STUDY MATERIAL FOR B.COM

FINANCIAL ACCOUNTING -II

SEMESTER – II

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PREPARED BY

COMMERCE DEPARTMENT

INDEX

UNIT I
HIRE PURCHASE AND INSTALMENT SYSTEM

Hire purchase and instalment systems are considered as a special system, since they are combination of purchase and sale. These systems are considered as a revolution in bringing durable goods of high value to middle and lower middle class people, which were once available only to the rich and upper class people. These two systems have made the market expend.

17.1HirePurchaseSystem

Goods which are purchased under hire purchase system are not immediately bought, but the purchaser has to pay the price in instalments. Goods are immediately delivered but ownership of the goods comes only when the last payment is paid and all the terms and conditions of the contract are fulfilled .Till then the goods are treated as on Hire. It is clear that Hire purchase is a trading system of retail business which agrees to sell the goods on the condition that the buyer pays the purchase price along with interest for a deferred fixed number of instalments. As the good are not legal sold out the ownership of the goods are not transferred along with the delivery of goods.

According to the Hire Purchase Act 1972-Section2(c) "Hire purchase Agreement means an agreement under which goods are let on hire and under which the hire has an option to purchase them in accordance with the terms of the Agreement and includes an agreement under which

(i) Possession of goods is delivered by the owner thereof to a person on condition that such person pays the agreed amount in periodical instalments,
(ii) The property of the goods is to pass on to such person on the payment of the last of such instalment and
(iii) SuchpersonhasarighttoterminatetheAgreementatanytimebeforethepropertyso passes."

17.4 Important Terms in Hire Purchases system

(i) **Hirer-**Hirer is a person who buys or in this case who obtains the possession of the goods from the owner as per the Hire purchase Agreement.

(ii) **Hirer Vendor-**Hirer vendor or the owner is a person who lets or who has delivered or delivers the goods to hirer under an agreement. Hire vendor is the seller of the goods on the hire purchase system.

(iii) **Cash Price-** The cash price is the price of the goods which can be purchased by cash or there tail price, if not purchased under hire purchase system.

(iv) **Hire Purchase Price-**It is the total amount payable by the hirer under the hire purchase agreement, in the agreed number of instalments for the purchase of goods. Hire purchase price is the total of cash price and interest.

Hire purchase price=Cash price +Interest

(v) **Interest-**Interest is the amount which is payable in addition to the actual cash price of the goods. It is the amount paid by the buyer for the delayed and postponed payment.

(vi) **Hire Instalment-**It is the amount payable periodically by the hirer or the buyer, instalment may be an equal amount or different amounts which are based on the agreement.

Down Payment or initial amount-The amount is a lump-sum out of the total Hire purchase price, payable to the vendor in advance while the agreement is signed, which does not carry any interest on it.

17.6AccountingTreatmentofHirePurchase System

The records in hire purchase system depend on the value of goods that are delivered. High value goods like Machinery, trucks etc, have a different treatment from those having small value having many individual customers like televisions, refrigerators, washing machine, motor cycles etc.,

Accounting Treatment for High Value Goods

The high value goods with less number of customers for whom individual ledgers can be maintained by the hire-vendor. At the same time the Hire also maintain the asset A/c.
For such high value goods, two methods of records can be maintained.

(i) **First method –**Capitalising only the portion of cash price paid or as set accrual method.
(ii) **Second method –**Capitalising the full cash price or credit purchase with interest method.

Before recording the transactions in Hire purchase system, one has to be clear regarding the calculation of interest, hire purchase price and cash price of the Hire purchase Agreement. Interest calculations are common for both the methods, which has to be calculated before passing journal entries.

Hire purchase price–As already explained, Hire purchase price includes cash price and interest.

Hire purchase price= Cash Price +Interest Cash price=Hire Purchase price– Interest Interest= Hire Purchase price –Cash price

Cash price = Cost price + Profit

therefore, Hire purchase price=Cost price+ Profit +Interest.

To solve the problems, one should make sure that all the three information are available i.e., cash price, interest and hire purchase price.

