THIRD YEAR

VI SEMESTER BBA-601

ADVANCED ACCOUNTANCY

Unit I: Company Final Account:

Companies are governed by the Companies Act, 1956. Therefore, it is statutory obligation that all companies are expected to follow the relevant section for the Act that governs the maintaining of accounts.

Section 209 and 210 of the companies act specifies regarding preparation of final accounts. Section 2.9 to 217 of the Companies Act deals with the preparation and presentations of accounts by the company.

The Companies Act requires every company to prepare every year a Profit and Loss Account or Income and Expenditure Account and Balance Sheet of the end of the year – Final Accounts of company including Trading Account, Profit and Loss Account, Profit and loss Appropriation Account and Balance Sheet.

Final Accounts:

Section 210 of the Companies Act governs the preparation of final account of a Company. The Board of Directors of a Company must, within 18 month from the date of incorporation, and subsequently once a year, lay take the company in general meeting the Balance Sheet of the Company and a Profit and Loss Account.

PROFIT ANS LOSS APPROPRIATION ACCOUNT FOR THE YEAR ENDED

Dr. Cr.

	Rs.		Rs.
To Transfer to Reserves		By Balance brought forward	
To General Reserve		From last year	
To Sinking Fund		By Net Profit from the Profit	
To Expenses of Last year		And Loss A/c	
To Interim Dividend		By Transfer from Reserves	
To Proposed Dividend		By Transfer from Reserves no	
To Surplus Carried to Balance Sheet		Longer required	

COMPANY FINAL ACCOUNTS

A: Horizontal form

Schedule VI (see. Section 211)

Part I – Form of Balance Sheet

Balance Sheet ..... (enter the name of the company here)

As on ...... (enter the date at which the Balance Sheet is made out here)

Figures for the pervious year Rs.	Liabilities	Figures for the current year Rs.	Figures for the previous year Rs.	Assets	Figures for the current year Rs.
	Share capital : Authorised ..... shares of Rs..... each Issued (distinguishing between the various classes of capital and stating the particulars specified below in respect of each class) .....shares Rs. ..... each subscribed (distinguishing) between the various classes of capital and stating the particulars specified below in respect of each class) ..... shares .... Of Rs..... each Rs..... called up. Of the above shares ..... shares are allotted as fully paid pursuant to a contract without payment being received in cash. Of the above shares ..... shares are allotted as fully paid up by way of bonus shares. *Less*: calls-in-arrears (i) By Directors (ii) By Others Add: Forfeited shares (amt originally paid up) *Reserves and surplus*: 1. Capital reserve 2. capital redemption reserve			Fixed Assets: (a) Goodwill (b) Land (c) Buildings (d) Leaseholds (e) Railway sidings (f) Plant & Machinery (g) Furniture & fittings (h) Development of property (i) Patents, trademarks and designs (j) Livestock (k) Vehicles etc. Investments: Showing nature of investments and mode of valuation, for example, cost or market value and distinguishing between: 1. Investments in Government or trust securities. 2. Investment in shares. Debentures or bonds 3. immovable properties 4. investment in the capital of partnership firm *current assets loans and advances*: I current assets: (a) interest accrued on investments (b) Stores and spare parts	

	3. securities premium A/c			(c) Loose tools	
	4. other reserves specifying the nature of each reserve and the amount in respect thereof.			(d) Stock-in-trade	
	Less: Debit balance in P & L A/c (if any)			(e) Work-in-progress	
	5. Surplus i.e., Balance in P & L A.c after providing for proposed allocations, namely dividend, bonus or reserves.			(f) Sundry debtors	
	6. proposed additions to reserves			(g) Debts outstanding for a period exceeding six months	
	7. sinking funds			(ii) Other debts	
	secured loans			*Less*: Provisions	
	1. Debentures			(g) (i) Cash balance in hand	
	2. loans and advances from banks to			(ii) Bank Balance	
	3. loans and advances from subsidiaries			(i) with scheduled banks and	
	4. Other loans & advances			(ii) With others.	
	Unsecured loans:			***II loans and Advances***:	
	1. Fixed deposits			(h) (i) Advances & Loans to subsidiaries	
	2. Loans and advances from subsidiaries			(ii) Advances and Loans to partnership firm	
	3. short term loans and advances			(i) Bill of exchange	
	4. other loans and advances			(ii) Advances recoverable in cash or in kind or for value to be received e.g., rates, taxes, insurance. Etc.	
	(a) From banks			(k) Balance on current account with managing agents or secretaries and treasurer	
	(b) From other			(l) Balances with customs, part trust, etc, (where payable on demand)	
	Current liabilities and provisions:			Miscellaneous expenditure (To the extent not written off or adjusted)	
	(A) *Current liabilities*:			1. Preliminary expenses	
	1. Acceptances			2. Expenses incurred commission or brokerage on under writing or subscription of shares or debentures	
	2. Sundry creditors			3. Discount allowed on the issue of shares or debentures.	
	3. Subsidiary companies			4. Interest paid out of capital during contraction (also stating	
	4. advance payments and- unexpired discounts for the portions for which value has still to be given i.e., in case of the following companies: Newspaper, fire insurance, theatres, clubs				

	banking, steamship companies, etc, 5. Unclaimed dividends 6. other liabilities (if any) 7. Interest accrued but not due on loans **(B) Provisions:** 1. Provisions for taxation 2. Proposed dividends 3. for contingencies 4. for provident funds schemes 5. for insurance pension and similar staff benefit schemes 6. Other provisions (a foot note to be Balance Sheet may be added to show separately) 1. Claims against the company not acknowledged as debts. 2. Uncalled liability on shares, partly paid 3. Arrears of fixed cumulative dividends 4. Estimated amount of contracts remaining to be executed on c capital account and not provided for. 5. Other money for which the company is contingently liable			the rate of interest) 5. Development expenditure not adjusted 6. Other items (specifying nature) *Profit & Loss A/c* (show here the debit balances of P & L A/c carried forward, after deduction of the uncommitted reserves, if any)	

B. Vertical Form

Name of the Company

Balance Sheet as at

			Schedule No.	Figures at the end of current financial year Rs.	Figures at the end of previous financial year Rs.
	Source of funds:				
	(1) Shareholders funds:				
	(a) Capital				
	(b) Reserves and surplus				
	(2) *Loan funds*				
	(a) Secured loans				
	(b) Unsecured Loans				
	Total				
	Application of funds:				
	(1) Fixed assets				
	(a) Gross block				
	(b) Less depreciation				
	(c) Net block				
	(d) Capital work-in-progress				
	(2) Investments				
	(3) Current assets, Loans & Advances				
	(a) Inventories				
	(b) Sundry debtors				
	(c) Cash & Bank Balances				
	(d) Other current assets				
	(e) Loans and advances				
	Less: Current liabilities & Provisions				
	(a) Liabilities				
	(b) Provision				
	Net current assets				
	(4) (a) Miscellaneous expenditure to the extent not written off or adjusted				
	(b) Profit & Loss A/c				
	Total				

1. Details under each of the above items shall be given in separate schedules. The schedules shall incorporate all the information required to be given under A. Horizontal form read with notes containing general instructions for preparation of Balance Sheet.

2. The schedules, referred to above, accounting policies and explanatory notes that may be attached shall form an integral pan of the Balance Sheet.

3. The figures in the Balance Sheet may be rounded off to the nearest '000' or '00' as may be expressed in terms of decimals of thousands.

4. A foot note to the Balance Sheet may be added to show separately the contingent liabilities.

(VIII) Special points to be remembered while preparing Balance Sheet:

1. Calls-in-arrears:

It refers to the amount not paid by the shareholders on the calls made on them by the company. This item is usually given in the trial balance. It should be deducted from the called up the liabilities side of the Balance Sheet to find paid up capital.

If the Trial balance shows only the paid up capital and the call-in-arrears is given in the adjustment, the amount is first added to the paid up capital to show the called up capital and then deducted against so that the paid up capital can be shown in the outer column.

2. Unclaimed dividend:

It refers to the amount of dividend not collected by the shareholders from the company. This item is always shown on the credit side of Trial Balance. It is shown on the liabilities side of the Balance Sheet under the heading "Current Liabilities".

3. Forfeited shares account:

This item appears as a credit item in the Trial Balance and is shown on the liabilities side of the Balance sheet by adding it to the paid up capital.

4. Securities premium account:

This item is shown on the liabilities side of the Balance Sheet under the heading "Reserves and Surplus".

Statement of Companies (Schedule VI of Companies Act, 1956)

Schedule VI to the **Companies Act**, **1956** deals with the form of Balance Sheet and Profit and Loss Account and classified disclosure to be made therein and it applies uniformly to all the **companies** registered **under the Companies Act**, **1956**, for the preparation of financial **statements** of an accounting year.

Figures for the previous year	Liabilities	Figures for the current year	Figures for the previous year	Assets	Figures for the current year
	Share Capital			Fixed Assets	
	Authorized			Goodwill	
	Issued			Land and Buildings	
	Subscribed			Plant and machinery	
	Less calls unpaid			Furniture	
	Reserves and surplus			Vehicles, etc.	
	Capital Reserve			**Investments**	
	General Reserve			Government Bonds	
	Other Reserves			Shares, Debentures	
	P&L App. A/c			Immovable Properties	
	Secured Loans			**Current Assets**	
	Debentures			**Loans and Advances**	
	Loans from Banks			Current Assets	
	Other loans			Interest Accrued	
	Unsecured Loans			Stocks	
	Fixed Deposits			Debtors	
	Current Liabilities and Provisions			Cash & Bank balances Loans and Advances:	
	Current liabilities:			Advances	
	Sundry Creditors			Bills Receivable	
	Bills Payable			Advance payments	
	Outstanding expenses			**Miscellaneous**	
	Provisions:			**Expanses**	
				Preliminary expenses	

Unit II: Royalty Account:

Royalty: A **royalty** is a payment made by one party, the licensee or franchisee to another that owns a particular asset, the licensor or franchisor for the right to ongoing use of that asset. Royalties are typically agreed upon as a percentage of gross or net revenues derived from the use of an asset or a fixed price per unit sold of an item of such, but there are also other modes and metrics of compensation. A **royalty interest** is the right to collect a stream of future royalty payments.

A license agreement defines the terms under which a resource or property are licensed by one party to another, either without restriction or subject to a limitation on term, business or geographic territory, type of product, etc. License agreements can be regulated, particularly where a government is the resource owner, or they can be private contracts that follow a general structure. However, certain types of franchise agreements have comparable provisions.

Minimum Rent:

Minimum Rent or Fixed Rent

It is the amount that has to be paid by the lessee to the lessor whether or not he has derived benefit from the asset. Hence, it is also called Dead Rent or Rock Rent. Minimum rent can be a fixed sum for every year or may change every year as per the terms of the agreement.

- When the actual royalty for a year is less than the minimum rent, the lessee will pay the minimum rent to the lessor.
- When the actual royalty for a year is more than the minimum rent, the lessee will pay the actual royalty to the lessor.

Usually, there is a stipulation that in case of low output or low sales, a certain sum of money will be payable in any case even if the royalties based on output or sales are lower. It means that the sum payable is the minimum amount or actual royalties whichever is higher. Thus, if A, the patentee, allows B to use his patent on a royalty of Rs 2 per unit produced subject to minimum of Rs 10,000, then, in case the output is 4,000 units, the amount payable will be Rs 10,000 and in case the output is 7,000 units, it will be Rs 14,000.

The minimum sum is known as minimum rent or dead rent. The excess of minimum rent over actual royalties is termed as “short-workings’. In case, such excess is irrecoverable, it should be debited to “Short-workings Irrecoverable Account” and debited to Profit and Loss Account.

Minimum rent is also known as dead rent, fixed rent, flat rent, rock rent and contract rent. A minimum sum guaranteed to the lessor by the lessee in order to make the lessor receive a minimum amount in any particular period, whether he derived any benefit or not, out of the right is known as minimum rent. It is a pre-determined rent and being disclosed in the royalty agreement where both parties have their consent. But if the production or sale is more than the minimum quantities previously agreed upon, then the royalty will be paid for the actual production. In other words, when the royalty is less than the minimum rent, the lessee pays the minimum rent, but when the royalty exceeds the minimum rent, royalty is payable.

Short-workings:

It is the excess of Minimum Rent over the Actual Royalty payable. It is calculated only when it is allowed to be adjusted against the future royalties by the lessor. Short-working is that amount by which the minimum rent exceeds actual royalty. In other words, whenever the minimum rent is more than the actual royalty, the difference is called redeemable dead rent. Suppose, if a mine owner agreed to let the mine to a lessee for $ 20,000 for extraction of 1,000 kg. of coal and lessee actually produced only 600kg. of coal. Then $ 8,000(i.e. $20 X 400kg.) is known as short-working. Short-working is also called 'royalty suspense' by lessor.

Short-workings = Minimum Rent – Actual Royalty

Entries in the books of Lessor:

The following are the accounting entries in the books of lessor:

(1) When the Royalties are Less than Minimum Rent and Short Workings are Recoverable out of Future Years:

(*a*)	Lessee's Account (with the Minimum Rent) To Royalties Receivable Account (with actual royalty) To Royalties Suspense Account (with the difference) (Being Royalties and shortworkings due)	Dr
(*b*)	Bank Account To Lessee's Account (Being amount of royalty received)	Dr.
(*c*)	Royalties Receivable Account To Profit & Loss Account (Royalties earned transferred)	Dr.

(2) When the Royalties Earned Exceed the Minimum Rent and Short Workings are Recovered:

(*a*) Lessee's Account Dr.
To Royalties Receivable Account
(Being the amount of royalties earned)

(*b*) Royalties Suspense Account Dr.
To Lessee's Account
(Being the recoupment of shortworkings)

(*c*) Bank Account Dr.
To Lessee's Account
(Being the amount of royalties received)

Note: In place of (*b*) and (*c*) the following combined entry may be done;
Royalties Suspense Account Dr.
Bank Account Dr.
To Lessee's Account
(Being the amount of Royalty Suspense recouped and balance received)

(*d*) Royalty Receivable Account Dr.
To Profit & Loss Account
(Being Royalty Receivable transferred to Profit & Loss Account)

If the Royalty Suspense Account shows any balance, which is no longer recoverable, it should be transferred to Profit & Loss Account:

Royalty Suspense Account Dr.
To Profit & Loss Account

Illustration 1:

Y Company is a lessee of a mine on a royalty or Re 1 per ton of coal raised with min.mum re to R 8.000 per annum with power to recoup short workings during the first two years of the lease only.

The output for the first three years is:

2003	5,000 tons
2004	9,000 tons
2005	8,000 tons

Pass the necessary journal entries in the books of landlord.

