accounting period. (iv) As arithmetical accuracy is not possible, possibility of committing fraud or manipulation is greater in comparison with Double Entry System.
(v) Any statistical information relating to the business or the comparison between the two firms or the interim accounts etc,.which help the management to take decision or to formulate policy in future is not possible under this system.
(vi) Income-tax authorities, Bank etc. do not recognize single entry

system. **Key Differences between Single Entry System and Double**

Entry System

Single entry system	Double entry system
In single entry system only one aspect of a transaction is recorded, i.e. either debit or credit.	Double Entry System is a system of keeping records of both the aspects of a transaction.
Single Entry Transaction is simple and easy.	Double Entry System is complex as well as it requires expertise in accounting for maintaining records.
The Single Entry system is best suited for small enterprises	Big organizations prefer Double Entry System.

In single entry system, incomplete records are maintained	In double entry system complete record of transactions are maintained
In this system is very hard to identify the error in the books.	In this system it is easy to identify the error in the books.
It is not accepted by the taxation department.	It is accepted by the taxation department
Frauds and embezzlement cannot be located in single entry system	Frauds and embezzlement are easy to identify in double entry system

Method of Ascertainment of Profit

There are two methods of ascertaining profit or loss under single entry system.

1. Conversion method
2. Statement of Affairs Method/ Increase in Net Worth Method/Comparison Method

Conversion method: The Conversion Method of Single Entry System is a more scientific way of preparation of Final Accounts from Incomplete Records. It is also called the Transaction Approach. The process of collecting, computing and recording missing information along with the available date in the incomplete books of a business is called Conversion Method. Once the books are converted all future transaction can be recorded as per Double entry system.

Statement of Affairs Method: Under this method, a trader can ascertain his profit or loss for a particular period by **comparing the capital at the beginning of the period with the capital at the end of the period.**

For this purpose two comparative **Statement of Affairs** are prepared, one giving the capital at the commencement and other at the end of the period. *Capital in both cases is being represented by Net Worth i.e. excess of Assets over Liabilities.* Although a Statement of Affairs shows a collection of assets and liabilities, it cannot be called a Balance Sheet. This is because the values of such assets and liabilities are not taken from ledger accounts but are estimates made by the owner of the business

The balancing figure of the statement of affairs on a particular date = Total Assets – Total Liabilities = Capital as on that date

BASIS FOR

Comparison method

Performa of Statement of Affairs

Statement of Affairs as at …….

Liabilities	**Amount**	**Assets**	**Amount**
Bills Payable	xxxxx	Land and Building	xxxx
Creditors	xxxxx	Plant and Machinery	xxxx
Outstanding Expenses	xxxxx	Furniture	xxxx
Income received in advance	xxxxx	Stock	xxxx
Capital (balancing figure)	xxxxx	Debtors/Bills Receivable	xxxx
		Cash and Bank	xxxx
		Prepaid Expenses	xxxx
		Accrued Income	xxxx
Total	**XXXXX**	**Total**	**XXXXX**

Steps:

- Determine the Opening Capital by preparing the Statement of Affairs at the beginning of the year.
  - Determine the Closing Capital by preparing the statement of affairs at the end of the year. ● Add drawings made by the proprietor to the closing capital during the year. ● Deduct the additional capital introduced by the owner during the year.
- Find out the Profit or Loss by deduction the opening capital from the adjusted closing capital.
  - If the adjusted closing capital exceeds the opening capital, it represents profit and vice

versa. **Ascertainment of profit under single entry system:**

Statement of affairs is a statement of all assets and liabilities as on a particular date. The difference between the two sides is regarded as capital-balancing figure. It is based on the equation Capital=Assets-Liabilities.

Statement showing the profit or loss made during the period

Capital at the end of the period	**xxxxxx**
Add : Drawing made during the period	**XXXX**

	XXXX
Less: Capital at the beginning of the period	**XXXX**

Profit or loss made during the year	**XXXX**

UNIT-3

NON TRADING CONCERN

The non-trading concerns are the organizations which are established with a view to provide services to the society and not to make profits. The examples of such organization are sports, dub, school, hospitals, temples etc.

INTRODUCTION TO NON-TRADING CONCERN

The non-trading concerns are the organizations which are established with a view to provide services to the society and not to make profits. The examples of such organization are sports, dub, school, hospitals, temples, etc. Though, they are not established with a view to earn profit but still it needs to maintain a set of accounting books in order to avoid misappropriation of funds. The main purpose of non-trading concern is to provide necessary services to its members and society through welfare activities. So, their main objective is not to arn profit.

Non-profit organizations can be defined as, “An entity whose prime motive is to provide services to the society and not to make a profit.” This organization prepares financial statement so that all the legal requirement can be fulfilled.

Features of Non-profit Organization

- It provides service to a certain group or the public at large.
- They are governed by the public or its members.
- The main source of their incomes is subscriptions, grants, donations, etc.
- Fund based items are credited to the capital fund or the general fund.
- Profit and loss derived from income and expenditure a/c is adjusted to capital fund in the balance sheet.

Important terminologies of non-profit organization

Subscription

Subscription is the amount paid by the members of the organization periodically. Subscription is the main source of income for non-profit organization. It is created in receipt side of receipt and payment and in income side of income and expenditure account. It is also called membership fee. The subscription received in receipt and payment account is shown for an irrespective period but in income and expenditure account is shown only for a current year.

For example:

A sports club received Rs.30000 subscription for the year 2009 of which Rs.3000 relate to the year 2008 and Rs.2000 to the year 2010 and at the end 2009 subscription still to be received Rs. 10000. The subscription for current year will be calculated as follows:

Solution:

Subscription received during the year 2009: 30000
(-) Subscription o/c for 2008: 3000
(-) Advance subscription for 2010: 2000
(+) O/S Subscription for 2009:10000
Income from subscription for the year 2009: 35000

The above amount of subscription is shown in subscription a/c as below:

Subscription a/c

Particulars	**Amount**	**Particulars**
To O/S subscription 2008	3000	By cash (Subs. Received during the year)
To advance subscription for 2010	2000	By O/S subscription for 2009
To Income & Expenditure	35000	
	40000	

Income and expenditure a/c

Expenditure	**Amount**	**Income**
		By subscription a/c

Entrance fee

Entrance fee is the amount paid by the new members at the time of joining the club. It is also called admission fee. When the entrance fee is received regularly every year then it is treated as income. When the entrance fee is received once for all then it is treated as capital.

Treatment of entrance fee:

The following are the different cases for the treatment of the entrance fee for the preparation of final account of non-profit organization.

Case I: During the year 2053, entrance fee received Rs.500000. The organization treats the entrance fee as a revenue receipt.

Income & Expenditure a/c

Expenditure	**Amount**	**Income**
		By entrance fee

Case II: During the year 2065 entrance fee received Rs. 500000. The organization treats entrance fee as a capital receipt.

Balance Sheet

Liabilities	**Amount**	**Assets**
Entrance fee	500000	

Case III: During the year 2068, entrance fee received Rs. 500000. The organization treats of entrance fee as a revenue receipt and the rest as capital receipt.

Income & Expenditure a/c

Expenditure	Amount	Income
		By entrance fee

Balance Sheet

Liabilities	Amount	Assets
Entrance fee	375000	

Legacy

Legacy is the amount given as per will of the deceased person. If it appears on the receipt and payment account, then it is treated as capital receipt and shown on the liabilities side of balance sheet. If the amount of legacy is nominal, then it may be treated as income and shown on the income side of income & expenditure.