First method

In this method cash price paid is alone capitalized. The asset account is debited with the amount of cash price paid in that instalment. This method as use that the title pages two the buyer only after the last instalment is paid. Unit then the seller is the owner. So as and when the instalment amount is paid the case price in the instalment is capitalized. In this method the goods are consider to the acquired only gradually when the cash price is paid each time.

Journal entries

In the books of Hire-Purchaser or Hirer

Date of signing the agreement	**1. For down payment due** Asset A/c Dr. To Hire vendor's A/c
Date of sign only The agreement	**2.Fordownpaymentpaid** Hire vendor's A/c Dr. To Cash A/c
Date of the 1st instalment	**3.For1st Instalmentamount due** Asset A/c Dr.(Cash price in 1st instalment) Interest A/c Dr. (Interest due in 1st instalment) To Hire vendor's A/c(1st Instalmentamount)
„	**4.For the1st Instalment paid** Hire vendor's A/c Dr. To cash A/c
At the end of Depreciation A/c **Year**	**5.Forprovidingdepreceiatinthe accounting** Dr. To Asset A/c
„	**6.Fortransferringdepreciationandinterestto P&LA/c** P&LA/c Dr. To Interest A/c To Depreciation A/c

Note: Entries number:3,4,5 and 6 are to be repeated for second year and subsequent years till the last instalment is paid off.

Second method:

In this method the full case price is capitalised. The hire purchaser debits the Asset account A/c with full case price and credits the higher vendor A/c. this method assumes that the assets are consider to be acquired immediately when the position is taken. The purchaser enters into an agreement with the intention of fulfilling it.

Journal entries

In the books of Hire purchaser or Hirer

Date of signing the agreement	1.**For the cash price of Asset purchased**	
	Asset A/c	Dr.
	To Hire vendor's A/c	
	(Total cash price)	
,,	**2.FordownPaymentpaid**	
	Hire vendor's A/c	Dr.
	To Cash	
Date of the 1st Instalment	**3.ForInterest payable on the1st Instalment**	
	Interest A/c	Dr.
	To Hire vendor 's A/c	
,,	**4.Forpaymentof 1st Instalment**	
	Hire vendor' s A/c	Dr.
	To Cash A/c	
Date of closing the accounts	**5. For providing the depreciation**	
	Depreciation A/c	Dr.
	To Asset A/c	
,,	**6.For transferring Interest and depreciation to P&LA/c**	
	Profit& loss A/c	Dr.
	To Interest A/c	
	To Depreciation A/c	

Note: Entries no: 3,4,5 & 6 are to be repeated for 2nd year and subsequent years till the last instalment is paid off.

In the books of Hire vendor

Journal entries in hire vendor books are common for both the methods.

Journal Entries

In the Books of Hire vendor

1. **For goods sold on hire purchase**

   Hire purchaser A/c Dr.

   To hire sale a/c

2. **For receipt of down payment**

   Cash A/c Dr.

   To Hire purchaser A/c

3. **ForInterestreceivableon1st Instalment**

   Hire Purchase A/c Dr.

   To Interest A/c

4. **For receiptof1stInstalment**

   Cash A/c Dr.

   To Hire purchaser A/c

5. **For transferring interest to P&LA/c**

   Interest A/c Dr.

   To P & LA/c

Note: Entries 3, 4 & 5 are to be repeated for 2nd year and subsequent years till the last instalment is received.

Interest Calculation

As already discussed on hire purchase price and cash price, we know that Interest amount (total) is the difference between hire purchase price and cash price. Hire purchase price is an higher amount than cash price since the interest payable is included. Interest is paid by the hire purchaser for the delayed payments that he makes. Interest receivable is the main source of income in hire purchase business. The seller gets Interest amount for the sacrifice he makes by receiving the amount after certain period but delivering the goods immediately.

Total Interest= Hire purchase price–Cash price

Each Instalment amount includes cash paid towards the total amount and Interest due for that period

Instalment amount=Cash price paid +Interest for the period

While calculating the interest make sure that the Instalment amount and cash price paid for the period are ascertained.

The followings are the situations under which interest is calculated:-

1. **When rate of interest, the total cash price and Instalment amounts are given.**

Interest is calculated on the outstanding balance at a particular rate. Down payment does not carry Interest .Cash price paid (Instalment amount (given)- Interest) is deducted from the total cash price each year. The Interest for the last year is found by the difference between cash price outstanding and the amount of last Instalment.