SOLUTION

Analytical Table

Year	*Output*	*Royalty Receivable @ Re 1 per ton*	*Minimum Rent*	*Royalty Reserve*	*Royalty Reserve adjusted*	*Unrecouped Royalty*	*Actual Amount Received*
	Ton	*Rs*	*Rs*	*Rs*	*Rs*	*Rs*	*Rs*
2003	5,000	5,000	8,000	3,000	–	–	8,000
2004	9,000	9,000	8,000	–	1,000	–	8,000
2005	8,000	8,000	8,000	–	–	2,000	8,000

Journal Entries in the Books of Landlord **Dr.** **Cr.**

Year		LF	Rs	Rs
2003	Y Company Account Dr. To Royalty Receivable Account To Royalty Reserve Account (Being Minimum Rent due; the difference between Minimum Rent and Royalty Receivable transferred to Royalty Reserve)		8,000	5,000 3,000
	Bank Account Dr. To Y Company Account (Being Royalty received)		8,000	8,000
	Royalty Receivable Account Dr. To Profit & Loss Account (Being the amount of Royalty Receivable transferred to Profit and Loss Account)		5,000	5,000
2004	Y Company Account Dr. To Royalty Receivable A/c (Being royalty earned and receivable)		9,000	9,000
	Royalty Reserve Account Dr. Bank Account Dr. To Y Company Account (Royalty Reserve Account recouped by Lessee and received the balance)		1,000 8,000	9,000
	Royalty Receivable Account Dr. Royalty Reserve Account Dr. To Profit & Loss Account (Being the balance of Royalty Receivable and Royalty Reserve transferred to Profit & Loss A/c)		9,000 2,000	11,000
2005	Y Company Account Dr. To Royalty Receivable A/c (Being royalty receivable)		8,000	8,000
	Bank Account Dr. To Y Company Account (Being cash received from Y Company)		8,000	8,000
	Royalty Receivable Account Dr. To Profit & Loss Account (Being royalty receivable transferred to Profit & Loss A/c)		8,000	8,000

Entries in the books of Lessee:

The following are the accounting entries passed in the books of lessee:

(1) When the Royalty is Less than Minimum Rent and the Minimum Rent Account is not Maintained:

(a)	Royalties Account	Dr.
	(With actual amount of royalty)	
	Shortworkings Account	Dr.
	(With actual shortage)	
	To Landlord Account (with Minimum rent payable)	
	(Being the minimum rent payable to Landlord)	
(b)	Landlord Account	Dr.
	To Bank Account	
	(Being the minimum rent paid to Landlord)	
(c)	Trading/Profit & Loss Account	Dr
	To Royalties Account	
	(Royalties account transferred to Trading/Profit & Loss Account)	

(2) When the Royalty is Less than Minimum Rent and the Minimum Rent Account is Maintained:

(a)	Minimum Rent Account	Dr.
	To Landlord Account	
	(Being minimum rent payable to Landlord)	
(b)	Royalties Account	Dr.
	Shortworkings Account	Dr.
	To Minimum Rent Account	
	(Being the amount or royalties earned and excess amount debited to Shortworkings Account to make up the minimum rent)	
(c)	Landlord Account	Dr.
	To Bank Account	
	(Being payment made to Landlord)	
(d)	Trading/Profit & Loss Account	Dr
	To Royalties Account	
	(Being Royalties account transferred to Trading/Profit & Loss Account)	

(3) When Royalties are More than Minimum Rent:

(a)	Royalties Account To Landlord (Being Royalties earned and payable to Landlord)	Dr
(b)	Landlord Account To Shortworkings Account (Recoupment of shortworkings of earlier years)	Dr
(c)	Landlord Account To Bank Account (Being payment made to Landlord)	Dr
	In the place of (*b*) and (*c*) above, the following one entry may be passed:	

	Landlord Account
	    To Shortworkings Account
	    To Bank Account
	(Being recoupment of shortworking to the extent balance paid)
		Dr

(d)	Trading/Profit & Loss Account To Royalties Account (Being transfer of Royalties A/c)	Dr.

(4) When Short Working cannot be Recouped in Future:

Profit & Loss Account To Shortworkings Account (Being transfer to irrecoverable Shortworking to Profit & Loss A/C)	Dr.

Illustration:

2002 9,000 tons
2003 12,000 tons
2004 16, 000 tons
2005 20,000 tons
Pass Jounral entries

SOLUTION

Analytical Table

Year	Output	Royalty @ Rs 1.50 per ton	Minimum Rent	Surplus	Short-working	Shortworkings Recouped	Shortworkings Unrecouped	Amount Payable to Landlord
	Tons	Rs	Rs	Rs	Rs	Rs	–	Rs
2002	9,000	13,500	20,000	–	6,500	–	–	20,000
2003	12,000	18,000	20,000	–	2,000	–	–	20,000
2004	16,000	24,000	20,000	4,000	–	4,000	4,500	20,000
2005	20,000	30,000	20,000	10,000	–	–	–	30,000

Journal Entries in Lessee's Books

Date	Particulars		LF	Rs	Rs
2002 Dec. 31	Royalties Account	Dr.		13,500	
	Shortworkings Account	Dr.		6,500	
	To Landlord Account				20,000
	(Being the Minimum Rent payable to Landlord)				
	Landlord Account	Dr.		20,000	
	To Bank Account				20,000
	(Being payment made to the Landlord)				
	Profit & Loss Account	Dr.		13,500	
	To Royalties Account				13,500
	(Being the amount of Royalties transferred to Profit and Loss Account)				
2003 Dec. 31	Royalties Account	Dr		18,000	
	Shortworkings Account	Dr		2,000	
	To Landlord Account				20,000
	(Being the Minimum Rent payable to Landlord)				
	Landlord Account	Dr		20,000	
	To Bank Account				20,000
	(Being payment made to the Landlord)				
	Profit & Loss Account	Dr		18,000	
	To Royalties Account				18,000
	(Being payment made to the Landlord Profit & Loss A/c)				
2004 Dec. 31	Royalties Account	Dr		24,000	
	To Landlord Account				24,000
	(Being Royalties earned payable)				

	Landlord Account	Dr.	24,000	
	To Shortworkings Account			4,000
	To Bank Account			20,000
	(Being recovery of shortworkings of Rs 4,000 and balance paid to Landlord)			
	Profit & Loss Account	Dr.	28,500	
	To Royalties Account			24,000
	To shortworkings Account			4, 500
	(Being Royalties A/c and unrecouped Shortworking transferred to Profit & Loss Accounts)			
2005 Dec. 31	Royalties Account	Dr.	30,000	
	To Landlord Account			30,000
	(Being Royalties earned payable to Landlord)			
	Landlord Account	Dr.	30,000	
	To Bank Account			30,000
	(Being payment made to Landlord)			
	Profit & Loss Account	Dr.	30,000	
	To Royalties Account			
	(Being transfer of Royalties Account to Profit & Loss Account)			30,000

N.B. The excess of Minimum Rent over actual Royalty is termed as Short workings. Here, the Lessee has a right to recover the Short workings over the first three years only. Therefore, in the year 2004. Lessee could recover Rs 4,000 out of the Royalty; the balance of Short workings Account amounting to Rs 4,500 (Rs. 6,500 + 2,000 = 8,500 – 4,000 = 4,500) written off to Profit & Loss Account, as the amount is no longer recoverable.

Alternatively,

Date			Dr.	Cr.
			Rs	Rs
2002 Dec. 31	Minimum Rent Account	Dr.	20,000	
	To Landlord Account			20,000
	(Being Minimum Rent due)			
	Royalties Account	Dr.	13,500	
	Shortworkings Account	Dr.	6,500	
	To Minimum Rent Account			20,000
	(Being Shortworkings Account brought into accounts)			
	Landlord Account	Dr.	20,000	
	To Bank Account			20,000
	(Being amount paid to Landlord)			
	Profit & Loss Account	Dr.	13,500	
	To Royalties Account			13,500
	(Being Royalties account transferred to Profit & Loss account)			
2003 Dec.	Minimum Rent Account	Dr.	20,000	
	To Landlord Account			20,000
	(Being Minimum Rent due)			

Royalties Account Dr Shortworkings Account Dr To Minimum Rent Account (Being Shortworking Account brought into account)		18,000 2,000	20,000
Landlord Account Dr To Bank Account (Being the amount paid to Landlord)		20,000	20,000
Profit & Loss Account Dr To Royalties Account (Being Royalties Account transferred to Profit & Loss Account)		18,000	18,000

Entries for 2004 and 2005 are the same, as done. The reason is that in 2004 and 2005 the amounts of Royalties are more than the Minimum Rent. Therefore, Minimum Rent will not be opened.

Accounting Problems Relating to Coal Mine:

Royalties: Problem and Solution # 1.

S.K. Collieries Co. Ltd. took from M/s Bihari Bros, a lease of a coal field for a period of 25 years from 1st April, 2007 on a royalty of Rs 25 per tonne of coal extracted with a Dead Rent of Rs 2,20,000 a year with power to recoup short-workings during the first five years of the lease. The company closes its books of account on 31st March every year.

The output in the first five years of the lease was as follows:

Year ended 31st March, 2008	...	2,000	tonnes
Year ended 31st March, 2009	...	3,600	"
Year ended 31st March, 2010	...	9,000	"
Year ended 31st March, 2011	...	15,000	"
Year ended 31st March, 2012	...	20,000	"

(a) Pass journal entries for all the transactions relating to royalties for the five years in the books of S.K. Collieries C. Ltd.

(b) Suppose, output for the year ended 31st March, 2012 was 14,000 tonnes only. What would be the journal entries for the year 2011-2012 then?

Solution:

Before proceeding to pass journal entries, preparation of the following chart minimises the chances of mistakes in the amounts of the journal entries:

Date	Output (in tonnes)	Royalty @ ₹ 25 per tonne ₹	Minimum Rent ₹	Shortworkings Arising ₹	Shortworkings Being Recouped ₹	Shortworkings Becoming Irrecoverable ₹	Amount Payable to Landlord ₹
31-3-2008	2,000	50,000	2,20,000	1,70,000	—	—	2,20,000
31-3-2009	3,600	90,000	2,20,000	1,30,000	—	—	2,20,000
31-3-2010	9,000	2,25,000	2,20,000	—	5,000	—	2,20,000
31-3-2011	15,000	3,75,000	2,20,000	—	1,55,000	—	2,20,000
31-3-2012	20,000	5,00,000	2,20,000	—	1,40,000	—	3,60,000
(*b*) 31-3-2012	14,000	3,50,000	2,20,000	—	1,30,000	10,000	2,20,000

Journal

				₹	₹
2008 Mar.	31	Royalties Account ...	Dr.	50,000	
		Shortworkings Account ...	Dr.	1,70,000	
		To M/s Bihari Bros.			2,20,000
		Royalties @ ₹ 25 per tonne on 2,000 tonnes subject to a minimum of ₹ 2,20,000.			
"	"	M/s Bihari Bros. ...	Dr.	2,20,000	
		To Bank			2,20,000
		Payment of the sum due to Bihari Bros; the landlord.			
"	"	Profit and Loss Account ...	Dr.	50,000	
		To Royalties Account			50,000
		Transfer of Royalties Account to Profit and Loss Account.			

				₹	₹
2009 Mar.	31	Royalties Account ...	Dr.	90,000	
		Shortworkings Account ...	Dr.	1,30,000	
		To M/s. Bihari Bros.			2,20,000
		Royalties @ ₹ 25 per tonne on 3,600 tonnes *plus* ₹ 1,30,000 needed to make it up to ₹ 2,20,000 payable to M/s Bihari Bros, the landlord.			
Mar.	31	M/s. Bihari Bros. ...	Dr.	2,20,000	
		To Bank			2,20,000
		Payment of the sum due to Bihari Bros., the landlord.			
"	"	Profit and Loss Account ...	Dr.	90,000	
		To Royalties Account			90,000
		Transfer of Royalties Account to Profit and Loss Account.			
2010 Mar.	31	Royalties Account ...	Dr.	2,25,000	
		To M/s. Bihari Bros.			2,20,000
		To Shortworkings Account			5,000
		Royalties @ ₹ 25 per tonne on 9,000 tonnes *less* ₹ 5,000 recovered against shortworkings payable to landlord.			
"	"	M/s. Bihari Bros. ...	Dr.	2,20,000	
		To Bank			2,20,000
		Payment of the sum due to landlord.			
"	"	Profit and Loss Account ...	Dr.	2,25,000	
		To Royalties Account			2.25,000
		Transfer of Royalties Account to Profit & Loss Account.			
2011 Mar.	31	Royalties Account ...	Dr.	3,75,000	
		To M/s. Bihari Bros.			2,20,000
		To Shortworkings Account			1,55,000
		Royalties @ ₹ 25 per tonne on 15,000 tonnes *less* ₹ 1,55,000 recovered against shortworking payable to landlord.			
"	"	M/s. Bihari Bros. ...	Dr.	2,20,000	
		To Bank			2,20,000
		Payment of the sum due to landlord.			
"	"	Profit and Loss Account ...	Dr.	3,75,000	
		To Royalties Account			3,75,000
		Transfer of Royalties Account to Profit & Loss Account.			
2012 Mar.	31	Royalties Account ...	Dr.	5,00,000	
		To Shortworkings Account			1,40,000
		To M/s. Bihari Bros.			3,60,000
		Royalties @ ₹ 25 per tonne on 20,000 tonnes *less* ₹ 1,44,000, the balance in Shortworkings Account, recouped payable to M/s Bihari Bros., the landlord			

Date		Particulars		L.F.	₹	₹
2012 Mar.	31	M/s. Bihari Bros. ...	Dr.		3,60,000	
		To Bank				3,60,000
		Payment of the sum due to landlord.				
"	"	Profit and Loss Account ...	Dr.		5,00,000	
		To Royalties Account				5,00,000
		Transfer of Royalties Account to Profit and Loss Account.				

(*b*) Output for the year ended 31st March, 2012 being 14,000 tonnes only :—

Date		Particulars		L.F.	₹	₹
2012 Mar.	31	Royalties Account ...	Dr.		3,50,000	
		To Shortworkings Account				1,30,000
		To M/s. Bihari Bros.				2,20,000
		Royalties @ ₹ 25 per tonne on 14,000 tonnes *less* ₹ 1,30,000 recovered against shortworkings payable to landlord.				
"	"	M/s. Bihari Bros. ...	Dr.		2,20,000	
		To Bank				2,20,000
		Payment of the sum due to landlord.				
"	"	Profit and Loss Account ...	Dr.		3,60,000	
		To Royalties Account				3,50,000
		To Shortworkings Account				10,000
		Transfer of royalties for the year and the balance in the Shortworking Account which is now irrecoverable to Profit & Loss Account.				

Royalties: Problem and Solution # 2.

A colliery worked coal under a lease which provided for the payment of royalties at Rs 5 per tonne with a minimum rent of Rs 1,70,000 per annum. Each year's excess of minimum rent over the actual royalties was recoverable during the subsequent three years.