Life membership fee

Life membership fee is the fee paid for the whole life in a lump sum instead of regular payment for the subscription by the members. It is a capital receipt and shown on the liabilities side of balance sheet.

Endowment fund

According to **Eric L. Kohler**," It is a fund arising from a bequest or gift, the income of which is devoted to a specific purpose." It is a capital receipt and shown on the liabilities side of balance sheet.

Grants

A grant is an amount provided by the government or public for the institution. It may be provided in cash or in kinds. Grants may be of following two types:

1. **Operating Grants:** Some institutions like school, college, hospital, clubs, etc. depends on a grant for their operation. It is provided to meet their operating expenses. It is a revenue receipt and treated as income of the institutions.
2. **Development Grants:** It is provided to meet the specific purpose. The amount received is utilized for the same purpose. It is a capital item and treated as a liability in the balance sheet.

Donations

The donation is the gift given by an organization or a person in the form of cash and property. It appears on the receipt side of receipt and payment account. Donation may be classified as below:

1. **Specific donation:** Specific donation is the donation received for a specific purpose. It is a capital item and treated as a liability in the balance sheet irrespective of amount big or small.

2. **General donation:** General donation is the donation received for general purpose. It is revenue receipts and treated as income in the income & expenditure a/c.

Sale of Fixed Assets

It is a capital receipt and should be deducted from the assets concerned in the balance sheet, and hence it should not be treated as income. However, profit or loss made from the sale of these assets can be treated as income (profit) & expenditure (loss).

Honorarium

An honorarium is the amount paid to the person for their volunteer's service but who are not the employees of the organization. For e.g. amount paid to the visiting professors, guest artist, etc.

Financial Statements of non-profit organization consists the following statements:

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

Receipts & payments a/c:

Receipt and payment account functions as a summary of cash payments and receipts of an organisation during an accounting period. It provides a picture of the cash position of a Not-for-Profit organisation. It does not differentiate between the receipts and payments, whether they are of capital or revenue in nature and records all cash and bank transactions of both capital and revenue nature.

Receipt and payment account does not include any non-cash transactions such as depreciation. The Receipt and payment account is prepared at the end of an accounting period.

Features of Receipt and Payment Account

Below mentioned are some of the features of Receipt and Payment Account :

1.It does not include any transactions that are not cash or bank items.

2.It shows all cash payments and receipts without making any difference between capital and revenue

3. Receipt and Payment Account starts with the opening balance of cash and bank and ends with ending balance of cash and bank

4. It is prepared on the last day of the accounting period of the business organisation.

5. All cash and cheque receipts are recorded in the debit side while all cash and cheque payments are recorded on the credit side.

Receipts and Payments Account
for the period ending on

Dr. Receipts		Rs.	Payments		Cr. Rs.
To Balance b/d :			By Balance b/d (Bank overdraft)		xxx
Cash	xxx		By Annual Sports Expenses		xxx
Bank	xxx	xxx	By Salaries & Wages		xxx
To Subscription :			By Rent, Rates & Taxes		xxx
for previous year	xxx		By Insurance		xxx
for current year	xxx		By Furniture		xxx
for next year	xxx	xxx	By Sports Equipments		xxx
To Entrance Fees		xxx	By Books & Periodicals		xxx
To Donation for Building		xxx	By Audit Fees		xxx
To General Donations		xxx	By Printing & Stationery		xxx
TO Life Membership Fees		xxx	By Honorarium		xxx
To Legacy		xxx	By Bank Charges		xxx
To Grant from Govt.		xxx	By Postage & Telegrams		xxx
To Contribution for Annual Dinner		xxx	By Water & Electricity		xxx
			By Conveyance & Travelling		xxx
To Rent		xxx	By Sundry Expenses		xxx
To Receipt on Annual Sports		xxx	By Annual Dinner Expenses		xxx
To Sale of Old Sports Materials		xxx	By 19% Investments		xxx
To Sale of Old Magazines		xxx	By Balance c/d:		xxx
To Sundry Receipts		xxx	Cash	xxx	
To Balance c/d (Bank overdraft)		xxx	Bank	xxx	xxx
		xxx			xxx

INCOME AND EXPENDITURE A/C

The income and expenditure account is prepared by the non-trading entities to determine surplus or deficit of income over expenditures for a particular time frame. The accumulated or accrual concept of accounting is rigidly pursued while preparing income and expenditure a/c of non-trading concerns. It is prepared as a portion of final accounts of non-trading entities and is equal to the profit and loss account outlined by for-profit business entities.

Features of Income and Expenditure Account

Below mentioned are the characteristic features of Income and Expenditure Account :

- Income and expenditure account presented by non-trading entities are much like the profit and loss a/c presented by trading entities.
- It is prepared by stringently following the fundamentals of the double-entry system of bookkeeping or accounting.
- It is always prepared during the end of the period which normally comprises of 1 year.
- It decides the surplus or deficit of income over expends of the non-trading entities for the particular year.
- The surplus or deficit from the income and expenditure account is moved to the capital fund a/c.

- The Income and expenditure account of only revenue nature are incorporated in this account. Any income and expenditure of capital nature are not comprehended.
- It is prepared by accountants chosen by the enterprise's management and is audited by an independent auditor.
- It does not begin with the opening balance, and it follows back the incomes received and expenditures incurred by the non-trading entities during the financial year.
- The accumulated or accrual concept of accounting is rigidly pursued when it is prepared.

INCOME AND EXPENDITURE ACCOUNT
for the year ended ....

Dr. Cr.

Expenditure	₹	Income	₹
To Consumable Materials	xxx	By Subscriptions	xxx
To Honorarium	xxx	By Grants Received	xxx
To Salary and Wages	xxx	*(for General Purposes)*	
To Repairs	xxx	By Entrance Fees	xxx
To Expenses Paid on Specific Show	xxx	*(To the extent not capitalized)*	
(Any cultural events)	xxx	By General Donations	xxx
To Entertainment Expenses	xxx	By Interest on deposits	xxx
To Printing and Stationery	xxx	By Dividends	xxx
To News Papers and Periodicals	xxx	By Collection for Specific Show	xxx
To Postage	xxx	*(Any Cultural events)*	
To Upkeep of Lawns	xxx	By Profit on Sale of Fixed Assets	xxx
To Rent	xxx	By Locker's Rent	xxx
To Municipal Taxes	xxx	By Cloak Room Rent Received	xxx
To Insurance	xxx	By Hall Rent Received	xxx
To Loss on sale of Fixed Asset	xxx	By Receipts from Sale of	xxx
To Depreciation on Fixed Assets	xxx	Newspapers and Magazines	
To Audit Fees	xxx	By Miscellaneous Incomes	xxx
To Miscellaneous Expenses	xxx	By Deficit*	xxx
To Surplus *	xxx	*(Excess of Expenditure over*	xxx
(Excess of Income over Expenditure)	xxx	*Income)*	
	xxx		xxx

Balance Sheet

• It is a statement of assets & liabilities of the concern on a particular date. It shows the financial strength of the organisation

• Note: The excess of assets over liabilities is called as Capital (general) fund & is made up of surplus of income over expenditure & certain items which are capitalised. If the beginning or opening capital fund is not given , then the Balance Sheet at the beginning has to be prepared.

NAME OF THE ORGANIZATION
BALANCE SHEET
-----Date-----

Liabilities		$	Assets		$
Capital fund	XXXX		Building	XXXX	
Add: Surplus	XXXX	XXXX	Less: Depreciation	XXXX	XXXX
Subscription received in advance		XXXX	Furniture	XXXX	
Outstanding wages		XXXX	Less: Depreciation	XXXX	XXXX
Outstanding salaries		XXXX			
			Sports equipment	XXXX	
			Less: Depreciation	XXXX	XXXX
			Subscription receivable		XXXX
			Prepaid rent		XXXX
			Cash		XXXX
Total liabilities		XXXX	Total assets		XXXX

UNIT-4

PARTNERSHIP ACCOUNTS-1

Introduction to Partnership

Partnership is an association of two or more individuals who agree to share the profits of a lawful business.

It is managed and carried on either by all or by any, or some of them acting for all.

The formation of partnership is easy and simple. Each member of such a group is individually known as '*partner*' and collectively the members are known as a '*partnership firm*'.

1. Two or More Persons:

Section 11 of Indian Partnership Act, 1932 provides that the maximum number of persons a firm can have is 10 in case of partnership firm carrying on a banking business. In case of partnership firm carrying on any other business the number of partners can be 20.

2. Agreement:

A partnership comes into being through an agreement between persons who are competent to enter into a contract (e.g. Minors, lunatics, insolvents etc. not eligible). The agreement may be oral, written or implied.

3. Lawful Business:

The aim of a partnership firm should be profit-making by conducting only lawful business activities. Partnership business should be as per the law of land. Association formed for conducting illegal actions like theft, black-marketing and smuggling cannot be called as partnership

4. Profit Sharing:

The main object of partnership is to make profit and share the profits as per the agreed ratio. If the partnership agreement does not include any clause on profit-sharing, then the partners share profit equally as per the rules of the Indian Partnership Act, 1932..

5. Principal-Agent Relationship:

Each partner acts in two capacities, i.e., he is both a principal and agent. As an agent, he can bind the other partners by his acts and as a principal; he is bound by the acts of other partners. Each partner has a right to deal with outsiders in the capacity of the principal and to other partners, every partner is an agent.

6. Unlimited Liability:

In India, all partnership firms are general partnerships and the liability of every partner is unlimited i.e., all partners are collectively responsible for the payments of
liabilities of the firm and even their personal property can be utilised for recovery of debts of the firm.

7. Joint Ownership:

Each partner is a joint owner of the property of the firm and hence, in the eyes of law the firm and the partners are considered to be one and the same. Partnership has no separate existence apart from the partners composing it.

8. Utmost Good Faith:

It means the trust and confidence of partners in each other. Each partner has to work in the best interest of the firm. He must strive to attain and maintain the good faith of his partners. The partner should not make any profit secretly and must disclose all the information which is directly or indirectly related to the business.

9. Non-Transferability of Interest:

A partner cannot, without the consent of other partners, transfer his interest in the firm to an outsider. There is a strict restriction on admission and retirement of any partner. Any changes concerning the partners are done as per the agreement, and or with the consent of all partners.

Absence of a Partnership Deed

In case partners do not adopt a partnership deed, the following rules will apply:

a. The partners will share profits and losses equally.
b. Partners will not get a salary.
c. Interest on capital will not be payable.
d. Drawings will not be chargeable with interest.
e. Partners will get 6% p.a. interest on loans to the firm.

Profit and Loss Appropriation Account

Profits are an important part of a business so as its allocation. That is why the Profit and Loss Appropriation Account is an important part of an organization. Profit and Loss Appropriation Account is necessary for businesses, especially partnerships because they help to allocate the net of expenditures and incomes among the various partners. A firm prepares it after the preparation of profit and loss account at the end of every Financial Year. It is prepared just like many other ledger accounts.

Format of Profit and Loss Appropriation Account

Profit and Loss Appropriation Account

Particulars	**Amount**	**Particulars Amount**
To Net Loss transferred from P&L Account	XXXXX	By Net Profit Transferred XXXXX from the P&L Account
To Transfer of profit to Reserves		
To Salary to Partners, To Interest on Capital,	XXXXX	By interest on drawing by XXXXX the partners
To Commission to Partners	XXXXX	
To interest on Partner's Loan	XXXXX	
To profit t/s to partners' capital account	XXXXX	
	X**XXXX**	
	XXXXX	
	XXXXX	**XXXXX**

Drawings means the amount withdrawn by partners, in cash or in kind, for their personal use. Drawings are may be Out Of Profit or Out Of Capital. **Interest on Drawings** is calculated on Drawings Out of Profit. Interest on Drawings is income to the firm and an expense to the partners.

Treatment

▪ **If Partnership Deed is Silent :-** Interest on drawings is <u>not charged</u> from partners.

▪ **If Partnership Deed Provides :-** Interest on drawings is <u>charged</u> from partners.

▪ **Journal Entry: -**

Partner's Capital (or Current if Capital A/c is fixed) A/cs (individually) …. Dr

To Profit and Loss Appropriation A/c

▪ **If date of withdrawal is not given: -** Interest on total drawings for the year is calculated for 6 months on the average basis.

▪ **If rate of interest is given without the word 'per annum': -** Interest is charged without considering time.

- **Beginning of the Month - 6 ½ Months**
- **End of the Month - 5 ½ Months**
- **Middle of the Month - 6 Months**

Capital Accounts (Fixed and Fluctuating)

A Capital Account is a general ledger account which shows some of the special transactions like proprietor's investment in his own business, the aggregate amount of earning, expenses of companies, etc. There are many more transactions which affect the Capital. Like: Interest on Capital, Interest on Drawings, Salaries to the Partners, Commission for the Partners, etc. These values are put in Profit and Loss Appropriation Account and at the same time credited or debited to their respective Capital Accounts.

Methods of Capital Account Creation

- Fluctuating Capital Account Method
- Fixed Capital Account Method

Fluctuating Capital Account Method

Firstly, fluctuate means anything having unpredictable ups and downs. Hence, under this method, the Capital of each Partner keeps on changing from time to time.

In a firm, there is a single account under the name "Capital" which shows all the necessary information about the different transactions related to the capital. It mostly starts with a credit amount of the capital invested by the partner in the initial time of the business. All the adjustments leading to a decrease in the Capital are shown on the Debit side of the Capital Account. For example, Drawings by Partners and interest on drawings comes on the debit side of the Capital account. All the adjustments leading to an increase in the Capital are shown on the Credit side like salary to partners, commission, Profit for the year etc.

Partner's Capital Account

Description	*Amount*	*Description*	*Amount*
Balance b/d		Balance b/d	****
(In case of Debit opening balance)		(In case of Credit opening balance)	
Bank Account	****	Bank Account	****
(Permanent withdrawal of excess capital)		(Fresh capital introduced by partner)	
Drawing Account	****	Salary Account	****
Interest on Drawing Account	****	Interest on Capital Account	****
Profit and Loss Appropriation Account	****	Profit and Loss Appropriation Account	****
(For share of Loss)		(For share of profit)	
Balance c/d	****	Balance c/d	****
(In case when Credit closing balance)		(In case when Debit closing balance)	
Total	****	**Total**	****

Fixed Capital Account Method

Under this method, the firm prepares 2 accounts which show different transactions related to the capitals of the partners.

These two accounts are as follows:

(a) Fixed Capital Account

A firm prepares Fixed Account with very basic capital related transactions. Unlike the Capital account, under these repetitive capital related transactions does not affect the Capital balance. Like, Salary of employees, commission for employees, interest on capital, interest on drawings, etc.