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

The output was as follows:

For the year ended 31st March,	2007	4,000 tonnes
For the year ended 31st March,	2008	28,000 "
For the year ended 31st March,	2009	30,000 "
For the year ended 31st March,	2010	46,000 "
For the year ended 31st March,	2011	30,000 "
For the year ended 31st March,	2012	50,000 "

<u>During the year 2010-11 there was a stoppage due to strike lasting three months. Give the necessary ledger accounts in the books of the colliery for each of the above years.</u>

Solution :

Minimum Rent Account

			₹				₹
2007				2007			
Mar.	31	To Landlord	1,70,000	Mar.	31	By Royalties Account on 4,000 tonnes @ ₹ 5 per tonne	20,000
				"	"	By Shortworkings A/c	1,50,000
			1,70,000				1,70,000

			₹				₹
2008				2008			
Mar.	31	To Landlord	1,70,000	Mar.	31	By Royalties Account— on 28,000 tonnes @ ₹ 5 per tonne	1,40,000
				"	"	By Shortworkings A/c	30,000
			1,70,000				1,70,000
2009				2009			
Mar.	31	To Landlord	1,70,000	Mar.	31	By Royalties A/C on 30,000 tonnes @ ₹ 5 per tonne	1,50,000
				"	"	By Shortworkings A/C	20,000
			1,70,000				1,70,000

Dr. **Royalties Account** *Cr.*

			₹				₹
2007				2007			
Mar.	31	To Minimum Rent A/c	20,000	Mar.	31	By Production A/c—transfer	20,000
2008				2008			
Mar.	31	To Minimum Rent A/c	1,40,000	Mar.	31	By Production A/c—transfer	1,40,000
2009				2009			
Mar.	31	To Minimum Rent A/c	1,50,000	Mar.	31	By Production A/c—transfer	1,50,000
2010				2010			
Mar.	31	To Landlord	2,30,000	Mar.	31	By Production A/c—transfer	2,30,000
2011				2011			
Mar.	31	To Landlord	1,50,000	Mar.	31	by Production A/c—transfer	1,50,000
2012				2012			
Mar.	31	To Landlord	2,50,000	Mar.	31	By Production A/c—transfer	2,50,000

Dr. **Landlord** *Cr.*

			₹				₹
2007				2007			
Mar.	31	To Bank	1,70,000	Mar.	31	By Minimum Rent A/c	1,70,000
2008				2008			
Mar.	31	To Bank	1,70,000	Mar.	31	By Minimum Rent A/c	1,70,000
2009				2009			
Mar.	31	To Bank	1,70,000	Mar.	31	By Minimum Rent A/c	1,70,000
2010				2010			
Mar.	31	To Shortworkings A/c— recovery	60,000	Mar.	31	By Royalties A/c	2,30,000
		To Bank	1,70,000				
			2,30,000				2,30,000
2011				2011			
Mar.	31	To Shortworkings A/c	22,500	Mar.	31	By Royalties A/c	1,50,000
"	"	To Bank*	1,27,500				
			1,50,000				1,50,000
2012				2012			
Mar.	31	To Shortworking A/c	20,000	Mar.	31	By Royalties A/c	2,50,000
"	"	To Bank	2,30,000				
			2,50,000				2,50,000

*Due to stoppage of work for 3 months during the year ended 31st March, 2011, the minimum rent is reduced by 25% or ₹ 42,500. Hence, the landlord will get ₹ 1,27,500 only as the minimum rent.

Shortworkings Account

Dr.							Cr.
2007			₹	2007			₹
Mar.	31	To Minimum Rent A/c	1,50,000	Mar.	31	By Balance *c/d*	1,50,000
2007				2008			
Apr.	1	To Balance *b/d*	1,50,000	Mar.	31	By Balance *c/d*	1,80,000
2008							
Mar.	31	To Minimum Rent A/c	30,000				
			1,80,000				1,80,000
2008				2009			
Apr.	1	To Balance *b/d*	1,80,000	Mar.	31	By Balance *c/d*	2,00,000
2009							
Mar.	31	To Minimum Rent A/c	20,000				
			2,00,000				2,00,000
2009				2010			
Apr.	1	To Balance *b/d*	2,00,000	Mar.	31	By Landlord	60,000
				"	"	By Profit & Loss A/c— Balance of shortworking for 2006-2007 being irrecoverable now	90,000
				"	"	By Balance *c/d*	50,000
			2,00,000				2,00,000
2010				2011			
Apr.	1	To balance *b/d*	50,000	Mar.	31	By Landlord	22,500
				"	"	By Profit and Loss A/c— balance of shortworking for 2007-2008	7,500
				"	"	By Balance *c/d*	20,000
			50,000				50,000
2011				2012			
Apr.	1	To Balance *b/d*	20,000	Mar.	31	By Landlord	20,000

Production Account

Dr.							Cr.
2007			₹				
Mar.	31	To Royalties A/c	20,000				
2008							
Mar.	31	To Royalties A/c	1,40,000				
2009							
Mar.	31	To Royalties A/c	1,50,000				
2010							
Mar.	31	To Royalties A/c	2,30,000				
2011							
Mar.	31	To Royalties A/c	1,50,000				
2012							
Mar.	31	To Royalties A/c	2,50,000				

Profit and Loss Account

2011			₹				
Mar.	31	To Shortworkings A/c	90,000				
2012							
Mar.	31	To Shortworkings A/c	7,500				

Unit III: Accounts of Instalment Retailing:

Hire Purchase:

Hire purchase system refers to the system wherein, the seller of goods delivers the goods to the buyer without transferring the ownership of goods. The payment for the goods will be made by the buyer in instalments.

Hire purchase is an arrangement for buying expensive consumer goods, where the buyer makes an initial down payment and pays the balance plus interest in instalments. The term hire purchase is commonly used in the United Kingdom and it's more commonly known as an instalment plan in the United States. However, there can be a difference between the two: With some instalment plans, the buyer gets the ownership rights as soon as the contract is signed with the seller. With hire purchase agreements, the ownership of the merchandise is not officially transferred to the buyer until all the payments have been made.

Purchase and sale of goods under a hire purchase system is different from cash sale and credit sale. In case of cash sale, the buyer pays the lump sum to the seller and immediately ownership is passed along with the goods. While in credit sale the payment is made in future. In these both cases the ownership and possession of goods pass on the buyer. However, hire purchase system is a special system of purchase and sale.

In hire purchase system, the buyer acquires the property by promising to pay necessary instalment payment of monthly, quarterly, half yearly or any other period. The period of payment has to be fixed while, signing the hire sell agreement. Though, the buyer acquires the asset under hire purchase system after signing the agreement, the title of ownership remains with vendor until the buyer squares up his/her entire liability. When the buyer pays the final instalment and any other obligation according to hire purchase agreement, only then the title of ownership of the goods would be transferred to hirer. If the hirer makes default in the payment of any instalment, the hire vendor has the right to re-possess the goods. When the vendor re-possesses the goods due to the default of payment of instalment, in this case the amount already paid so far by the hirer will be forfeited.
The hire purchase price of goods is normally higher than the cash down price of article because it includes interest as well as cash price. Under hire purchase system, the vendor is responsible to repair the goods which are in the possession of buyer provided that the buyer takes the utmost proper care of the goods acquired. The risk is also borne by the vendor until the payment of

last instalment. The buyer has the right to return the goods to the vendor, if they are not according to the terms and condition of hire purchase agreement.

Hire Purchase Operation:

Hire purchase involves a certain procedure, that is to say, modus operandi to be followed. For this, an agreement called hire purchase agreement is made in written between the parties involved in the hire purchase transaction.

The agreement contains the following:

(i) The hire purchase price of the goods to which the agreement relates;

(ii) The cash price of the goods, that is to say, the price at which the good is purchased for cash;

(iii) The date of the commencement of the agreement;

(iv) The number and time interval of instalments by which the hire purchase price is to be paid;

(v) The name of goods, with its sufficient identity, to which the hire purchase agreement relates to;

(vi) The amount to be paid, if any, at the time of signing the agreement;

(vii) The signatures of the parties involved in transaction.

If the hire purchase transaction is financed by the manufacturer or dealer, then two parties, called, hire vendor and hire purchaser, are involved in the agreement. The hire purchase transaction is financed by some financial institution, and then there are three parties involved in the transaction.

These are:

(i) Hire Vendor,

(ii) Hire Purchaser, and

(iii) Financial Institution.

In such case, the vendor, firstly, receives the bills of exchange for hire purchase price of the goods from the hirer. The vendor, then, discounts the bills with the financial institution and, thus, gets payment for the goods sold under hire purchase system. The financial institution collects the payments of the bills from the hirer, as and when the instalments fall due.

This entire process is depicted in the following Figure 20.1

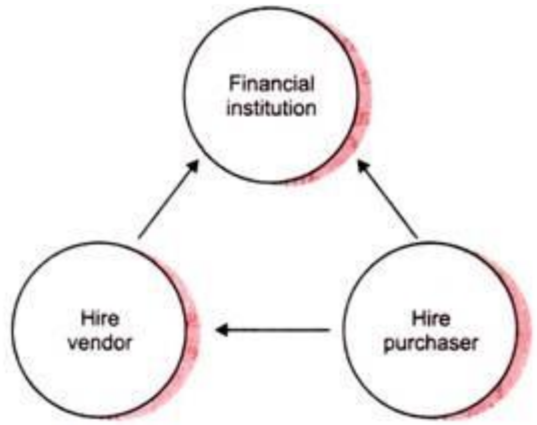


Fig. 20.1. Three Party Hire Purchase

Hire-purchase transaction benefits all parties involved in it. While it increases vendor's sales, it enables the hire purchaser to make use of costly machinery, equipment's, etc., without making full payment on the date of signing the agreement. After making the payment of the last instalment, the hire purchaser also acquires the ownership of the goods purchased under hire-purchase system.

NSIC and Hire Purchase:

Small scale firms can acquire industrial machinery, office equipment, vehicles, etc., without making full payment through hire purchase. With the help of assets acquired through hire purchase they can produce and sell. From the earning payments can easily be made in instalments. Ultimately the ownership of assets can be acquired.

Now several agencies like NSIC provide machinery and equipment to small scale units on hire purchase basis and on lease basis.

How Hire Purchase Agreements Work:

Hire purchase agreements are similar to rent-to-own transactions that give the lessee the option to buy at any time during the agreement, such as rent-to-own cars. Like rent-to-own, hire purchase can benefit consumers with poor credit by spreading the cost of expensive items that they would otherwise not be able to afford over an extended time period. It's not the same as an extension of credit, though, because the purchaser technically doesn't own the item until all of the payments are made.

Because ownership is not transferred until the end of the agreement, hire purchase plans offer more protection to the vendor than other sales or leasing methods for unsecured items. That's because the items can be repossessed more easily should the buyer be unable to keep up with the repayments.

Entries in Hire Purchasers Book

Journal Entries in the books of Purchaser

1.	Asset Account	Dr.	
	Interest Suspense Account	Dr.	
	To Vendor Account		
	(Being purchase under instalment purchase system)		
2.	Vendor Account	Dr.	
	To Bank Account		
	(Being down payment to vendor at the time of delivery of asset)		
3.	Interest Account	Dr.	
	To Interest Suspense Account		
	(Being interest due)		
4.	Vendor Account	Dr.	
	To Bank Account		
	(Being payment of instalment)		
5.	Depreciation Account	Dr.	
	To Asset Account		
	(Being charging depreciation at...)		
6.	Profit and Loss Account	Dr.	
	To Interest Account		
	To Depreciation Account		
	(Being transfer of Interest and Depreciation Accounts)		

Entries in Vendors Book

Journal Entries in the books of Vendor

1.	Buyer Account To Sales Account To Interest Suspense Account (Being sale of goods on instalment system)	Dr.		
2.	Bank Account To Buyer Account (Being cash received on delivery of goods)	Dr.		
3.	Interest Suspense Account To Interest Account (Being interest due)	Dr.		
4.	Cash Account To Buyer Account (Being receipt of instalment)	Dr.		
5.	Interest Account To Profit & Loss Account (Being transfer of interest)	Dr.		
6.	Sales Account To Trading Account (Being transfer of sales to Trading Account)	Dr.		

Instalment Payment System:

Instalment payment system (also called the deferred **instalments**) is a **system** where the buyer is given the ownership as well as the possession of the gods at the time of signing the contract. The buyer has the facility to **pay** the price in **instalments**.

An instalment system is just like a credit purchase and hire purchase system of selling and buying goods. Like hire purchase, in instalment system an agreement is made between buyer and seller to purchase and sell of goods. The buyer makes certain down payment at the time of signing agreement and the balance is paying in instalment over a period of time.
An instalment system is a credit sale in which payments are made in instalments over a period of time. In this system, the buyer gets the possession as well as ownership of the goods right at the time of signing the agreement. During the course of paying the instalment, if the buyer makes default in paying the instalment, the vendor cannot responses the goods. In that case, the vendor can sue the buyer for recovery of dues. Like in hire purchase even the paid instalments also cannot be forfeited in case of default in paying instalment.
Thus, it can be said that instalment system is a kind of credit sale where instalments are entertained over the period and default in such payment cannot responses the goods and in that case, the vendor can only sue the buyer for the recovery of amount due.

Features Of Instalment Purchase System:

The following are the features of instalment purchase system:

1. Instalment purchase system is just like an outright credit sale of goods.
2. The buyer makes the payment in different instalment over a period of time as agrees upon in the agreement.
3. Under instalment purchase system, the buyer gets the immediate possession as well as the ownership of goods.
4. The seller cannot responses the good if the buyer made default in the payment of instalment but he/she can sue against the buyer for the recovery of amount due.
5. In case of default in the payment of instalment, the total amount of instalments already paid by the buyer cannot be forfeited.
6. Under instalment system, the buyer can sell or mortgage the goods even before clearing all the instalments.
7. Risk of goods/assets are to be borne by the buyer just after signing the agreement.
8. The buyer of the goods under instalment purchase system has no right to return the goods to the seller.

Accounting Problems on Hire Purchase, Instalments and Lease

Hire Purchase, Instalments and Lease: Problem and Solution # 1.

On 1st April, 2008, Bihar Collieries obtained a machine on the hire purchase system, the total amount payable being Rs. 2,50,000. Payment was to be made Rs 50,000 down and the balance in four annual instalments of Rs 50,000 each. Interest charged was at the rate of 15 per cent. At what value should the machine be capitalised?

Solution:

If amount due in the beginning of a year is Rs 100, interest for the year will be Rs 15 and the amount of instalment due at the end of the year will be Rs 115. Thus, interest is 15/115 or 3/23 of the amount due at the end of each year.

Keeping this in mind, the cash price of the machine can be calculated in the following manner:

	₹
Amount due on 31st March, 2012 just before payment of the fourth instalment	50,000
Less: Interest for the fourth year = ₹ 50,000 × 3/23	6,522
Amount due on 1st April, 2011	43,478
Add: Amount of the third instalment	50,000
	93,478
Less: Interest for the third year = ₹ 93,478 × 3/23	12,193
Amount due on 1st April, 2010	81,285
Add: Amount of the second instalment	50,000
	₹
	1,31,285
Less: Interest for the second year = ₹ 1,31,285 × 3/23	17,124
Amount due on 1st April, 2009	1,14,161
Add: Amount of the first instalment	50,000
	1,64,161
Less: Interest for the first year = ₹ 1,64,161 × 3/23	21,412
Amount due on 1st April, 2008 after down payment	1,42,749
Add: Down payment	50,000
Cash price	1,92,749

Alternatively, the present value at 15% per annum of one rupee received annually at the end of four years is Rs 2-85498. Thus, the present value of Rs 50,000 is Rs 50,000 x 2-85498 = Rs 1,42,749. To this, we add down payment of Rs 50,000. Therefore, the cash price is Rs 1,42,749 + Rs 50,000 = Rs 1,92,749.

Hire Purchase, Instalments and Lease: Problem and Solution # 2.

G acquired a plant delivered on April 1, 2010 on the following terms:

(i) Initial payment of Rs 40,000 immediately; and

(ii) 4 half-yearly instalments of Rs 30,000 each commencing September 30, 2010.

Interest is 10% with yearly rests. What is the cash price?

Solution :

If x is the cash price less down payment, the interest for the first year will be $x \times \frac{10}{100}$ and the amount due will be $x + \frac{10}{100}x - 60{,}000$.