The firm opens the account in the name of "Fixed Capital Account". Initial Investment will appear on the credit side as the starting entry. Only 2 kinds of Capital related transactions can affect its balance

(1) Addition of Capital

(2) Permanent Withdrawal of Capital

Partner's Capital Account

Description	Amount	Description	Amount
Bank Account	****	Balance b/d	****
(Permanent withdrawal of excess capital)		(Capital contributed till last year)	
Balance c/d	****	Bank Account	****
(Balance of capital at the end of year)		(Fresh capital introduced by partner)	
Total	****	**Total**	****

(b) Current Account

It includes all the capital related transactions other than the initial investment of capital, addition of capital and withdrawal of capital. Hence, It mainly includes items such as :

1. Interest on Capital
2. Interest on Drawings
3. Salaries and other remuneration to employees
4. Commission to employees and even more.

Hence, by preparing this account, we can let the main capital of the business "fixed". As a result of which there is no fluctuation at all. Hence, the firm will be able to find out the exact reasons behind the change.

Partner's Current Account

Description	Amount	Description	Amount
Balance b/d	****	Balance b/d	****
(In case of Debit opening balance)		(In case of Credit opening balance)	
Drawing Account		Salary Account	****
Interest on Drawing Account		Interest on Capital Account	****
Profit and Loss Appropriation Account		Profit and Loss Appropriation Account	****
(For share of Loss)		(For share of profit)	
Balance c/d	****	Balance c/d	****
(In case when Credit closing balance)		(In case when Debit closing balance)	
Total	****	**Total**	****

ADMISSION OF A PARTNER:

Admission of a partner

When a firm requires additional capital or managerial help or both for the expansion of its business a new partner may be admitted to supplement its existing resources. According to the Partnership Act 1932, a new partner can be admitted into the firm only with the consent of all the existing partners unless otherwise agreed upon. With the admission of a new partner, the partnership firm is reconstituted and a new agreement is entered into to carry on the business of the firm

Whenever a new partner is admitted into the firm he acquires 2 rights. 1. the right to share in the Assets of the partnership & 2. the right to share in the profits of the business.

For the right to acquire share in the assets and profits of the partnership firm, the partner brings an agreed amount of capital either in cash or in kind. Moreover, in the case of an established firm which may be earning more profits than the normal rate of return on its capital the new partner is required to contribute some additional amount known as premium or goodwill. This is done primarily to compensate the existing partners for loss of their share in super profits of the firm. The term premium means payment that one has to make for the purpose of enjoying the fruits of another person's efforts.

Following are the other important points which require attention at the time of admission of a new partner:

1. New profit sharing ratio;
2. Sacrificing ratio;
3. Valuation and adjustment of goodwill;
4. Revaluation of assets and Reassessment of liabilities;
5. Distribution of accumulated profits (reserves); and
6. Adjustment of partners’ capitals

Calculation of new profit sharing ratio

When a new partner is admitted he acquires his share in profits from the old partners. In other words, on the admission of a new partner, the old partners sacrifice a share of their profit in favour of the new partner. But, what will be the share of the new partner and how he will acquire it from the existing partners is decided mutually among the old partners and the new partner. However, if nothing is specified as to how the new partner acquires his share from the old partners; it may be assumed that he gets it from them in their profit sharing ratio. In any case, on admission of a new partner, the profit sharing ratio among the old partners will change keeping in view their respective contribution to the profit sharing ratio of the incoming partner. Hence, there is a need to ascertain the new profit sharing ratio among all the partners. This depends upon how the new partner acquires his share from the old partners for which there are many possibilities.

1. If the new partner share is given and nothing else is mentioned in the question, then it is presumed that the remaining partner will share the rest of the profits in the old ratio.

Illustration 1 Anil and Vishal are partners sharing profits in the ratio of 3:2. They admitted Sumit as a new partner for 1/5 share in the future profits of the firm. Calculate new profit sharing ratio of Anil, Vishal and Sumit.

Solution:

Sumit's share = 1/5

Remaining share = 1 - 1/ 5 − = 4/ 5

Anil's new share = 3/ 5 of 4/ 5 = 12 /25

Vishal's new share = 2/5 of 4/ 5 = 8/ 25

New profit sharing ratio of Anil, Vishal and Sumit will be 12:8:5.

2. The new partner, in some cases, purchases his share of profit from the old partners in a particular ratio. New profit sharing ratio of the old partners will be calculated by deducting the proportion given to the new partner from the shares of old partners.

Illustration 2 Anshu and Nitu are partners sharing profits in the ratio of 3:2. They admitted Jyoti as a new partner for 3/10 share which she acquired 2/10 from Anshu and 1/10 from Nitu. Calculate the new profit sharing ratio of Anshu, Nitu and Jyoti.

Solution :

Jyoti's share = 3 /10

Ashu's new share = 3/5 - 2/10 = 4/10

Nitu's new share = Old share – Share Surrendered

=2/5 - 1/10 = 3/10

The new profit sharing ratio between Anshu, Nitu and Jyoti will be 4 : 3 : 3.

3. In some cases, old partner surrender's a particular portion of his share in favour of a new partner. In this case, first of all standard proportion is to be calculated for each partner and then this will be deducted from his old profit sharing ratio in order to calculate his new profit sharing ratio.

Illustration 3 Ram and Shyam are partners in a firm sharing profits in the ratio of 3:2. They admit Ghanshyam as a new partner. Ram surrenders 1/4 of his share and Shyam 1/3 of his share in favour of Ghanshyam. Calculate new profit sharing ratio of Ram, Shyam and Ghanshyam.

Solution :

Ram's old share = 3/5

Share surrendered by Ram = 1/ 4 of 3/ 5 = 3/20

Ram's new share = 3 /5 - 3/20 = 9/20

Shyam's old share = 2 / 5

Share surrendered by Shyam = 1/ 3 of 2 / 5 = 2/15

Shyam's new share = 2 /5 - 2/15 = 4/15

Ghanshyam's new share = Ram's sacrifice + Shyam's Sacrifice

= 3/20 + 2/15 = 17/60

New profit sharing ratio among Ram, Shyam and Ghanshyam will be 27:16:17

4. Sometimes a new partner acquires his share from the old partner in a particular ratio.Then it becomes necessary to calculate the fraction of share which he got from

each partner. This fraction should be deducted from the share of the old partner in order to calculate the new profit sharing ratio.

Illustration 4 Ram and Shyam are partners sharing profits and losses in the ratio of 3:1. They agreed to admit Mohan into the partnership firm. Mohan is given 1/4th share in the future profits which acquires in the ratio of 2:1 from Ram and Shyam. Calculate the new profit sharing ratio?

Solution :

Mohan gets from Ram ¼ X ⅔ = 2/12

Mohan gets from Shyam = ¼ X ⅓ = 1 /12

Ram's Share = ¾ - 2/12 = 7/12

Shyam share = ¼ - 1/12 = 2/12

New profit sharing ratio of Ram: Shyam: Mohan = 7:2:3

Sacrificing ratio:

When a new partner is admitted, the old partner forgoes a fraction of his share in favour of the new partner, thus reducing the share of profit or loss of the old partner. Sacrifice made by the old partners can be found out by deducting the new share from the old share.

Sacrificing ratio = Old ratio - new ratio.

The new partner is required to compensate the old partner for their loss of share in the profits of the firm for which he brings in an additional amount known as premium or goodwill. This amount is shared by the existing partners in the ratio in which they forego their shares in favour of the new partner which is called the sacrificing ratio. The ratio is normally clearly given as agreed among the partners which could be the old ratio, equal sacrifice, or a specified ratio. If in addition to the old ratio of the old partner, the new ratio of the incoming partner is given then, in the absence of details of the sacrifices made by the old partners it is assumed that the loss is suffered by the old partner in their old profit sharing ratio.

Illustration 5 Rohit and Mohit are partners in a firm sharing profits in the ratio of 5:3. They admit Bijoy as a new partner for 1/7 share in the profit. The new profit sharing ratio will be 4:2:1. Calculate the sacrificing ratio of Rohit and Mohit.

Solution

Rohit's old share = 5/ 8

Rohit's new share = 4/7

Rohit's sacrifice = 5/ 8 - 4/7 = 3/56

Mohit's old share = 3 /8

Mohit's new share = 2/ 7

Mohit's sacrifice = 3 /8 - 2/ 7 = 5/56

Sacrificing ratio among Rohit and Mohit will be 3:5

Treatment of Goodwill

Over a period of time a well established business develops an advantage of good name, reputation and wide business connections. This helps the business to earn more profits when compared to new competitors.In accountancy, the monetary value of such an advantage is called Goodwill.It is an intangible asset.
Goodwill is the reputation of the firm in respect of profits expected in future, over and above the normal rate of profits.It is generally observed that when a person pays for Goodwill, they pay for something which places them in a special position of being able to earn super profits as compared to the profits earned by the other firms in the same industry.
Goodwill may be defined as the " Present value of a firm's anticipated excess earnings."

Factors Affecting Goodwill

1. **Quality Of Product:** Better quality of product will increase the sales and profits, which will increase the value of goodwill.
2. **Efficiency Of Management:** A well-handled interest normally enjoys the merit of more cost efficiency and productivity, which will increase the value of goodwill. 3. **Location:** The better location will attract more customers resulting in an increase in sales and profits, which, in turn, will result in an increase in the value of goodwill. 4. **Nature of Business:** If the business is dealing in necessary goods or it is in a monopoly situation or limited competition , this facilitates the concern to earn more gains which leads to more value of goodwill
5. **Access To Supplies (Raw Material Etc.):** If a firm has better access to supplies or assured supply of inputs, then it enjoys a better reputation than others and higher goodwill.
6. **Special Advantages:** If a firm enjoys special advantages like patents, trademarks, brand image, or any other exclusive benefit, then the firm enjoys a higher value of goodwill.
7. **External resources:** After-sales service, Research & Development, Effectiveness of Advertisement, the supply of electricity, import licenses, well-known collaborators, long-term contracts for the supply of materials, trademarks, patents, etc. certainly enjoy more value of goodwill.
8. **Time factor:** Time also increases the value of Goodwill. The business or profession which is running for the last 20 years on profits will have more value than the business that has been established only 2 yrs back.
9. **Capital requirements:** If the business requires more capital , the value of Goodwill in such business will be less as compared to a business where the capital required is less.
10. **Possibility of competition:** The value of goodwill will be more in those businesses where there is no competition or competition is negligible.

Need for Valuation of Goodwill

● The difference in the profit-sharing ratio (PSR) amongst the existing partners ● Admission of a new partner
● Retirement of a partner
● Death of a partner
● Dissolution of an enterprise involving the sale of the business as a trading concern ● Amalgamation of partnership firms

Methods of Valuation of Goodwill

The significant methodologies of valuation are mentioned :

- Average Profits Method
- Super Profits Method
- Capitalisation Method

Average Profits Method

Under this method, the goodwill is valued at agreed number of 'years' purchase of the average profits of the past few years. It is based on the assumption that a new business will not be able to earn any profits during the first few years of its

operations. Hence, the person who purchases a running business must pay in the form of goodwill a sum which is equal to the profits he is likely to receive for the first few years. The goodwill, therefore, should be calculated by multiplying

the past average profits by the number of years during which the anticipated profits are expected to accrue.

For example, if the past average profits of a business works out at Rs. 20,000 and it is expected that such profits are likely to continue for another three years, the value of goodwill will be Rs. 60,000 (Rs. 20,000 × 3).

Super Profit Method

The basic assumption in the average profits (simple or weighted) method of calculating goodwill is that if a new business is set up, it will not be able to earn any profits during the first few years of its operations. Hence, the person who purchases an existing business has to pay in the form of goodwill a sum equal to the total profits he is likely to receive for the first 'few years'. But it is contended that the buyer's real benefit does not lie in total profits; it is limited to such amounts of profits which are in excess of the normal return on capital employed in similar business. Therefore, it is desirable to value, goodwill on the basis of the excess profits and not the actual profits. The excess of actual profits over the normal profits is termed as super profits.

$$\text{Normal Profit} = \frac{\text{Capital Employed} \times \text{Normal Rate of Return}}{100}$$

Suppose an existing firm earns Rs. 18,000 on the capital of Rs. 1,50,000 and the normal rate of return is 10%. The Normal profits will work out at Rs. 15,000 (1,50,000 × 10/100). The super profits in this case will be Rs. 3,000 (Rs. 18,000 – 15,000). The goodwill under the super profit method is ascertained by multiplying the super profits by certain number of years' purchase. If, in the above example, it is expected that the benefit of super profits is likely to be available for 5 years in future, the goodwill will be valued at Rs. 15,000 (3,000 × 5). Thus, the steps involved under the method are:

1. Calculate the average profit,
2. Calculate the normal profit on the capital employed on the basis of the normal rate of return,
3. Calculate the super profits by deducting normal profit from the average profits, and
4. Calculate goodwill by multiplying the super profits by the given number of years' purchase.

Capitalisation Methods

Under this method the goodwill can be calculated in two ways: (a) by capitalizing the average profits, or (b) by capitalizing the super profits.

(a) *Capitalisation of Average Profits:* Under this method, the value of goodwill is ascertained by deducting the actual capital employed (net assets) in the business from the capitalized value of the average profits on the basis of normal rate of return. This involves the following steps:

(i) Ascertain the average profits based on the past few years' performance. (ii) Capitalize the average profits on the basis of the normal rate of return to ascertain the capitalised value of average profits as follows:

Average Profits × 100/Normal Rate of Return

(iii) Ascertain the actual capital employed (net assets) by deducting outside liabilities from the total assets (excluding goodwill).

Capital Employed = Total Assets (excluding goodwill) – Outside Liabilities (iv) Compute the value of goodwill by deducting net assets from the capitalised value of average profits, i.e. (ii) – (iii).

Capitalisation of Super Profits: Goodwill can also be ascertained by capitalising the super profit directly. Under this method there is no need to work out the capitalised value of average profits. It involves the following steps.

(i) Calculate capital employed of the firm, which is equal to total assets minus outside liabilities.

(ii) Calculate normal profits on capital employed. (iii) Calculate average profit for past years, as specified.

(ii) Calculate super profits by deducting normal profits from average profits.
(iii) Multiply the super profits by the required rate of return multiplier,

that is, Goodwill = $\frac{\text{Super Profits} \times 100}{\text{Normal Rate of Return}}$

In other words, goodwill is the capitalised value of super profits. The amount of goodwill worked out by this method will be exactly the same as calculated by capitalising the average profits.

The various methods of treating goodwill in the books of the firm at the time of of admission of new partner are as follows:

1. **When the amount of goodwill is paid privately:** Sometimes goodwill is not brought into the partnership books at all but is paid separately by cheque to the old partners by the newcomer & is treated as a matter outside the business. In this case no entry is passed in the books of accounts.
2. **When the goodwill is received in cash & retained in the business**: In this case the amount of goodwill received is entered in the books of accounts & is retained in the business as additional working capital after the old partners capital accounts have been duly credited with their shares in the sacrificing ratios.