Next year, the interest will be $\frac{10}{100}\left[x + \frac{10}{100}x - 60{,}000\right]$

Total amounts paid by way of instalments in respect of cash price if instalments total ₹ 1,20,000. Therefore,

$$1{,}20{,}000 = x + \frac{10}{100}x + \frac{10}{100}\left[x + \frac{10}{100}x - 60{,}000\right]$$

$$= x + \frac{1}{10}x + \frac{1}{10}x + \frac{1}{100}x - 6{,}000$$

$$1{,}26{,}000 = x + \frac{21}{100}x$$

$$= \frac{121}{100}x$$

$$1{,}04{,}132 = x.$$

The present value of the instalments is ₹ 1,04,132; adding the cash down payment of ₹ 40,000, the total cash price is ₹ 1,44,132.

Hire Purchase, Instalments and Lease: Problem and Solution # 3.

Delhi Tourist Service Ltd. purchased from Maruti Udyog Ltd. a motor van on 1st April 2009 the cash price being Rs 1,64,000. The purchase was on hire purchase basis, Rs 50.000 being paid on the signing of the contract and, thereafter, Rs 50,000 being paid annually on 31st March, for three years, Interest was charged at 15% per annum.

Depreciation was written off at the rate of 25 per cent per annum on the reducing instalment system. Delhi Tourist Service Ltd. closes its books every year on 31st March. Prepare the necessary ledger accounts in the books of Delhi Tourist Service Ltd.

Solution:

Motor Van Account

Dr.		₹			Cr. ₹
2009 Apr. 1	To Maruti Udyog Ltd.	1,64,000	2010 Mar. 31	By Depreciation— 25% of ₹ 1,64,000	41,000
			" "	By Balance c/d	1,23,000
		1,64,000			1,64,000
2010 Apr. 1	To Balance b/d	1,23,000	2011 Mar. 31	By Depreciation— 25% of ₹ 1,23,000	30,750
			" "	By Balance c/d	92,250
		1,23,000			1,23,000
2011 Apr. 1	To Balance b/d	92,250	2012 Mar. 31	By Depreciation— 25% of ₹ 92,250	23,063
			" "	By Balance c/d	69,187
		92,250			92,250
2012 Apr. 1	To Balance b/d	69,187			

Maruti Udyog Ltd.

		₹			₹
2009 Apr. 1	To Bank	50,000	2009 Apr. 1	By Motor Van Account	1,64,000
2010 Mar. 31	To Bank	50,000	2010 Mar. 31	By Interest Account— 15% of ₹ 1,14,000	17,100
" "	To Balance c/d	81,100			
		1,81,100			1,81,100
2011 Mar. 31	To Bank	50,000	2010 Apr. 1	To Balance c/d	81,100
" "	To Balance c/d	43,265	2011 Mar. 31	By Interest Account— 15% of ₹ 81,100	12,165
		93,265			93,265
2012 Mar. 31	To Bank	50,000	2011 Apr. 1	By Balance b/d	43,265
			2012 Mar. 31	By Interest Account— (balancing figure)	6,735
		50,000			50,000

Interest Account

		₹			₹
2010 Mar. 31	To Maruti Udyog Ltd.	17,100	2010 Mar. 31	By Profit & Loss A/c —transfer	17,100
2011 Mar. 31	To Maruti Udyog Ltd.	12,165	2011 Mar. 31	By Profit & Loss A/c —transfer	12,165
2012 Mar. 31	To Maruti Udyog Ltd.	6,735	2012 Mar. 31	By Profit & Loss A/c —transfer	6,735

Depreciation Account

		₹			₹
2010 Mar. 31	To Motor Van Account	41,000	2010 Mar. 31	By Profit & Loss A/c —transfer	41,000
2011 Mar. 31	To Motor Van Account	30,750	2011 Mar. 31	By Profit & Loss A/c —transfer	30,750
2012 Mar. 31	To Motor Van Account	23,063	2012 Mar. 31	By Profit & Loss A/c —transfer	23,063

Profit & Loss Account (relevant portions only)

		₹			
2010 Mar. 31	To Interest A/c	17,100			
" "	To Depreciation A/c	41,000			
2011 Mar. 31	To Interest A/c	12,165			
" "	To Depreciation A/c	30,750			
2012 Mar. 31	To Interest A/c	6,735			
" "	To Depreciation A/c	23,063			

If all the transactions are journalised, the journal entries will appear as follows:—

Journal

				Dr. ₹	Cr. ₹
2009 Apr.	1	Motor Van Account ... Dr. To Maruti Udyog Ltd. Cash price of motor van purchased on hire purchase basis credited to Maruti Udyog Ltd., hire-vendor.		1,64,000	1,64,000
"	"	Maruti Udyog Ltd. ... Dr. To Bank Down payment made to Maruti Udyog Ltd.		50,000	50,000

Date		Particulars		₹	₹
2010 Mar.	31	Interest Account ...	Dr.	17,100	
		To Maruti Udyog Ltd.			17,100
		Interest @ 15% p.a. for one year on ₹ 1,14,000 due to Maruti Udyog Ltd.			
"	"	Maruti Udyog Ltd. ...	Dr.	50,000	
		To Bank			50,000
		Payment of the first annual instalment to Maruti Udyog Ltd.			
"	"	Depreciation Account ...	Dr.	41,000	
		To Motor Van Account			41,000
		Depreciation provided on Motor Van @ 25% per annum for the year.			
"	"	Profit & Loss Account ...	Dr.	58,100	
		To Interest Account			17,100
		To Depreciation Account			41,000
		Transfer of Interest Account and Depreciation Account to Profit and Loss Account.			
2011 Mar.	31	Interest Account ...	Dr.	12,165	
		To Maruti Udyog Ltd.			12,165
		Interest @ 15% p.a. for one year on ₹ 81,100 due to Maruti Udyog Ltd.			
"	"	Maruti Udyog Ltd. ...	Dr.	50,000	
		To Bank			50,000
		Payment of the second annual instalment to Maruti Udyog Ltd.			
"	"	Depreciation Account ...	Dr.	30,750	
		To Motor Van Account			30,750
		Depreciation provided on Motor Van @ 25% on the written down value, ₹ 1,23,000.			
"	"	Profit & Loss Account ...	Dr.	42,915	
		To Interest Account			12,165
		To Depreciation Account			30,750
		Transfer of Interest Account and Depreciation Account to Profit and Loss Account.			
2012 Mar.	31	Interest Account ...	Dr.	6,735	
		To Maruti Udyog Ltd.			6,735
		Interest due to Maruti Udyog Ltd. the amount necessary to make up the amount of instalment of ₹ 50,000.			
"	"	Maruti Udyog Ltd. ...	Dr.	50,000	
		To Bank			50,000
		Payment of the last instalment to Maruti Udyog Ltd.			
"	"	Depreciation Account	Dr.	23,063	
		To Motor Van Account			23,063
		Depreciation provided on Motor Van @ 25% on the written down value, ₹ 92,250.			

Date		Particulars		₹	₹
2012 Mar.	31	Profit & Loss Account ...	Dr.	29,798	
		To Interest Account			6,735
		To Depreciation Account			23,063
		Transfer of Interest Account and Depreciation Account to Profit and Loss Account.			

Hire Purchase, Instalments and Lease: Problem and Solution # 4.

On 1st April, 2008, Ashok acquired machinery on hire purchase system from Modmac Ltd., agreeing to pay four annual instalments of Rs 60,000 each payable at the end of each year. There is no down payment. Interest is charged @ 20% per annum and is included in the annual instalments.

Because of financial difficulties, Ashok, after having paid the first and second instalments, could not pay the third yearly instalment due on 31st March, 2011, whereupon the hire vendor repossessed the machinery.

Ashok provides depreciation on the Machinery @ 10% per annum according to the written down value method. He closes his books of account every year on 31st March.

Show Machinery Account and the account of Modmac Ltd. for all the years in the books of Ashok. All workings should form part of your answer.

Solution :

Working Notes :

(*i*) **Calculation of interest and cash price**

Date of instalment	*Amount of instalment*		*Towards interest*	*Towards cash price*
	₹		₹	₹
31.3.2012	60,000	$\frac{20}{120} \times$ Rs. 60,000	10,000	50,000

	₹		₹	₹
31.3.2011	60,000	$\frac{20}{120} \times$ ₹ (50,000 + 60,000)	18,333	41,667
31.3.2010	60,000	$\frac{20}{120} \times$ ₹ (50,000 + 41,667 + 60,000)	25,278	34,722
31.3.2009	60,000	$\frac{20}{120} \times$ ₹ (50,000 + 41,667 + 34,722 + 60,000)	31,065	28,935
Total	2,40,000		84,676	1,55,324

(ii) *Calculation of depreciation* :

	₹
Cash price of machinery as per working note (i)	1,55,324
Less : Depreciation @ 10%. p.a. for the year 2008–2009	15,532
	1,39,792
Less : Depreciation @ 10%. p.a. for the year 2009–2010	13,979
	1,25,813
Less : Deprecation @ 10%. p.a. for the year 2010–2011	12,581
	1,13,232

In the books of Ashok

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

		₹			₹
2009 Mar. 31	To Modmac Ltd.	28,935	2009 Mar. 31	By Depreciation Account	15,532
			" "	By Balance c/d	13,403
		28,935			28,935
2009 Apr. 1	To Balance b/d	13,403	2010 Mar. 31	By Depreciation Account	13,979
2010 Mar. 31	To Modmac Ltd.	34,722	" "	By Balance c/d	34,146
		48,125			48,125
2010 Apr. 1	To Balance b/d	34,146	2011 Mar. 31	By Depreciation Account	12,581
			" "	By Profit and Loss Account — Balance written off on repossession by Modmac Ltd.	21,565
		34,146			34,146

Dr. **Modmac Ltd.** *Cr.*

		₹			₹
2009 Mar. 31	To Bank	60,000	2009 Mar. 31	By Machinery Account	28,935
			" "	By Interest Account	31,065
		60,000			60,000
2010 Mar. 31	To Bank	60,000	2010 Mar. 31	By Machinery Account	34,722
			" "	By Interest Account	25,278
		60,000			60,000

Hire Purchase, Instalments and Lease: Problem and Solution # 5.

Kareem Restaurant purchased from E.C. Ltd. a colour T.V. set on 1st October 2010 on the hire-purchase system. The cash price of the set was Rs 15,000. Terms of payment were Rs 15000 down and Rs 4 000 half yearly over two years, the first instalment was to be paid on 31st March, 2011. Rate of interest was 12% per annum.

Kareem Restaurant wrote off 15% depreciation per annum on reducing instalments basis and closed its books every year on 31st March. It could not pay the second instalment due on 30th September 2011 and as a consequence, EC Ltd. repossessed the T.V. set.

Prepare T'V Set Account and the hire vendor's account in Kareem Restaurant's ledger. Also calculate the loss suffered by Kareem Restaurant on repossession of T.V. set by E.C. Ltd. Make all calculations to the nearest rupee.

Solution :

First Method

In Kareem Restaurant's Ledger

Dr. **T.V. Set Account** *Cr.*

Date	Particulars	₹	Date	Particulars	₹
2010 Oct. 1	To E.C. Ltd. (cash price)	15,000	2011 Mar. 31	By Depreciation A/c —for six months @ 15% p.a. on ₹ 15,000	1,125
			Mar. 31	By Balance *c/d*	13,875
		15,000			15,000
2011 Apr. 1	To Balance *b/d*	13,875	2011 Sept. 30	By Depreciation A/c —for six months @ 15% p.a. on ₹ 13,875	1,041
			" "	By E.C. Ltd.— Amount not paid	11,322
			" "	By Profit & Loss A/c (balancing figure)	1,512
		13,875			13,875

Dr. **E.C. Ltd.** *Cr.*

Date	Particulars	₹	Date	Particulars	₹
2010 Oct. 1	To Bank— down payment	1,150	2010 Oct. 1	By T.V. Set Account	15,000
2011 Mar. 31	To Bank— first instalment	4,000	2011 Mar. 31	By Interest Account —@ 12% p.a. on ₹ 13,850 for 6 months	831
" "	To Balance *c/d*	10,681			
		15,831			15,831

Date	Particulars	₹	Date	Particulars	₹
2011			2011		
Sept. 30	To T.V. Set Account —transfer on repossession	11,322	Apr. 1	By Balance *b/d*	10,681
			Sept. 30	By Interest Account —@ 12% p.a. on ₹ 10,681 for 6 months	641
		11,322			11,322

The loss suffered by Kareem Restaurant is ₹ 1,512 in addition to ₹ 641 interest payable for the half year ended 30th September, 2011—total loss thus being ₹ 2,153.

Second Method

Dr. **T.V. Set Account** *Cr.*

Date	Particulars	₹	Date	Particulars	₹
2010			2011		
Oct. 1	To E.C. Ltd.— down payment	1,150	Mar. 31	By Depreciation A/c —on full cash price of ₹ 15,000 @ 15% p.a. for six months	1,125
2011					
Mar. 31	To E.C. Ltd. (₹ 4,000—₹ 831)	3,169	Mar. 31	By Balance *c/d*	3,194
		4,319			4,319
2011			2011		
Apr. 1	To Balance *b/d*	3,194	Sept. 30	By Depreciation A/c —for six months @ 15% per annum on ₹ 13,875	1,041
			Sept. 30	By Profit & Loss A/c —balance written off on repossession by E.C. Ltd.	2,153
		3,194			3,194

E.C. Ltd.

Date	Particulars	₹	Date	Particulars	₹
2010			2010		
Oct. 1	To Bank— down payment	1,150	Oct. 1	By T.V. Set Account	1,150
2011			2011		
Mar. 31	To Bank— first instalment	4,000	Mar. 31	By T.V. Set Account	3,169
			" "	By Interest Account	831
		5,150			5,150

<u>Instalment Payment System Operation:</u>

When a seller allows a customer to pay for a sale over multiple years, the transaction is frequently accounted for by the seller using the instalment method. Because of the long period of time involved, the risk of loss from customer non-payment is higher, so a prudent person would defer the recognition of some portion of the sale - which is what the instalment method does.

The primary circumstance under which the instalment method is used is a transaction in which the buyer makes a number of periodic payments to the seller, and it is not possible to determine the collectibility of cash from the customer. This is an ideal recognition method for large-dollar items, such as:

- Real estate
- Machinery
- Consumer appliances

The instalment method is better than generic accrual basis accounting when payments may be received for a number of years, for the accrual basis may recognize all of the revenue up front, without factoring in all of the risk inherent in the transaction. The instalment method is more conservative, in that revenue recognition is pushed off into the future, thereby making it easier to tie actual cash receipts to revenue.

An overview of the instalment method is that someone using it defers the gross margin on a sale transaction until the actual receipt of cash. When accounts receivable are eventually collected, a portion of the deferred gross profit from the following calculation is recognized:

Gross profit % x Cash collected

Use of the instalment method requires an enhanced level of record keeping for the duration of the associated instalment payments. The accounting staff should track the amount of deferred revenue remaining on each contract that has yet to be recognized, as well as the gross profit percentage on instalment sales in each separate year.

The following steps are used to account for an instalment sale transaction:

1. Record instalment sales separately from other types of sales, and keep track of the related receivables, layered by the year in which the receivables were originally created.
2. Trace cash receipts as they arrive to the instalment sales to which they relate.
3. At the end of each fiscal year, shift the instalment sales revenues and cost of sales occurring in that year to a deferred gross profit account.
4. Calculate the gross profit rate for instalment sales occurring in that year.