Journal entry:

i.) Cash/ Bank A/c Dr.
To goodwill (premium)A/c

ii.) Goodwill (premium) A/c Dr (in sacrifice ratio)
To Old partners' capital A/c

Or alternatively 1 entry an be passed
Cash/ Bank A/c Dr.
To Old partners' capital A/c

3. **When the amount of goodwill is received in cash & withdrawn by old partners**: In this case the goodwill is recorded in the books as received but is immediately withdrawn by the old partners in their sacrificing ratios

Journal entries:

i.) Cash/ Bank A/c Dr.
To goodwill (premium)A/c

ii.) Goodwill (premium) A/c Dr (in sacrifice ratio) To Old partners' capital A/c

Or alternatively 1 entry an be passed
Cash/ Bank A/c Dr.
To Old partners' capital A/c

iii.) Old Partners' capital A/c Dr.
To Cash / Bank A/c

Revaluation of assets & liabilities :-

Revaluation account :-

Account which is prepared to record changes in the value of assets & liabilities at time of admission, retirement, death and change in profit ratio of existing partners.This account is debited with all losses and credited with all gains. Balance of Revaluation Account is transferred to the old partner in their old ratio. Proforma of Revaluation Account is given below :-

Revaluation Account

Particulars		Particulars	Amount
To Decrease in value of assetsTo Increase in value of liabilities To Unrecorded liabilities To Profit on revaluation transferred to partner’s capital accounts (in old ratio)		By Increase in value of assets By Decrease in value of liabilities By unrecorded assets By loss on revaluation transferred to partners’ capital accounts (in old ratio)	

Partners’ Capital Account

Particulars	A	B	C	Particulars	A	B	C
To drawings To interest on drawings To profit & loss (Share of loss) To revaluation A/c (share of loss) To balance c/d				By balance b/d By cash/bank A/c By interest on capital By salary By commission By P&L appropriation A/c (share of profit) By revaluation A/c (share of profit)			

Revaluation Journal entries

For decrease in the value of assets & increase in the value of Assets / unrecorded Assets:-

1. Revaluation A/c Dr.
To assets A/c (decrease)

2. Assets A/c Dr.
To revaluation A/c
(increase)

3. Unrecorded assets A/c Dr.
To revaluation A/c

ii.) For increase / decrease of liabilities or unrecorded liabilities :- 1. Revaluation A/c. Dr.
To liabilities A/c (increase)

2. Liabilities A/c Dr.
To Revaluation A/c (decrease)

3. Revaluation A/c Dr
To unrecorded liabilities A/c

iii.) Revaluation A/c shows profit or loss :-
1. Revaluation A/c. Dr. (in profit)
To Old partners' capital A/c (in old ratio)

2. Old partners' capital A/c. Dr. (in loss)
To revaluation A/c (in old ratio)

Accounting treatment of reserves and accumulated profits or losses :- Accumulated profits and reserves are distributed to partners in their old profit sharing

ratio.

i.) For distributing reserves and accumulated profits among old partners in old ratio -

General reserve A/c Dr.
Reserve A/c Dr.

P&L A/c {cr. Balance} Dr.
To old partners' capital a/c / current a/c.

ii.) For distributing accumulated losses among old partners in old ratio

Old partner's capital A/c Dr.
To P&L A/c { Dr. balance}

Adjustment of old partner's capital accounts on the basis of new partner's capital:-

When the capitals of old partners are adjusted on the basis of the newly admitted partner. In such a case the following steps have to be followed : 1. Entire capital of the firm is determined on the basis of the new partners capital account.

2. Then amount of capital of each partner is determined on the basis of division of capital in step 1 in their profit sharing ratio
3. The difference in the old capital & the capital in step 2 is found out and the necessary journal entries are passed

i.) If the existing capital of any partner is less then his newly calculated capital:- Bank A/c / Partner's Current a/c. Dr.
To Old Partner's Capital A/c.

ii) If the existing capital of any partner is more than his newly calculated capital : Old Partner's Capital A/c. Dr.
To Bank A/c. / Partner's Current A/c.

Admission of a partner (practical problems)

Problem no 1

Find the new profit sharing ratio

1. Amar Akbar and Anthony sharing profits and losses in the ratio of 5:3:2 . they admit Waheguru into partnership for 1/5 share. Find the new profit sharing ratio

2. Ram & Shyam are partners in a firm sharing profits and losses in the ratio of 3:2 they admit Ravan join the firm and Ram surrenders ¼ share and Shyam ⅕ of his share in the favour of Ravan.

3. A and B are partners they admit C for or 1/4 the share in future the ratio between A and B would be 2 :1

4. Seeta and Geeta partners sharing profits and losses in the ratio of 3 :2 they admit meeta other new partner for ⅕ share in profit Which which She acquires ⅕ from Sita and ⅘ from Geeta

5. X Y and Z are partners sharing profits and losses if the ratio of 3:2:1 . they admit W as a new partner for 1/6 share in profits and Z would retain his original share

6. P and Q sharing profit and losses in the ratio of 3:2 . R is admitted for ¼ share and P and Q decided to share equality in future

Answer:(1)10:6:4:5 (2)45:32:23 (3) 2:1:1 (4) 14:6:5 (5) 12:8:5:5 (6) 3:3:2

Problem no 2

Sandeep and Navdeep are partners in a firm sharing profits in 5:3 ratio. They admit C into the firm and the new profit sharing ratio was agreed at 4:2:1. Calculate the sacrificing ratio?

Answer-(3:5)

Problem no 3

Rao and Swami are partners in a firm sharing profits and losses in 3:2 ratio. They admit Ravi as a new partner for 1/8 share in the profits. The new profit sharing ratio between Rao and Swami is 4:3. Calculate new profit sharing ratio and sacrificing ratio? **Answer: (4:1)**

Problem no 4

Compute the value of goodwill on the basis of four years' purchase of the average profits based on the last five years? The profits for the last five years were as follows:

Year	Amt. (₹)
2002	40,000
2003	50,000
2004	60,000
2005	50,000
2006	60,000

Answer : Goodwill = 2,08,000

Problem no 5

Capital employed in a business is Rs. 2,00,000. The normal rate of return on capital employed is 15%. During the year 2002 the firm earned a profit of Rs. 48,000. Calculate goodwill on the basis of 3 years purchase of super profit?

Answer : Goodwill =54,000

Problem no 6
Rajan and Rajani are partners in a firm. Their capitals were Rajan Rs. 3,00,000; Rajani Rs. 2,00,000. During the year 2002 the firm earned a profit of Rs. 1,50,000. Calculate the value of goodwill of the firm assuming that the normal rate of return is 20%?

Answer : Goodwill =2,50,000

Problem no 7
Verma and Sharma are partners in a firm sharing profits and losses in the ratio of 5:3. They admitted Ghosh as a new partner for 1/5 share of profits. Ghosh is to bring in Rs. 20,000 as capital and Rs. 4,000 as his share of goodwill premium. Give the necessary journal entries:
a) When the amount of goodwill is retained in the business.
b) When the amount of goodwill is fully withdrawn.
c) When 50% of the amount of goodwill is withdrawn.
d) When goodwill is paid privately

Problem no 8
Given below is the Balance Sheet of A and B, who are carrying on partnership business on 31.12.2006. A and B share profits and losses in the ratio of 2:1.