5. Apply the gross profit rate for the current year to cash collected on receivables from current year sales to derive the gross profit that can be realized.
6. Apply the gross profit rate for prior years to the cash receipts arriving that relate to instalment sales occurring in those prior periods, and recognize the resulting amount of gross profit.
7. Any deferred gross profit at the end of the current year is carried forward to the next year, to be recognized at a later date when the associated receivables are paid.

Entries in the books of buyer:

Instalment System: Journal Entries in Books of Purchase and Vendor!

In instalment system, there is an immediate sale, in which the price, instead of being paid in one lump sum, is spread over a period, interest being charged on unpaid balances. Under this system, the property in goods is passed on immediately to the buyer on signing the contract. The seller gives up the possession of the goods. If the buyer makes default in payment of instalment, the seller cannot repossess the goods but he can sue for the balance of debt.

Hire purchaser is just like a bailee but under instalment the buyer is the owner.

Journal Entries in the books of Purchaser

1.	Asset Account Interest Suspense Account To Vendor Account (Being purchase under instalment purchase system)	Dr. Dr.	
2.	Vendor Account To Bank Account (Being down payment to vendor at the time of delivery of asset)	Dr.	
3.	Interest Account To Interest Suspense Account (Being interest due)	Dr.	
4.	Vendor Account To Bank Account (Being payment of instalment)	Dr.	
5.	Depreciation Account To Asset Account (Being charging depreciation at...)	Dr.	
6.	Profit and Loss Account To Interest Account To Depreciation Account (Being transfer of Interest and Depreciation Accounts)	Dr.	

Journal Entries in the books of Vendor

1.	Buyer Account To Sales Account To Interest Suspense Account (Being sale of goods on instalment system)	Dr.	
2.	Bank Account To Buyer Account (Being cash received on delivery of goods)	Dr.	
3.	Interest Suspense Account To Interest Account (Being interest due)	Dr.	
4.	Cash Account To Buyer Account (Being receipt of instalment)	Dr.	
5.	Interest Account To Profit & Loss Account (Being transfer of interest)	Dr.	
6.	Sales Account To Trading Account (Being transfer of sales to Trading Account)	Dr.	

Illustration:

A purchased, on instalment basis, a machine from B on 1st January, 2003, for a sum of Rs 80,000. Rs 20,000 is to be paid on signing of the contract and rest in three instalments of Rs 20,000 each. The cash price of the machine is Rs 74,500 and interest is charged by the vendor at 5% p.a. The buyer charges depreciation at 10% p.a. on the diminishing balance.

ADVERTISEMENTS:

You are required to pass necessary journal entries in the books of both the buyer and the vendor and also prepare ledger accounts.

Solution:

A's Journal

			Dr.	Cr.
			Rs	Rs
2003				
Jan. 1	Machinery Account	Dr.	74,500	
	Interest Suspense Account	Dr.	5,500	
	To *B* Account			80,000
	(Being purchase of machine on instalment basis)			
"	*B* Account	Dr.	20,000	
	To Bank Account			20,000
	(Being cash down payment)			
Dec. 31	Interest Account	Dr.	2,725	
	To Interest Suspense Account			2,725
	(Being interest @ 5% for the year)			
	B Account	Dr.	20,000	
	To Bank Account			20,000
	(Being payment of instalment)			

"	Depreciation Account Dr. To Machine Account (Being depreciation @ 10% p.a.)		7,450	7,450
"	Profit and Loss Account Dr. To Interest Account To Depreciation Account (Being transfer of Interest and Depreciation A/cs)		10,175	2,725 7,450
2004 Dec. 31	Interest Account Dr. To Interest Suspense Account (Being interest @ 5% for the year)		1,861	1,861
"	*B* Account Dr. To Bank Account (Being payment of instalment)		20,000	20,000
"	Depreciation Account Dr. To Machine Account (Being depreciation @ 10% p.a.)		6,705	6,705
Dec. 31	Profit and Loss Account Dr. To Interest Account To Depreciation Account (Being transfer of Interest and Depreciation Accounts)		8,566	1,861 6,705
2005 Dec. 31	Interest Account Dr. To Interest Suspense Account (Being interest @ 5% for the year)		914	914
"	*B* Account Dr. To Bank Account (Being payment of instalment)		20,000	20,000
"	Depreciation Account Dr. To Machine Account (Being depreciation @ 10% p.a.)		6,035	6,035
"	Profit and Loss Account Dr. To Interest Account To Depreciation Account (Being transfer of Interest and Depreciation Accounts)		6,949	914 6,035

Dr. **Machine Account** Cr.

2003		Rs	2003		Rs
Jan. 1	To *B* Account	74,500	Dec. 31	By Depreciation A/c	7,450
			"	By Balance c/d	67,050
		74,500			74,500

2004 Jan. 1	To Balance b/d	67,050	2004 Dec. 31	By Depreciation A/c	6,705
			"	By Balance c/d	60,345
		67,050			67,050
2005 Jan. 1	To Balance b/d	60,345	2005 Dec. 31	By Depreciation A/c	6,035
			"	By Balance c/d	54,310
		60,345			60,345
2006 Jan. 1	To Balance b/d	54,310			

Dr. **B Account** Cr.

		Rs			Rs
2003 Jan. 1	To Bank A/c	20,000	2003 Jan. 1	By Machine a/c	74,500
Dec. 31	To Bank A/c	20,000	"	By Interest Suspense A/c	5,500
"	To Balance c/d	40,000			
		80,000			80,000
2004 Dec. 31	To Bank A/c	20,000	2004 Jan. 1	By Balance b/d	40,000
"	To Balance c/d	20,000			
		40,000			40,000
2005 Dec. 31	To Bank A/c	20,000	2005 Jan. 1	By Balance b/d	20,000
		20,000			20,000

Dr. **Interest Suspense Account** Cr.

		Rs			Rs
2003 Jan. 1	To B Account	5,500	2003 Dec. 31	By Interest Account	2,725
			"	By Balance c/d	2,775
		5,500			5,500
2004 Jan. 1	To Balance b/d	2,775	2004 Dec. 31	By Interest Account	1,861
			"	By Balance c/d	914
		2,775			2,775
2005 Jan. 1	To Balance b/d	914	2005 Dec. 31	By Interest Account	914
		914			914

Dr. **Interest Account** Cr.

		Rs			Rs
2003 Dec. 31	To Interest Account	2,725	2003 Dec. 31	By Profit & Loss A/c	2,725

2004 Dec. 31	To Interest Account	1,861	2004 Dec. 31	By Profit & Loss A/c	1,861
2005 Dec. 31	To Interest Account	914	2005 Dec. 31	By Profit & Loss A/c	914

Dr. **Depreciation Account** Cr.

		Rs			Rs
2003 Dec. 31	To Machine A/c	7,450	2003 Dec. 31	By Profit & Loss A/c	7,450
2004 Dec. 31	To Machine A/c	6,705	2004 Dec. 31	By Profit & Loss A/c	6,705
2005 Dec. 31	To Machine A/c	6,035	2005 Dec. 31	By Profit & Loss A/c	6,035

B's Journal

			Dr. Rs	Cr. Rs
2003 Jan. 1	*A* Account	Dr.	80,000	
	To Sales Account			74,500
	To Interest Suspense Account			5,500
	(Being sale of goods on Instalment system)			
"	Bank Account	Dr.	20,000	
	To *A* Account			20,000
	(Being cash received on delivery)			
Dec. 31	Interest Suspense Account	Dr.	2,725	
	To Interest Account			2,725
	(Being the interest due)			
"	Bank Account	Dr.	20,000	
	To *A* Account			20,000
	(Being amount of instalment received)			
"	Interest Account	Dr.	2,725	
	To Profit and Loss Account			2,725
	(Being transfer of Interest Account)			
2004 Dec. 31	Interest Suspense Account	Dr.	1,861	
	To Interest Account			1,861
	(Being interest due)			
"	Bank Account	Dr.	20,000	
	To *A* Account			20,000
	(Being amount of instalment received)			
"	Interest Account	Dr.	1,861	
	To Profit and Loss Account			1,861
	(Being transfer of Interest Account)			

2005 Dec. 31	Interest Suspense Account Dr.	914	
	To Interest Account		914
	(Being interest due)		
"	Bank Account Dr.	20,000	
	To A Account		20,000
	(Being amount of instalment received)		
"	Interest Account Dr.	914	
	To Profit and Loss Account		914
	(Being transfer of Interest Account		

Dr. **B Account** Cr.

		Rs			Rs
2003 Jan. 1	To Sales Account	74,500	2003 Jan. 1	By Bank Account	20,000
"	To Interest Suspense A/c	5,500	Dec. 31	By Bank Account	20,000
			"	By Balance c/d	40,000
		80,000			80,000
2004 Jan. 1	To Balance b/d	40,000	2004 Dec. 31	By Bank Account	20,000
			"	By Balance c/d	20,000
		40,000			40,000
2005 Jan. 1	To Balance b/d	20,000	2005 Dec. 31	By Bank Account	20,000

Dr. **Interest Suspense Account** Cr.

		Rs			Rs
2003 Dec. 31	To Interest Account	2,725	2003 Jan. 1	By A Account	5,500
"	To Balance c/d	2,775			
		5,500			5,500
2004 Dec. 31	To Interest Account	1,861	2004 Jan. 1	By Balance b/d	2,775
"	To Balance c/d	914			
		2,775			2,775
2005 Dec. 31	To Interest Account	914	2005 Jan. 1	By Balance b/d	914

Dr. **Interest Account** Cr.

		Rs			Rs
2003 Dec. 31	To Profit & Loss A/c	2,725	2003 Dec. 31	By Interest Suspense A/c	2,715
2004 Dec. 31	To Profit & Loss A/c	1,861	2004 Dec. 31	By Inerest Suspense A/c	1,861
2005 Dec. 31	To Profit & Loss A/c	914	2005 Dec. 31	By Interest Suspense A/c	914

Difference between Hire Purchase & Instalment Payment System

1. **Nature of Contract**
   Hire Purchase System: It is a hiring goods agreement.
   Instalment System: It is an agreement of sale.

2. Ownership
Hire Purchase System: Ownership of goods is transferred after the payment of final instalment.
Instalment System: Ownership of the goods passes to the buyer just signing the agreement.

3. Right
Hire Purchase System: The buyer cannot sell, destroy or transfer the goods.
Instalment System: The buyer can sell, destroy or mortgage or transfer as his/her wish.

4. Risk
Hire Purchase System: All the risks are borne by the vendor before the payment of final instalment.
Instalment System: All the risks are to be borne by the buyer from the date of agreement.

5. Right of Return
Hire Purchase System: The buyer can return the goods before making the final instalment.
Instalment System: The buyer cannot return the goods to the seller.

6. Repair and Maintenance:
Hire Purchase System: The liability of repair and maintenance lies with the seller provided that the buyer takes the utmost good care.
Instalment System: The buyer is responsible for repair and maintenance.

7. Forfeiture of Instalment Paid:
Hire Purchase System: In case of default in payment of instalment, paid instalment will be forfeited and treated as hire charges.
Instalment System: The act of forfeiture cannot be activated.

Unit IV: Branch Account:

Concept of Branch Account:

Branch accounting is a bookkeeping system in which separate accounts are maintained for each branch or operating location of an organization. Typically found in geographically dispersed corporations, multinationals and chain operators, it allows for greater transparency in the transactions, cash flows and overall financial position and performance of each branch.

Branch accounts can also refer to records individually produced to show the performance of different locations, with the accounting records actually maintained at the corporate headquarters. But the term usually refers to branches keeping their own books and later sending them into the head office to be combined with those of other units.

In order to increase the volume of profit, it is the primary aim of all business enterprises to increase their volume of sales. For this purpose, many firms open their shops in different parts of the locality/country. (The parent establishment is known as 'Head Office' and its offshoots are termed as 'Branch'.)

Besides, if branches are opened, particularly in developed regions, both the local consumers and the firms are benefited.

Practically, it is an extension of an existing firm. It should be remembered that a branch has its separate existence but does not possess any separate legal entity. That is why, it is said that it is nearly an extension and a profit centre of an existing firm. Needless to say that all activities of the branches are controlled by the Head Office.

According to Sec. 2 (a) of the Companies Act, 1958, a branch (office) is defined as:

(a) any establishment described as a branch by the Company, or,

(b) Any establishment carrying on either the same or substantially the same activity as that carried on by the head office of the company, or

(c) Any establishment engaged in any production, processing or manufacture, but does not include any establishment specified in any order made by the Central Govt., u/s-8.

Similarly according to Sec. 8, the Central Govt., may, by order, declare that in the case of any company any establishment carrying on either the same or substantially the same activity as that carried on by the Head Office of the Company, or any establishment engaged in any production, Passing or manufacture shall not be treated as a branch office of the company for all or any of the purposes of the Act.

It has already been stated above that a branch is an extension and a profit centre of the Head Office. Consequently profit of the branch is to be ascertained periodically by the Head Officer this purpose proper accounting should be maintained both in the books of branch as well as in the books of Head Office.

As the activities of branches vary from branch to branch, system of branch accounting depends on their nature, type, size, locality i.e., area of operation etc.

The Basics of Branch Accounting

In branch accounting, each branch (defined as a geographically separate operating unit) is treated as an individual profit or cost center. Its branch has its own account. In that account, it records such items as inventory, accounts receivable, wages, equipment, expenses such as rent and insurance, and petty cash. Like any double-entry bookkeeping system, the ledger keeps a tally of assets and liabilities, debits and credits, and ultimately, profits and losses for a set period.

Technically speaking, in bookkeeping terms, the branch account is a temporary or nominal ledger account. It lasts for a designated accounting period. At the period's end, the branch tallies up its figures and arrives at ending balances, which are then transferred to the appropriate head office or head department accounts. The branch account is left with a zero balance until the accounting process begins all over again with the next accounting period or cycle.

Branch Accounting Methods

There are several different methods for keeping branch accounts, depending on the nature and complexity of the business and the operational autonomy of the branch. The most common include:

- Debtor system
- Income statement system
- Stock and debtor system
- Final accounts system

Where Branch Accounting Applies

Branch accounting can also be used for a company's operating divisions, which usually have more autonomy than branches, as long as the division is not set up legally as a subsidiary company. A branch is not a separate legal entity, although it can (somewhat confusingly) be referred to as an "independent branch" because it keeps its own accounting books.

However, branch accounting is not the same as departmental accounting. Departments may have their own accounts, but they usually operate from the same physical location. A branch, by its nature, is a geographically separate entity.

History of Branch Accounting

Though it seems synonymous with contemporary chain stores and franchise operations, branch accounting actually goes back a long way. Venetian banks maintained a form of it as early as the 14th century. The ledgers of a firm of Venetian merchants, dating from 1410-18, also show a form of it to try to account for overseas and home accounts. Luca Pacioli's *Summa de Arithmetica (*1494), the first accounting textbook, devotes a chapter to it.

By the 17th century, branch accounting was being widely used by German counting-houses and other businesses. Moravian settlements in throughout the thirteen original colonies used it for their books in the mid-1700s.

Pros and Cons of Branch Accounting

The primary advantages (and often the objectives) of branch accounting are better accountability and control since profitability and efficiency of different locations can be closely tracked.