Balance Sheet of A and B
as on December 31, 2006

Liabilities		Amt. (₹)	Assets	Amt. (₹)
Bills Payable		10,000	Cash in Hand	10,000
Creditors		58,000	Cash at Bank	40,000
Outstanding Expenses		2,000	Sundry Debtors	60,000
			Stock	40,000
Capitals			Plant	1,00,000
A	1,80,000		Buildings	1,50,000
B	1,50,000	3,30,000		
		4,00,000		4,00,000

C is admitted as a partner on the date of the balance sheet on the following terms:
(i) C will bring in Rs. 1,00,000 as his capital and Rs. 60,000 as his share of goodwill for 1/4 share in the profits.
(ii) Plant is to be appreciated to Rs. 1,20,000 and the value of buildings is to be appreciated by 10%.
(iii) Stock is found over valued by Rs. 4,000.
(iv) A provision for bad and doubtful debts is to be created at 5% of debtors. (v) Creditors were unrecorded to the extent of Rs. 1,000. Pass the necessary journal entries, prepare the revaluation account and partners' capital accounts, and show the Balance Sheet after the admission of C.

(Answer : Revaluation profit -27,000;capital accounts A- 2,38,000 B-1,79,000 C-1,00,000;B/S 5,88,000)

Problem no 9

A and B share profits in the proportions of 3/4 and 1/4 . Their Balance Sheet on Dec. 31, 2006 was as follows:

Balance Sheet of A and B
as on December 31, 2006

Liabiliti :	Amt. (₹)	Assets	Amt. (₹)
Sundry Creditors	41,500	Cash at Bank	26,500
Reserve Fund	4,000	Bills Receivable	3,000
Capital Accounts		Debtors	16,000
A	30,000	Stock	20,000
B	16,000	Fixtures	1,000
		Land and Building	25,000
	91,500		91,500

On Jan. 1,2007, C was admitted into partnership on the following terms: (a) That C pays Rs. 10,000 as his capital.
(b) That C pays Rs. 5,000 for goodwill. Half of this sum is to be withdrawn by A and B.
(c) That stock and fixtures be reduced by 10% and a 5%, provision for doubtful debts be created on Sundry Debtors and Bills Receivable.
(d) That the value of land and buildings be appreciated by 20%.
(e) There being a claim against the firm for damages, a liability to the extent of Rs. 1,000 should be created.
(f) An item of Rs. 650 included in sundry creditors is not likely to be claimed and hence should be written back.
Record the above transactions (journal entries) in the books of the firm assuming that the profit sharing ratio between A and B has not changed. Prepare the new Balance Sheet on the admission of C.
(Answer: Revaluation profit -1,600;capital accounts A- 36,075 B-18,025; C-10,000;B/S 1,05,950)

Problem no. 10

The following was the Balance Sheet of Arun, Bablu and Chetan sharing profits and losses in the ratio of 6:5:3

Liabilities		Amt. (₹)	Assets	Amt. (₹)
Creditors		9,000	Land and Buildings	24,000
Bills Payable		3,000	Furniture	3,500
Capital Accounts			Stock	14,000
Arun	19,000		Debtors	12,600
Bablu	16,000		Cash	900
Chetan	8,000	43,000		
		55,000		55,000

They agreed to take Deepak into partnership and give him a share of 1/8 on the following terms: a) that Deepak should bring in Rs. 4,200 as goodwill and Rs. 7,000 as his Capital; (b) that furniture be depreciated by 12%; (c) that stock be depreciated by 10% (d) that a Reserve of 5% be created for doubtful debts: (e) that the value of land and buildings having appreciated be brought upto Rs. 31,000 ;(f) that after making the adjustments the capital accounts of the old partners (who continue to share in the same proportion as before) be adjusted on the basis of the proportion of Deepak's Capital to his share in the business, i.e., actual cash to be paid off to, or brought in by the old partners as the case may be. Prepare Cash Account, Profit and Loss Adjustment Account (Revaluation Account) and the Opening Balance Sheet of the new firm. **(Answer: Revaluation profit -4,550;capital accounts A-21,000 ;B- 17,500 ; C-10,500;D-7,000 B/S 68,000)**

Problem no. 11

Azad and Babli are partners in a firm sharing profits and losses in the ratio of 2:1. Chintan is admitted into the firm with 1/4 share in profits. Chintan will bring in Rs. 30,000 as his capital and the capitals of Azad and Babli are to be adjusted in the profit sharing ratio. The Balance Sheet of Azad and Babli as on December 31, 2006 (before Chintan's admission) was as follows:

Balance Sheet of A and B

as on 31.12.2006

Liabilities		Amt. (₹)	Assets	Amt. (₹)
Creditors		8,000	Cash in Hand	2,000
Bills Payable		4,000	Cash at Bank	10,000
General Reserve		6,000	Sundry Debtors	8,000
Capital Accounts			Stock	10,000
Azad	50,000		Furniture	5,000
Babli	32,000	82,000	Machinery	25,000
			Buildings	40,000
		1,00,000		1,00,000

It was agreed that:

i) Chintan will bring in Rs. 12,000 as his share of goodwill premium. ii) Buildings were valued at Rs. 45,000 and Machinery at Rs. 23,000. iii) A provision for doubtful debts is to be created @ 6% on debtors. iv) The capital accounts of Azad and Babli are to be adjusted by opening current accounts. Record necessary journal entries, show necessary ledger accounts and prepare the Balance Sheet after admission.

(Answer: Revaluation profit -2,520;capital accounts A-60,000 ;B-30,000 ; C-30,000; current account A -3,680 B- 8,840 B/S 1,44,520)

Problem no. 12

Ashish and Dutta were partners in a firm sharing profits in 3:2 ratio. On Jan. 01, 2007 they admitted Vimal for 1/5 share in the profits. The Balance Sheet of Ashish and Dutta as on Jan. 01, 2007 was as follows:

Balance Sheet of A and B

as on 1.1.2007

Liabilities	Amt. (₹)	Assets		Amt. (₹)
Creditors	15,000	Land and Building		35,000
Bills Payable	10,000	Plant		45,000
Ashish's Capital	80,000	Debtors	22,000	
Dutta's Capital	35,000	(–) Provision	(2,000)	20,000
		Stock		35,000
		Cash		5,000
	1,40,000			1,40,000

It was agreed that:

i) The value of Land and Building be increased by Rs. 15,000.

ii) The value of plant be increased by 10,000.

iii) Goodwill of the firm be valued at Rs. 20,000.

iv) Vimal to bring in capital to the extent of 1/5th of the total capital of the new firm. Record the necessary journal entries and prepare the Balance Sheet of the firm after Vimal's admission.

Answer: Revaluation profit -25,000;capital accounts Ashish-97,400 ;Dutta- 46,600 ; Vimal-36,000; B/S 2,05,000)

RETIREMENT OF A PARTNER

A partner may ascertain to either withdraw or retire from the enterprise due to certain reasons such as his bad health, his age, change in enterprise's nature of a business, etc., In the Partnership at Will, a partner might retire at any time. Retirement leads to a reconstitution of an enterprise where the partners' contribution ratio and the profit sharing ratio change. The retiring partner is given his share of capital, revaluation profit or loss and goodwill. A Partner has the right to retire from the firm after giving due notice in advance. A new partnership comes into existence between the remaining partners.

A retiring partner is entitled to get the following:

1) Share in goodwill; Goodwill of the firm is valued and the retiring partners share of goodwill is credited to his capital account.
2) Share in Reserves: Reserves are the undistributed profits and it is also credited to the capital account of the retiring partner.
3) Share in revaluation of assets and liabilities: Assets and liabilities are revalued on the date of retirement and retiring partner's share of profit is credited or the loss is debited to his capital account.