On the downside, branch accounting may involve added expenses for an organization in terms of manpower, working hours and infrastructure. A separate account coding structure must be maintained for each operating unit. It may be necessary to appoint branch accountants to ensure accurate financial reporting and compliance with head office procedures and processes.

KEY TAKEAWAYS

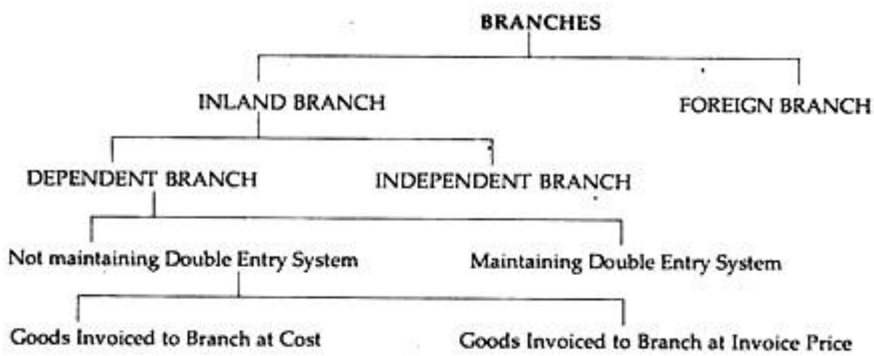
- Branch accounting is a bookkeeping system in which separate accounts are maintained for each branch or operating location of an organization.
- Technically, the branch account is a temporary or nominal ledger account, lasting for a designated accounting period.
- The primary objectives of branch accounting are better accountability and control, since profitability and efficiency can be closely tracked for individual locations.

- Branch accounting has a long history, going back to the Venetian banks of the 14th century.

Types of Branches:

There are different types of branches according to their nature and magnitude of operation, although all the branches are operated under the instruction of Head Office. As a result, the system of branch accounting is not the same in all the cases.

However, branches may be classified as:



(i) Inland Branch (also known as Domestic Branch or Home Branch):

These branches are situated within the territory of the country. These branches do not maintain accounts under Double Entry System. They simply read out periodical statements to Head Office relating to goods received, goods sold, amounts returned, expenses, stock position (both at the beginning and at the end.)

These branches are not allowed to purchase goods from outside market. As all collections are directly remitted to Head Office, naturally, expenses of branches are met by Head Office. In other words, these branches are operated and controlled by Head Office.

Dependent Branch:

Dependent branches are those which do not maintain separate books of account and wholly depend on Head Office. The result of the operation, i.e., profit or loss, is ascertained by Head Office. In other words Head Office maintains and opens a Branch Account in its book in order to find out the result of the operation. Branches supply some related information to the Head Office, i.e., position of cash, debtors stocks, etc.

Independent Branch:

Independent branches are those which maintain complete system of accounting. This particularly happens when their sizes are very large due to various functional complexities. In short, they prepare their accounts independently, i.e., they also purchase and sell goods for cash and credit independently in addition to the goods that are supplied by the Head Office.

They may supply goods to Head Office, pay expenses and deposit cash in their own account like an independent unit. Thus, they maintain their own accounts under Double Account System. That is why they are called Independent Branch.

(ii) Foreign Branch:

These branches are located outside the country. They are operated in the foreign country which has a different currency and, as such, question of rate of exchange will arise. These branches may be of: (i) Dependent Branch or (ii) Independent Branch depending on the method of accounting.

Accounting Problems related to Dependent Branches:

The accounts of the dependent branch are maintained by the Head Office in any one of the following ways;

1. Debtors System

2. Stock and Debtors System

3. Final Account System

4. Wholesale Branch System

1. Debtors System:

Under this system the Head Office opens one Branch Account to record various transactions with the Branch. Branch Account is maintained in the form of a Debtor Account. In the books of the Head Office, Branch Account is debited with the goods supplied and all expenses met by Head Office and credited with all remittances and returns, similar to Customers Account.

Therefore, the system can be called Debtors System or One Account System. The excess of the credit over its debit represents a profit or vice-versa, and is transferred to General Profit and Loss Account of Head Office. Branch Account is prepared in the books of Head Office and is a Nominal Account.

From the accounting point of view, the following are the further classifications:

(a) Branches receive goods from Head Office at cost price and are authorised to sell them for cash only.

(b) Branches receive goods from Head Office at cost price and are authorised to sell them for cash as well as on credit.

(c) Branches receive goods from Head Office at cost plus certain percentage.

(A) Branches Received Goods from Head Office at Cost Price and are Authorized to Sell them for Cash only:

The following journal entries are passed in the books of the Head Office for recording different Branch transactions:

1. Goods supplied to Branch	Branch Account To Goods sent to Branch Account	Dr.
2. Goods returned by Branch	Goods Sent to Branch Account To Branch Account	Dr.
3. Sales of goods for cash by the Branch	There is no journal entry in the books of Head Office. This transaction does not relate to the Head Office.	
4. Remittance of cash by Branch	Bank Account To Branch Account	Dr.
5. Cash sent to Branch by the Head Office for expenses	Branch Account To Bank Account	Dr.
6. Unsold stock lying with Branch	Closing Stock Account To Branch Account	Dr.
7. Closing balance of Petty Cash	Branch Petty Cash Account To Branch Account	Dr.
8. For Profit or Loss of the Branch (a) If Profit	Branch Account To General Profit and Loss Account	Dr.
(b) If Loss:	General Profit and Loss Account To Branch Account	Dr.

The above journal entries are posted in the Branch Account. The Branch Account appears as follows:

Branch Account
(In the books of the Head Office)

Dr.	Rs		Cr. Rs
To Stock (Opening Balance)		By Bank (Cash received)	
To Petty Cash (Opening Balance)		By Goods sent to Branch (Returns)	
To Goods sent to Branch		By Balance c/d:	
To Bank Account:		Closing Stock	
Salary		Petty Cash	
Rent		By Loss (if any) transferred to	
Petty Expenses		General Profit and Loss A/c	
To Profit, transferred to General Profit and Loss Account			

A simple branch Account in the books of the Head Office appears as given above.

The following entries may also be considered when there is opening balance and closing balance of stocks furniture, Outstanding expenses, Pre-paid expenses etc.

9. Closing balances of furniture, pre-paid expenses etc.	Branch Furniture Account Branch Prepaid Expense A/c To Branch Account	Dr. Dr.
10. Closing liabilities of Branch Account	Branch Account To Branch Liabilities A/c	Dr.

Note: Closing balance of the Branch Account will be opening balance in the following year. S.No. 9 and 10 entries may be reversed.

11. To transfer the balance in Goods Sent to Branch Account	Goods Sent to Branch Account To Trading Account	Dr.

Illustration 1:

Mr. Ram of Cochin has opened a Branch at Madras which sells goods for cash only.

The following are the transactions between Branch Office and the Head Office for the year ended 31st December 2005:

	Rs
Opening Stock at 1st January 2005	2,00,000
Goods supplied to Branch	5,00,000
Cash sent to Branch for Rent	2,000
-do- for other expenses	1,000
Cash received from Branch during 2005	6,00,000
Closing Stock on 31st December 2005	1,50,000
Petty Cash balance on 31st December 2005	100

From the above, pass journal entries and prepare Madras Branch Account.

SOLUTION

In the books of the Head Office

				Dr. Rs	Cr. Rs
2005 Dec. 31	Madras Branch Account	Dr.		5,00,000	
	To Goods sent to Madras Branch A/c				5,00,000
	(Being goods supplied to Madras Branch)				
"	Madras Branch Account	Dr.		3,000	
	To Bank Account				3,000
	(Being cash sent to Madras Branch to meet Rent Rs 2,000 and other expenses Rs 1,000)				
"	Bank Account	Dr.		6,00,000	
	To Madras Branch Account				6,00,000
	(Being cash received from Branch)				
"	Stock at Madras Branch Account	Dr.		1,50,000	
	Petty Cash at Madras Branch Account	Dr.		100	
	To Madras Branch Account				1,50,100
	(Being entry for closing stock and Petty cash at the Branch)				
"	Madras Branch Account	Dr.		47,100	
	To General Profit and Loss A/c				47,100
	(Being net profit transferred)				

Dr. **Madras Branch Account** Cr.

2005			Rs	2005		Rs
Jan. 1	To Balance b/d:			Dec. 31	By Bank Account	6,00,000
	Opening Stock		2,00,000	Dec. 31	By Balance c/d:	
	To Goods sent to Madras Branch Account		5,00,000		Stock	1,50,000
	To Bank Account:				Petty Cash	100
	Rent	2,000				
	Expense	1,000	3,000			
Dec. 31	To Net Profit transferred to General Profit & Loss A/c		47,100			
			7,50,100			7,50,100

Illustration 2:

From the following particulars, prepare Branch Account showing the profit or loss of the branch:

	Rs
Opening stock at the Branch	30,000
Goods sent to Branch	90,000
Sales (Cash)	1,20,000
Expenses:	
Salaries	10,000
Other expenses	4,000

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

Solution:

In the Books of Head Office
Branch Account

			Rs			Rs
?	To Balance b/d –Stock		30,000	?	By Bank – Sales	1,20,000
	To Goods sent to Branch		90,000		By Balance c/d –Stock	20,000 (1)
	To Bank:					
	Salaries	10,000				
	Other Expenses	4,000	14,000			
	To Manager's Commission		300 (2)			
	To General Profit & Loss Account		5,700			
			1,40,000			1,40,000

Workings:

(1) Closing Stock:

Opening Stock	Rs 30,000
Add: Goods sent to Branch	90,000
	Rs 1,20,000
Less: Cost of sales (Rs 1,20,000 × $\frac{100}{120}$)	1,00,000
	20,000

(2) Manager's Commission:

Before charging commission, profit = Rs 6,000 (Rs 1,40,000 – 1,34,000)

Commission Payable = 5% of Rs 6,000 = Rs 300

(B) Branches Receive Goods from Head Office at Cost Price and are Authorised to Sell them for Cash as Well as on Credit:

All the journal entries we have studied under (A) above are equally applicable to this method also. Here the Branch is permitted to sell the goods on credit in addition to cash sales. Branch has to keep records relating to credit sales.

When credit sales are allowed, the following additional journal entries are to be done in the books:

12. Credit Sales effected at the Branch	No entry in the books of Head Office	
13. Cash received from Debtors by the Branch	No entry in the books of Head Office	
14. Cash received from Debtors by the Branch and remitted to Head Office	Bank Account To Branch Account	Dr.
15. Discount allowed by the Branch to Sundry Debtors	No entry in the books of Head Office	
16. Bad Debts incurred by the Branch	No entry in the books of Head Office	
17. Goods returned by Branch Debtors to Branch	No entry in the books of Head Office	
18. For closing Debtors of the Branch Debtors	Branch Debtors Account To Branch	Dr.

2. Stock and Debtors System:

Under the Debtors System, the profit or Joss can be found out by preparing a Branch Account in the books of Head Office. The Branch Account has been treated as a customer, a personal account in an impersonal name. This type of accounting treatment works well in small Branches. When authorised to make credit sales also, the Debtors System proves inadequate. A detail of credit sales remains unaccounted in this system. To overcome this, Stock and Debtors System has been devised.

Under Stock and Debtors System, the Head Office maintains several accounts relating to each Branch.

The following are the accounts to record the branch transactions:

(A) When Goods are Supplied at Cost:

1. Branch Stock Account (Real Account):

This account is a record of transactions relating to goods and discloses the gross profit or loss of a branch. Head Office can have effective control over the Branch stock.

2. Branch Debtors Account (Personal Account):

This account is maintained to keep the transactions relating to Branch Debtors.

3. Branch Expense Account (Nominal Account):

This account discloses all branch expenses and losses incurred by the Branch.

4. Branch Profit and Loss Account (Nominal Account):

This account incorporates the gross profit from Branch Stock Account and expenses from Branch Expense Account. Its balance represents the net results.

5. Goods Sent to Branch Account is prepared to know the goods supplied to and returns received from the Branch.

6. Branch Cash Account reveals all the cash transactions with Branch.

(B) When Goods are Supplied at Invoice Price:

1. Branch Stock Account:

This account is maintained to record the transactions of goods at invoice price. This account will not disclose profit or loss, but discloses shortage, surplus or closing stock of goods.

2. Branch Adjustment Account:

This account is kept for finding out gross profit made at the Branch. All loadings in the goods sent to the Branch, Opening Balance, Closing Balance, Returns from the Branch, apart from shortages and surpluses etc., are recorded in this account.

3. Branch Debtors Account,

4. Branch Expense Account,

5. Goods Sent to Branch Account, and

6. Branch Profit and Loss Account are explained above.

Illustration 1: (Missing Value of Credit Sales)

From the following information, ascertain sales to the customers of the Branch on credit and prepare the Branch Account in the books of Head Office for the year ended 31st December 2005. All expenses are paid by the Head Office.

	Rs
Stock on 31.12.2005	90,000
Stock 1.1.2005	60,000
Debtors on 1.1.2005	40,000
Debtors on 31.12.2005	60,000
Cash sales remitted to Head Office	1,50,000
Cash collected from Debtors and remitted to Head Office	1,60,000
Goods invoiced to Branch	3,60,000
Rent	3,000
Salary	6,000
Goods returned to Head Office	6,000
Petty Cash on 1.1.2005	100
Petty Cash on 31.12.2005	50
Sale of Gunny bags	200

(Goods are invoiced by Head Office at 20% above the cost)

SOLUTION

In the books of Head Office

Branch Account

Dr. Cr.

		Rs			Rs.
To Balance b/d:			By Cash A/c		
Stock	60,000		Cash Sales	1,50,000	
Debtors	40,000		Cash Collected	1,60,000	
Petty Cash	100	1,00,100	Sales of Bags	200	3,10,200
To Goods Sent to Branch A/c		3,60,000	By Stock Reserve A/c		10,000
To Bank A/c:			By Goods Sent to Branch A/c		
Rent	3,000		Returns		6,000
Salary	6,000	9,000	By Goods Sent to Branch A/c		
			Loading in Goods Sent		60,000
To Stock Reserve A/c		15,000	By Balance c/d:		
To Goods Sent to Branch A/c		1,000	Stock	90,000	
To General Profit and Loss A/c		51,150	Debtors	60,000	
			Petty Cash	50	1,50,050
		5,36,250			5,36,250

Debtors Account

Dr. Cr.

	Rs		Rs
To Balance b/d	40,000	By Cash A/c	1,60,000
To Sales–Credit (Balancing figure)	1,80,000	By Balance c/d	60,000
	2,20,000		2,20,000

Illustration 2:

(Imprest system of Petty Cash and Assets Purchased by Branch)

Mr. Govind had a Branch at Agra. Goods are supplied by Head Office to Branch at cost plus 25%. All the Branch expenses are paid by Head Office, except petty expenses, which are to be paid out of petty cash balance of Rs 200 kept on Imprest System.

	Rs
Stock on 1.1.2005	5,000
Debtors on 1.1.2005	3,000
Petty Cash on 1.1.2005	200
Furniture on 1.1.2005	6,000
Goods invoiced to Branch	20,000
Returns from Debtors	1,000
Allowances to Customers	100
Bad Debts written off	50
Cash Sales	3,000
Credit Sales	15,000
Expenses at Branch:	
Salary	1,000
Rent (for 9 months)	900
Petty expenses paid by Branch Manager	120
Furniture purchased by Branch Manager (1.10.2005)	3,000
Cash paid to Head Office	16,000
Stock on 31.12.2005	3,000
Cash collected from Debtors	16,000

Write off 10% depreciation on Furniture. *(B.Com., Madurai, Bangalore)*

SOLUTION

In the books of Govind

Dr. **Agra Branch Account for the year ended 31st Dec. 2005** Cr.

		Rs			Rs
To Balance c/d:			By Cash Account		16,000
Stock	5,000		By Goods sent to Branch:		
Debtors	3,000		(Loading)		4,000
Petty Cash	200		(20,000 × 25/125)		
Furniture	6,000	14,200	By Stock Reserve		
To Goods Sent to Branch		20,000	(Opening Stock)		1,000
To Bank Account:			(5,000 × 25/125)		
Salary	1,000		By Bank c/d:		
Rent	900	1,900	Stock	3,000	
To Bank (Petty Cash)		120	Debtors	850	
To Stock Reserve			Petty Cash	200	
(Closing Stock)		600	Furniture	8,325	12,375
(3,000 × 25/125)			By General Profit and Loss		
To Rent Outstanding		300	Account		3,745
		37,120			37,120

Illustration 3:

Mr. Ganesh had a Branch at Agra and charges all goods sent to the Branch at cost plus 33 1/3%. It is arranged that all cash received by the Branch is to be paid daily to the Head Office Account in the Bank and necessary advice sent to the Head Office. The Branch is to effect very little credit sales. From the following particulars, prepare the Branch Account for 2005 under Single Column Method and Double Column Method.

	Rs
Stock on 1st January 2005	12,000
Goods sent to Branch	80,000
Debtors on 1st Jan. 2005	1,500
Cash sent to Head Office	1,24,000
Rent, Rates and Taxes	3,200
Salaries and wages	4,800
Debtors on 31st Dec. 2005	1,600
Stock on 31st Dec. 2005	14,800

SOLUTION

(A) Single Column Method

In the books of Head Office

Branch Account

Dr. Cr.

Date	Particulars		Rs.	Date	Particulars	Rs.
2005 Jan. 1	To Balance b/d:			2005 Dec. 31	By Bank Account	1,24,000
	Stock	12,000			By Branch Stock	14,800
	Debtors	1,500	13,500		By Branch Debtors	1,600
	To Goods sent to Branch		80,000		By Difference in value of opening stock	3,000@
	To Bank Account:				By Goods Sent to Branch A/c	20,000&
	Rent etc.	3,200				
	Salaries etc.	4,800	8,000			
	To Difference in value of Stock A/c		3,700*			
	To Net Profit, transferred to General Profit and Loss A/c		58,200			
			1,63,400			1,63,400

Note: The values of Opening Balance, Goods sent to Branch and Closing Stock are given under Invoice Price *i.e.*,

$$100 + 33\ 1/3\% = 133\ 1/3\%$$

Therefore, the excess price included:

$$\text{in Opening Stock} = \frac{12{,}000 \times 33\ 1/3\%}{133\ 1/3\%} = \text{Rs } 3{,}000^{@}$$

$$\text{in Goods sent to Branch} = \frac{80{,}000 \times 33\ 1/3\%}{133\ 1/3\%} = \text{Rs } 20{,}000^{\&}$$

$$\text{in Closing Stock} = \frac{14{,}800 \times 33\ 1/3\%}{133\ 1/3\%} = \text{Rs } 3{,}700^{*}$$

(*B*) *Double Column Method:*

In the books of Head Office

Branch Account

Dr.		Cost Price Rs	Invoice Price Rs	Cr.	Cost Price Rs	Invoice Price Rs
To Balance b/d:				By Bank Account	1,24,000	1,24,000
Opening Stock		9,000	12,000	By Branch Stock A/c	11,100	14,800
Debtors		1,500	1,500	By Branch Debtors A/c	1,600	1,600
To Goods Sent to Branch Account		60,000	80,000	By Difference in value of opening stock	–	3,000
To Bank Account:				By Goods Supplied to Branch A/c	–	20,000
Rent etc.	3,200					
Salaries etc.	4,800	8,000	8,000			
To Difference in value of closing stock		–	3,700			
To Net Profit, transferred to General Profit & Loss A/c		58,200	58,200			
		1,36,700	1,63,400		1,36,700	1,63,400

Journal entries under Stock and Debtor System

1. Goods supplied to Branch	Branch Stock Account To Goods Supplied to Branch A/c	Dr.
2. Cash Sales made at Branch	Branch Cash Account To Branch Stock Account	Dr.
3. Credit sales made at Branch	Branch Debtors Account To Branch Stock Account	Dr.
4. Goods returned to Head Office by Branch	Goods Sent to Branch Account To Branch Stock Account	Dr.
5. Goods damaged/destroyed etc.	Defective Goods Account To Branch Stock Account	Dr.
6. Cash received from Branch Debtors	Branch Cash Account To Branch Debtors Account	Dr.
7. Goods returned by Branch Debtors	Branch Stock Account To Branch Debtors Account	Dr.
8. Branch expenses	Branch Expenses Account To Bank/Cash Account	Dr.
9. On transferring Branch Expenses	Branch Adjustment Account To Branch Expenses Account	Dr.
10. Disposing of damaged goods (S.No. 5)	Branch Adjustment Account (Loading in such goods) Branch Profit & Loss Account (Cost price of such goods) To Damaged Goods Account	Dr. Dr.
11. Purchase of asset for Branch	Branch Asset Account To Cash Account	Dr.
12. Depreciation on Branch Assets	Branch Profit and Loss Account To Branch Asset Account	Dr.

Illustration 4: (Stock and Debtors System)

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

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

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

(CA Inter)
(B.Com., Osmania)

SOLUTION

In the books of Corkwood Industries, Mumbai

Dr. **Mangalore Branch Stock Account** Cr.

	Rs		Rs
To Balance b/d	6,000	By Bank A/c	
To Goods Sent to Branch A/c	60,000	Cash Sales	20,000
To Branch Debtors A/c		By Branch Debtors A/c	
Returns	800	Credit Sales	36,000
To Branch Profit and Loss A/c		By Goods Sent to Branch A/c	
Surplus	2,400	Returns	1,200
		By Balance c/d	
		Closing stock	12,000
	69,200		69,200

Dr. **Mangalore Branch Debtors Account** Cr.

	Rs			Rs
To Balance b/d	7,200	By Bank A/c		32,000
To Branch Stock A/c		By Branch Profit and Loss A/c		
Sales	36,000	Discount	600	
		Bad Debts	400	1,000
		By Branch Stock A/c		
		Returns		800
		By Balance c/d		9,400
	43,200			43,200

Dr. **Mangalore Branch Adjustment Account** Cr.

	Rs		Rs
To Goods Sent to Branch A/c		By Balance b/d	
Load on Returns to Head Office	240	Load on Opening Stock	1,200
To Branch Profit and Loss A/c	10,560	By Goods Sent to Branch A/c	
To Branch c/d		Load on Goods Sent	12,000
Load on Closing Stock	2,400		
	13,200		13,200

Dr. **Mangalore Branch Expenses Account** Cr.

		Rs		Rs
To Bank A/c:			By Profit and Loss A/c	8,400
Rent, Rates etc.	1,800			
Salaries etc.	6,000			
Office Expenses	600	8,400		
		8,400		8,400

Mangalore Branch Profit and Loss Account

Dr.		Rs	Cr.	Rs
To Branch Expenses A/c		8,400	By Branch Adjustment A/c	10,560
To Branch Debtors A/c			By Branch Stock A/c	2,400
Discount	600			
Bad Debts	400	1,000		
To General Profit and Loss A/c		3,560		
		12,960		12,960

Goods Sent to Mangalore Branch Account

Dr.	Rs	Cr.	Rs
To Branch Adjustment A/c	12,000	By Mangalore Branch Stock A/c	60,000
To Branch Stock A/c	1,200	By Branch Adjustment A/c	240
To Purchases A/c	47,040		
	60,240		60,240

Note:

Branch Stock Account discloses shortage or surplus after entering the closing stock at selling price on the credit side. Stock is taken at actual count. If the debit side is more, shortage occurs; and if credit side is more it is surplus. Shortage is entered on the credit side while surplus is entered on the debit side. In this illustration, it is surplus and is transferred to Branch Profit and Loss Account.

3. Final Account System (Branch Trading and Profit and Loss Account):

The profit or loss of a dependent Branch can also be known by preparing a Memorandum Branch Trading and Profit and Loss Account. This Account is usually prepared in cost price. Besides the final accounts, Branch Account is also to be prepared. This Branch Account is different from the Branch Account prepared under the Debtors System.

The Branch Account, appearing under Debtors System, is a nominal account. But the Branch Account, appearing under Final Account System, is a personal Account. Generally the Branch Account, under this system, will have debit balance.

Illustration 1:

A Kolkata trading firm has a branch at Patna to which the goods are charged out at cost plus 25%. Branch keeps its own Sales ledger and remits daily all cash received to the Head Office. All expenses are paid from the Head Office.

The transactions for the branch for the year 2005 are given below:

	Rs
Stock on 1-1-2005	55,000
Sundry Debtors on 1-1-2005	550
Petty cash balance on 1-1-2005	450
Cash Sales	13,250
Collections on Ledger Accounts	1,05,000
Goods returned to Head Office	1,500
Bad Debts	1,500
Allowances to Customers	1,250
Returns Inwards	2,500
Cheques sent to Branch	
For Rent	2,500
For Wages	1,500
For Salary and other Expenses	4,500
Stock on 31.12.2005	60,000
Sundry Debtors on 31-12-2005	15,000
Petty cash on 31.12.2005 (including sundry income of Rs 50 not remitted)	500

Prepare (*a*) the Branch Account and (*b*) Branch Trading and Profit and Loss Account for the year 2005 in the Head Office books.

(B.Com., Hons., Calcutta)

(B.Com., Madurai, Bharathidasan)

SOLUTION

(a) In the books of Kolkata Head Office

Patna Branch Account

Dr. Cr.

			Rs				Rs
2005				2005			
Jan. 1	To Balance b/d			Jan. 1	By Stock Reserve A/c		
	Stock	55,000			Load on Opening Stock		
	Debtors	550			(25/100 × 55,000)		11,000
	Petty Cash	450	56,000	Dec. 31	By Bank A/c–Remittance		
Dec. 31	To Goods Sent to				Received:		
	Branch A/c		1,00,000		Cash Sales	13,250	
Dec. 31	To Bank A/c Remittance				Collection from		
	for				Debtors	1,05,000	1,18,250
	Rent	2,500		Dec. 31	By Goods Sent to		
	Wages	1,500			Branch A/c		

	Salary and other Expenses	4,500	8,500		Returns from Branch		1,500
Dec. 31	To Goods Sent to Branch A/c Load on Return (25/100 × 1500)		300	Dec. 31	By Goods Sent to Branch A/c Load on Goods Sent (25/100 × 1,00,000)		20,000
Dec. 31	To Stock Reserve A/c Load on Closing Stock (25/100 × 60,000)		12,000	Dec. 31	By Balance c/d Stock	60,000	
					Debtors	15,000	
					Petty Cash	500	75,500
Dec. 31	To Profit and Loss A/c Branch Profit Transferred		49,450				
			2,26,250				2,26,250

(b) Patna Branch Trading and Profit and Loss Account for the year ended 31st December 2005 (cost price)

Dr. Cr.

		Rs			Rs.
To Opening Stock		44,000	By Sales–Cash	13,250	
To Goods Sent to Branch	80,000		Credit	1,24,700	
Less: Returns	1,200	78,800		1,37,950	
To Gross Profit c/d		60,650	*Less*: Returns	2,500	1,35,450
			By Closing Stock		48,000
		1,83,450			1,83,450
To Rent		2,500	By Gross Profit b/d		60,650
To Wages		1,500	By Miscellaneous Income		50
To Salary and other Expenses		4,500			
To Bad Debts		1,500			
To Allowances to Customers		1,250			
To Net Profit		49,450			
		60,700			60,700

Memorandum Branch Debtors Account

Dr. Cr.

	Rs		Rs
To Balance b/d	550	By Bank A/c–Collection	1,05,000
To Credit Sales A/c (Balancing figure)	1,24,700	By Bad Debts A/c	1,500
		By Allowances A/c	1,250
		By Returns Inwards A/c	2,500
		By Balance c/d	15,000
	1,25,250		1,25,250

Illustration 2:

The Bengal Trading Corporation invoices goods to its Cuttack Branch at cost which sells on credit as well as for cash. Cash received by the Branch is remitted to the H.O. Branch expenses are paid direct from the H.O. except petty expenses which are met by the Branch and for which periodical transfers are made from the H.O.

You are asked to prepare the Cuttack Branch Account and Branch Trading and Profit & Loss Account in the Head Office books from following the particulars:

	Rs
Opening Stock at Branch	6,000
Opening Petty Cash at Branch	250
Opening Debtors at Branch	15,200
Goods from Head Office	38,270
Goods returned by Customers	360
Total Sales	53,540
Cash Sales	15,320
Goods returned by customers	450
Allowances to customers	200
Discount allowed to customers	1,530
Bad Debts	370
Rent and Rates	1,200
Salaries and Wages	3,500
Petty expenses by the Branch	1,350
Closing Stock at Branch	7,560
Pilferage of goods at Branch	780
Closing Debtors at Branch	15,400
Closing Petty Cash at Branch	210

(B.Com., Madurai, Punjab, Poona)

SOLUTION

In the books of Bengal Trading Corporation

Cuttack Branch Account

Dr. Cr.

		Rs			*Rs*
To Balance b/d			By Bank A/c–Remittance Received		
Stock	6,000		Cash sales	15,320	
Debtors	15,200		Collection from Debtors	35,560	50,880
Petty Cash	250	21,450	By Goods Sent to Branch A/c		
To Goods Sent to Branch A/c		38,270	Returns from Branch:	450	
To Bank A/c–Remittance for:			Stock	7,560	
Rent and Rates	1,200		Debtors	15,400	
Salaries and Wages	3,500		Petty Cash	210	23,620
Petty Expenses	1,310	6,010			
To Profit and Loss A/c					
Branch Profit Transferred		8,770			
		74,500			74,500

Alternatively

Cuttack Branch Trading and Profit and Loss Account

for the year ended...

Dr. Cr.

		Rs			*Rs*
To Opening Stock		6,000	By Sales	53,540	
To Goods Sent to Branch	38,270		*Less*: Returns	360	53,180
Less: Returns	450	37,820	By Pilferage of Goods		780
To Gross Profit c/d		17,700	By Closing Stock		7,560
		61,520			61,520

To Rent and Rates	1,200	By Gross Profit b/d	17,700
To Salaries and Wages	3,500		
To Petty Expenses	1,350		
To Pilferage of Goods	780		
To Allowances to Customers	200		
To Discount Allowed	1,530		
To Bad Debts	370		
To Net Profit	8,770		
	17,700		17,700

Dr. **Memorandum Branch Debtors Account** Cr.

	Rs		Rs
To Balance b/d	15,200	By Returns Inward A/c	360
To Credit Sales A/c		By Allowances A/c	200
(Rs 53,540 – 15,320)	38,220	By Discount Allowed A/c	1,530
		By Bad Debts A/c	370
		By Bank A/c	
		Collection (Balancing figure)	35,560
		By Balance c/d	15,400
	53,420		53,420

Dr. **Memorandum Branch Petty Cash Account** Cr.