Accounting problems:

1) Calculation of new profit sharing ratio and gaining ratio of the continuing partners.
2) Treatment of goodwill.
3) Accounting treatment for revaluation of assets and liabilities.
4) Accounting treatment of reserves, accumulated profits and losses.
5) Accounting treatment of joint life policy.
6) Share in profits upto date of retirement
7) Payment to a retiring partner.
8) Adjustment of capitals in proportion to profit sharing ratios.

Calculation of new profit sharing ratio:

1) If the new profit sharing ratios of the remaining partners are not given in the question ,it will be assumed that the remaining partners continue to share profits and losses in the old ratio.
2) Sometimes the remaining partners purchase the share of retiring partner in some specified proportion .In such cases the fraction of shares purchased by them is added to their old share and the new ratio is calculated as follows:-
New ratio = old ratio + gain

Calculation of Gaining Ratio:

- Meaning of Gaining Ratio: Gaining ratio is the ratio in which the remaining partners will pay the amount of goodwill to the retiring partners.

- Calculation of Gaining Ratio:

1) If the new profits sharing ratios of the remaining partners are not given in the question, it will be assumed that the remaining partners continue to gain in the old ratio. 2) If the new profit sharing ratio of the remaining partners is given in the question, gaining ratio is calculated by deducting the old ratio from the new ratio.

Gaining Ratio = New Ratio – Old Ratio

*Difference between sacrificing Ratio and Gaining Ratio:

Basis	Sacrificing Ratio	Gaining Ratio
1) Meaning:	The ratio in which the old partners surrender a part of their share in favour of a new partner.	The ratio in which the remaining partner’s acquire the outgoing partners share.
2)When calculated	Calculated at the time of the admission of a new partner.	Calculated at the time of the retirement or death of a partner.
3)Formula for calculation	Sacrificing Ratio=Old Ratio-New Ratio	Gaining Ratio=New Ratio-Old Ratio
4) Purpose	New partners' share of goodwill is divided between the old partners in sacrificing ratio.	Goodwill paid to retiring partners is paid by the remaining partners in their gaining ratio.

Accounting Treatment of Goodwill:

1) Remaining partner’s capital A/c Dr. (In gaining ratio)
To Retiring partner’s capital A/c (with his share of goodwill)

2) When the goodwill A/c is already appearing in the books:
i) All partner’s capital A/c Dr.(in old ratio)
To Goodwill A/c (goodwill existing in the books)

ii) Remaining partner’s capital A/c Dr. (in the gaining ratio) To Retiring partner’s capital A/c

Adjustment of Accumulated profits and reserves:

1) For distributing reserves and accumulated profits- General Reserve A/c Dr.
Reserve Fund A/c Dr.
Profit and loss A/c (cr.) Dr.

To All partners capital or current A/c (in old ratio)
2) For distributing accumulated losses:
All partner's capital or current A/c Dr. (in old ratio) To Profit and loss A/c
3) For distributing surplus of specific funds:
Workmen compensation fund A/c Dr.
Investment fluctuation fund A/c Dr.
To All partner's capital or current A/c (in old ratio)

Adjustment of joint life policy on retirement of a partner:

1) when premium paid has been considered as revenue expenditure:
- Joint life policy A/c Dr. (surrender value on the date of retirement) To All partner's capital A/c (in old ratio)
2) when remaining partners decide not to show Joint life policy in books:

Remaining partner's capital A/c Dr. (in new profit sharing ratio) To Joint life policy A/c
3) when premium paid has been considered as capital expenditure: No further treatment required
if remaining partners decide not to show Joint life policy in books-

Remaining partner's capital A/c (in new ratio)
To Joint life policy A/c

Payment to retiring partner

a) If the amount is paid in cash or by cheque to retiring partner:

Retiring partner's capital A/c Dr.
To cash/Bank A/c (His share paid off)

b) If the amount is not paid in cash, the amount due to him will be transferred to his loan A/c: Retiring partner's capital A/c Dr. To Retiring partner's loan A/c

Death of a Partner

In the event of death of a partner, the structure of the partnership is changed in the same way as when a partner retires

According to the Indian Partnership Act, 1932. Deceased partner is one who has discontinued the partnership due to his death. A contract between the partners of the enterprise is not dissolved by the death of a partner, the estate of a dead partner is not responsible for any act of the enterprise done after his death.

The accounting treatment in the occurrence of death of a partner is :

- Similar to that, when a partner retires and that in case of deceased partner his belonging is transferred to his legal enforcers and settled in a similar way as that of the partner who retires
- However, there is one primary distinction, the retirement usually takes place during the closure of an accounting period or financial year, the death of a partner may take place any time
- Therefore, in the case of a partner, his rights shall also incorporate his share of gains or loss, interest on drawings (if any), interest on capital from the last date of the Balance Sheet to the date of his death of these, the main issue associates to the computation of profit for a moderate period
- Since, it is contemplated burdensome to close the books and outline final a/c, for the period, the dead partner's share of profit may be computed on the ground of previous year's gain (or aggregate of past few years) or on the base of sales.

1. Distribution of Existing Goodwill

All Partners' Capital A/c Dr.

To Goodwill A/c

(Being Goodwill written off)

Note : If Goodwill appears in the Balance sheet

2. Deceased partner's Share of Goodwill

Remaining Partners capital A/c Dr.

To Deceased Partners Capital A/c

3. Distribution of Reserves

Reserve fund/General Reserve A/c Dr.

To All Partners' Capital A/c

(Being the reserves amount distributed among all the partners)

4. Distribution of Accumulated Losses

All Partners' Capital A/c Dr.

To Profit & Loss A/c

5. Distribution of Accumulated Profits

Profit & Loss A/c Dr.

To All Partners' Capital A/c

Section 37 of the Partnership Act, the executive of the deceased partner would be entitled at their discretion either interest 6% per annum for the amount due from the date of death to the date of payment or to that portion of the profit that is earned by the firm with the amount due to the deceased partner.

1. Calculation of of deceased partner share of profits
2. Treatment of life policy or policies

1. Calculation of deceased partner share of profit: This can be determined either on the basis of time or turn over

a. On the basis of time: in this case it is assumed that the profit during the previous year has been earned uniformly in all months during the year, provided previous year is taken as the base for calculation of profits. Sometimes average profit for the past three or four years is taken as base rather than the previous year. Whatever base may be taken it is to be multiplied by the period for which the deceased partner remained in the and also by his profit sharing ratio at the time of his death.
b. On the basis of turnover: In this method, average past profit is divided into two portions, i.e., before the death and after the death on the basis of ratio of turnover to the date of death average turnover and then deceased partner share is calculated and credited to his capital account.

Journal Entry

Profit & Loss Suspense A/C…...Dr

To Deceased partners Capital A/C

(Being a deceased partner's share in the profit credited to his capital account)

2. Treatment of life policy or policies: When a partner dies, his legal representatives are required to be paid a large sum of money which might affect the financial as well as working position of the partnership business. To provide funds to the legal representatives of the deceased partner generally A Joint life policy or individual life policies for partners might be taken. The premium for such policies is charged to the profit and loss account.Joint life policy is an asset of the firm and the deceased partner has a right to share any profits or losses on such policy. So the claim which is received by the firm on the death of a partner is divided among the partner and credited to their capital accounts in their profit sharing ratio. If the firm has taken individual life policies and the
premiums were charged to the profit and loss account then, the deceased partner has a right share the amount not only received from Life Insurance Corporation of India but also the surrender value which the other partners policies would acquire at the time of his death.

Journal Entry

a. For Joint life Policy

Joint Life Policy A/C Dr.

To, All Partner's Capital A/c

b. For Individual Life policy

Insurance Policy A/c Dr.

To, All Partner's Capital A/c