	Rs		Rs
To Balance b/d	250	By Petty Expenses A/c	1,350
To Bank A/c		By Balance b/d	210
Remittance (Balancing figure)	1,310		
	1,560		1,560

4. Wholesale System:

There are many producers, now-a-days, who have their own retail shop (Branch). It deals in both retail and wholesale transactions. The profit rates earned by Branches differ between the retail sale and wholesale. Here, it is necessary to account the additional profit made by a Branch through retail trading over the wholesale trading. Wholesale price is always less than retail price.

For instance, the cost of a product is Rs 100, the wholesale price is Rs 140 and the retail price is Rs 160. If the Branch sells the product, the profit will be Rs 60; but the real profit earned by the Branch is Rs 20 (Rs 160 – 140), which is the contribution of Branch. The profit of Rs 40 (Rs 140 – Rs 100) would have been made by the Head Office by selling on wholesale basis to others.

Under this situation, to find out the real profit earned by a Branch, the Head Office charges the Branch with wholesale price. This facilitates the Head Office to know the retail profit earned by a Branch. In other words, the difference between the wholesale price and selling price is the pure profit on retailing.

The Head Office sends the goods to Branch at wholesale price and in case all the goods have been sold, there is no problem. If not, the unsold goods lying with the Branch will be at invoice price and in such case adjustment for the unrealized profit of the Head Office Trading Account must be made through Branch Stock Reserve Account in order to find out true profit of the concern as a whole.

Illustration 1:

Ascertain the profit that you consider as having been earned by the Delhi Branch of Jaipur Industries Ltd. from the following:

	Rs
Stock on 1st January 2005 (invoice price)	20,000
Goods sent to Branch during 2005 (at invoice price)	1,10,000
Expense at Branch during the year	6,000
Sales during the year	1,20,000

Goods are invoiced to the Branch at cost plus 25%; the sale price is cost plus 50%. Also ascertain the Stock Reserve that must be maintained in respect of unrealised profit. *(B.Com., Madras)*

SOLUTION

Jaipur Industries Ltd.
Trading and Profit and Loss Account of Delhi Branch
for the year ended 31st Dec. 2005

Dr. Cr.

	Rs		*Rs*
To Opening Stock	20,000	By Sales	1,20,000
To Goods from Head Office	1,10,000	By Closing Stock*	30,000
To Gross Profit	20,000		
	1,50,000		1,50,000
To Expenses	6,000	By Gross Profit	20,000
To Net Profit transferred to General Profit and Loss	14,000		
	20,000		20,000

* Closing stock at Delhi Branch:

	Rs	
Opening Stock	20,000	
Goods from Head Office	1,10,000	1,30,000
Less: Cost of goods sold: (1,20,000 × 125/150)		1,00,000
Closing stock (invoice price)		30,000

Stock Reserve in respect of closing stock Rs 30,000 = 30,000 × 25/125 = Rs 6,000

Illustration 2:

A Head Office sends goods to its Branch at 20% less than the list price. Goods are sold to consumers at cost plus 100%. From the following ascertain the profit made at the Head Office and the Branch on wholesale basis:

	Head Office	Branch
	Rs	Rs
Purchases	2,00,000	–
Goods sent to Branch (Invoice price)	80,000	–
Sales	1,70,000	80,000

(*B.Com., Delhi*)

SOLUTION

Trading and Profit and Loss Account
for the year ended.....

Dr. Cr.

	Head Office	*Branch Office*		*Head Office*	*Branch Office*
	Rs	*Rs*		*Rs*	*Rs*
To Purchases	2,00,000	–	By Goods sent to Branch	80,000	–
To Goods from H.O.	–	80,000	By Sales	1,70,000	80,000
To Gross Profit	1,15,000	16,000	By Closing Stock	65,000	16,000
	3,15,000	96,000		3,15,000	96,000
To Stock Reserve	6,000	–	By Gross Profit	1,15,000	16,000
To Net Profit Transferred to Head Office		16,000			
To Net Profit	1,09,000				
	1,15,000	16,000		1,15,000	16,000

Cost Price = 100%

Invoice price = 160% (20% less than List price)

List Price = 200% (100% + 100%)

Stock at Head Office:

			Rs
Purchases			2,00,000
Less: Goods sent to Branch (Rs 80,000 × 100/160)	=	50,000	
Less: Sales to Customers (Rs 1,70,000 × 100/120)	=	85,000	1,35,000
Stock at Head Office			65,000

Stock at Branch:

Goods sent to Branch	80,000
Less: Invoice price of goods sold (80,000 × 160/200)	64,000
Stock at Branch	1,6000

Stock Reserve = 16,000 × 60/160 = Rs 6,000

Unit V: Accounting System:

Double Accounting System:

The Double Account System is a method of presenting the annual final accounts/annual financial statements of public utility undertakings, like Railways, Electricity, Gas, Water Supply, Tramways etc.

These undertakings are usually incorporated under Special Acts and, as a result, the form of accounts is prescribed by, special statute.

These public utility undertakings are generally run by Government or by local authorities (except Electric Supply Companies and Tramways).

It should be remembered that accounts of Industrial undertakings, other than Railways and Electric Supply, are prepared as per Indian Companies Act, 1956. The object of this system is not to show the financial position at a particular date but to disclose how the capital is being raised and the application of the same, in the acquisition of different fixed assets. For this purpose two-chamber Balance Sheet is prepared—the first part being Receipts and Expenditure on Capital Account and the second part being the General Balance Sheet.

Double-entry bookkeeping, in accounting, is a system of bookkeeping so named because every entry to an account requires a corresponding and opposite entry to a different account. The double entry has two equal and corresponding sides known as debit and credit. The left-hand side is debit and right-hand side is credit. For instance, recording a sale of $100 might require two entries: a debit of $100 to an account named "Cash" and a credit of $100 to an account named "Revenue."

The accounting equation

Assets= Equity+ Liabilities

is an error detection tool; if at any point the sum of debits for all accounts does not equal the corresponding sum of credits for all accounts, an error has occurred. However, satisfying the equation does not guarantee that there are no errors; the ledger may still "balance" even if the wrong ledger accounts have been debited or credited.

Double-entry bookkeeping was pioneered in the Jewish community of the early-medieval Middle East. Jewish bankers in Old Cairo, for example, used a double-entry bookkeeping system which predated the known usage of such a form in Italy, and whose records remain from the 11th century AD. It has been hypothesized that Italian merchants likely learned the method from their interaction with ancient Indian merchants from the sea trade, the double-entry system was founded on a "Jama - Nama" system which had debits and credits in a reverse order. The oldest European record of a complete double-entry system is the *Messari* (Italian: Treasurer's) accounts of the Republic of

Genoa in 1340. The *Messari*accounts contain debits and credits journalised in a bilateral form, and include balances carried forward from the preceding year, and therefore enjoy general recognition as a double-entry system. By the end of the 15th century, the bankers and merchants of Florence, Genoa, Venice and Lübeck used this system widely.

However, the double-entry accounting method was said to be developed independently earlier in Korea during the Goryeo dynasty (918–1392) when Kaesong was a center of trade and industry at that time. The *Four-element bookkeeping system* was said to be originated in the 11th or 12th century.

The earliest extant accounting records that follow the modern double-entry system in Europe come from Amatino Manucci, a Florentine merchant at the end of the 13th century. Manucci was employed by the Farolfi firm and the firm's ledger of 1299-1300 evidences full double-entry bookkeeping. Giovannino Farolfi & Company, a firm of Florentine merchants headquartered in Nîmes, acted as moneylenders to the Archbishop of Arles, their most important customer.[8] Some sources suggest that Giovanni di Bicci de' Mediciintroduced this method for the Medici bank in the 14th century.

Ragusan economist Benedetto Cotrugli's 1458 treatise *Della mercatura e del mercante perfetto* contained the earliest known description of a double-entry bookkeeping system, but his manuscript was not officially published until 1573.

Luca Pacioli, a Franciscan friar and collaborator of Leonardo da Vinci, first codified the system in his mathematics textbook *Summa de arithmetica, geometria, proportioni et proportionalità* published in Venice in 1494. Pacioli is often called the "father of accounting" because he was the first to publish a detailed description of the double-entry system, thus enabling others to study and use it.

In pre-modern Europe, double-entry bookkeeping had theological and cosmological connotations, recalling "both the scales of justice and the symmetry of God's world".[

Main Features of Double Account System:

The main features of Double Account System are:

(a) Generally, a public utility undertaking needs a large amount of capital which is invested in the acquisition of fixed assets. Therefore, fixed assets, fixed liabilities and current assets, current liabilities are to be separately dealt with. Fixed Assets and fixed or long-term liabilities are recorded in Receipts and Expenditure on Capital Account. Similarly, current assets and current liabilities are recorded in the General Balance Sheet.

(b) Revenue Account and Net Revenue Account are prepared instead of Profit and Loss Account and Profit and Loss Appropriation Account.

(c) Normally, no adjustment of asset is made in the Capital Account.

(d)Depreciation is not deducted from the asset concerned but the same is shown as a liability by way of a fund. And, as such, fixed assets are recorded at book value.

(e) Any kind of funds and reserve — e.g., Sinking Fund, Depreciation Fund, General Reserve, Capital Reserve, the Balance of Revenue/Net Revenue Account — are shown in the liabilities side of the General Balance Sheet.

(f) Discount and Premiums are permanently treated as capital items.

(g) Loan capital (debentures) Shares and Stocks are treated as capital items.

(h) Interest on Loan and Debentures (i.e., all fixed interests) are to be charged against Net Revenue Account.

Objects of Double Accounting System:

The following are the main objectives of double entry system of book-keeping:

1. To keep complete record of every financial transactions systematically and scientifically.

2. To ascertain profit or loss of business organization.

3. To provide the real picture about the financial position of organization.

4. To provide appropriate data for comparison

5. To facilitate the rational decision making by providing appropriate financial data at appropriate time.

6. To provide the financial information of the business.

7. To check the arithmetically accuracy of recording financial transaction.

Voyage Accounting:

Meaning: Voyage accounting is used to find financial results from the business of marine ship. Owner of marine ship uses it for transporting the goods and passengers. For completing the voyage accounting, accountant has to open voyage account for each traveling. All the expenses of voyage will be included in the debit side of voyage account and all the incomes of voyage will be included in the credit side of voyage account.

The method of accounting followed by shipping companies is known as voyage accounting. Shipping companies prepare their accounts periodically and also prepare the results of each voyage separately. Shipping companies carry goods from one place to another. Some companies carry passengers also in addition to goods from one place to another place.

In order to ascertain the result of operating a ship's voyage, Voyage Account is prepared. The Voyage Account is a revenue account. It is important to note that there is no difference in the manner of preparing accounts period-wise and voyage-wise.

All expenses connected with the voyage, such as port charges, wages and salaries of the crew, captain and other staff, trans-shipment, agency fees, provisions, loading and unloading charges, bunker and harbour wages, freight and insurance, insurance of the ship on a time policy according to duration of voyage, depreciation arising as a result of the journey, address commission paid to brokers for freight for the ship, commission to captain on net profit etc. are debited to concerned Voyage Account.

All incomes such as freight on cargo carried, passage money, primate etc. are credited.

Following are some of the items of income and expenditure peculiar to Voyage Accounts.

Accounting Entries- Debit and Credit:

Voyage Account is debited usually with the following items:

1. Bunker Cost:

This is the expenditure incurred on fuel oil, diesel, coal and fresh water used during the voyage. Now-a-days oil and diesel are used in place of coal. The bin or storing place of coal is referred to as bunker. Hence the name bunker costs.

2. Port Charges:

Port is used by the shipping companies for loading and unloading of goods and parking of ships, hence the charges paid for these purposes are known as port charges.

3. Depreciation:

Depreciation of the ship for the period of voyage is calculated and charged to the Voyage Account.

4. Insurance:

Insurance premium of cargo must be entirely debited to the concerned Voyage Account whereas the insurance charges of the ship are charged proportionately to each voyage on the basis of time of voyage.

5. Address Commission and Brokerage:

This is payable to the brokers and agents who help the shipping company in procurement of cargo, i.e., freight or business. This is calculated at a certain per cent of the freight earned including the primage or surcharge and debited to Voyage Account. Address commission is payable to the Charterer whereas brokerage is payable to the agent of the charterer.

6. Stevedoring Charges:

The expenses which are incurred in loading of goods on the ships and unloading of goods from the ships are known as stevedoring charges.

7. Port Charges:

These are the charges paid to port authorities for allowing the ship to use the port either for loading or unloading the cargo.

8. Salaries and wages of the crew, captain and other staff.

9. Harbour charges

10. Manager’s commission, if any.

<u>Voyage Account is credited usually with the following items:</u>

1. Freight:

The amount which is charged by the shipping companies for taking goods or cargo from one place to another is called freight. It is an income.

2. Primage:

It is additional freight just like surcharge on freight originally collected for the captain of the ship, now-a-days it is treated as income of the shipping company.

3. Passage Money:

Fare collected from the passengers travelled in addition to the fare collected for merchandise.

4. Closing Stocks of Stores, Provisions, Coal, Fuel etc.

Generally, voyage profit represents the excess of voyage incomes earned over the expenses incurred for this purpose. But if, however, the voyage is in progress, the incomes and expenses relating to the unfinished voyage are carried forward to the next year.

Excess of credit side of Voyage Account over its debit side is profit on the voyage. Excess of debit side of Voyage Account over its credit side is loss on the voyage. This profit or loss is transferred to General Profit and Loss Account of the shipping company.

Important Terms of Voyage Accounting:

Voyage Account: Preparation and Common Terms Used!

Introduction:

In order to ascertain the result of operating a ship's voyage, a Voyage Account is prepared which is nothing but a revenue account or Profit and Loss Account relating to the expenditure incurred and income earned by a vessel for a particular voyage.

A voyage includes both outward and return journey. Each voyage is numbered and separate record is to be maintained for all expenses and charges relating to each voyage together with the freight earned per voyage.

Some common terms used in Voyage Account:

Brokerage and Address Commission:

Brokerage and Commission payable to broker for procuring freight for the ship which is calculated on a certain percentage of freight inclusive of primage, and address commission is paid to the charterer which is debited to Voyage Account.

Primage:

Percentage on freight collected for the ship-owner previously and which is retained with the ship-owner for ensuring safe carriage of cargo. It is an income of the shipping company since it is a part of freight.

Passage Money:

Fare collected from the passengers travelled in addition to the fare' collected for merchandise.

Port Charges:

Charges paid to port authorities for allowing the ship using the port for loading or unloading purposes.

Bunkers Cost:

Amount spent on account of fuel, coal, diesel and fresh water and refers to actually coal bin of the ship. Generally, voyage profit represents the excess of voyage incomes earned over the expenses incurred for this purpose. But if, however, the voyage is in progress, the incomes and expenses relating to the unfinished voyage are carried forward to the next year.

To sum up, the following expenses are usually debited to Voyage Account:

Expenses:

Port dues, Bunkers Cost, Wages and Salaries, Stores, Sundry Expenses, Deprecation (on the basis of time of voyage), Insurance (on the basis of time of voyage), Address Commission, Harbour Wages etc. (Moreover, in addition to above, general overheads are also to be apportioned).

Income:

The following incomes are usually credited to Voyage Accounts— Freight, Passage Money, Primage etc.