Illustration1

Mr. Nirmal purchased a machine on hire purchase system on 1.1.2007.The total cash price of the machine is Rs. 29800, payable Rs. 8000 on 31st December of every year for 3 years Rs. 8000 is payable on signing the agreement. Interest is charged at 5% p.a. Calculate interest payable by the buyer.

Solution

Table Showing Calculation of Interest

Particulars	Total cash Price	Interest @5%p.a.	Instalment (given)	Cash price Paid (Inst-Int)
Total cash price	29,800.00	-		
(-)Down payment	8,000.00		8,000	8,000
	21,800.00	1090.00 (21800×5%)		
(-) I Instalment	6,910.00		8,000	6,910.00
	14,890.00	744.50 (14890×5%)		
(-)II Instalment	7,255.50		8,000	7,255.50
	7,634.50	365.50 (8000-7634.50)		
(-)III Instalment	7,634.50		8,000	7,634.50
	Nill	2,200.00	32,000	29,800.00

This method can be identified with the help of the following calculation.

Total amount payable

	Rs.
Down payment=	8,000
Instalment amount (8000x3)	24,000
	32,000

(-)Total cash price 29,800

Total Interest 2,200

The total payable amount is more than the total cash price payable, so the difference is the total amount of interest .Therefore Rs. 8000 payable for 3 years is Instalment amount. Cash price paid has to be found out i.e.(Instalment amount – Interest).

Illustration 2

On 1.1.2006 Sujatha bought a machine from Chirtra & Co on hire purchase system Rs. 1,20,000wasthecashprice,Rs.30,000downpaymentandattheendof1yearRs.34,500,II year Rs. 33000 and III year Rs. 31,500 was payable. The vendor charged interest @ 5% and depreciation is provided @ 10% annually .Journalise the entries in the books of both the parties

Solution

Table Showing the Calculation of Interest

Particulars	Total cash Price	Interest @5%	Instalment (given)	Cash price Paid (Instalment -Interest)
Total cash price (-)Down payment	1,20,000 30,000	-	30,000	30,000
I Instalment	90,000 30,000	4,500	34,500	30,000
II Instalment	60,000 30,000	3,000	33,000	30,000
III Instalment	30,000 30,000	1,500	31,500	30,000
	-	9,000	1,29,000	1,20,000

II **Journal Entries in the Books of Sujatha**

Date	Particulars	2006		2007		2008	
		Debits Rs	Credit Rs	Debits Rs	Credits Rs	Debits Rs	Credits Rs
Jan1	Machinery A/c Dr To Chitra&CoA/c [Total cash price]	1,20,000	1,20,000	-	-	-	-
"	Chitra & Co A/c Dr To Cash A/c [Down payment]	30,000	30,000	-	-	-	-
Dec31	Interest A/c Dr To Chitra & Co A/c [Instalment amount paid]	4,500	4,500	3,000	3,000	1,500	1,500
"	Chitra & Co A/c Dr To Cash A/c [Instalment amount paid]	34,500	34,500	33,000	33,000	31,500	31,500
"	Depreciation A/c Dr To Machine A/c [Depreciation charge]	12,000	12,000	10,800	10,800	9,720	9,720
"	P & L A/c Dr To Interest A/c To Depreciation [transferred to p&L A/c]	16,500	4,500 12,000	13,800	3,000 10,800	11,220	1,500 9,720

III Journal Entries in the Books of Chitra&Co

Date	Particulars	2006		2007		2008	
		Debits Rs	Credit Rs	Debits Rs	Credits Rs	Debits Rs	Credits Rs
Jan1	Sujatha A/c Dr	1,20,000					
	To Hire sales A/c		1,20,000	-	-	-	-
"	Cash A/c Dr	30,000					
	To Sujatha A/c		30,000	-	-	-	-
Dec 31	Sujatha A/c Dr	4,500		3,000		1,500	
	To Interest A/c		4,500		3,000		1,500
"	Cash A/c Dr	34,500		33,000		31,500	
	To Sujatha A/c		34,500		33,000		31,500
	Interest A/c Dr	4,500		3,000		1,500	
	To P & L A/c		4,500		3,000		1,500
	[transferred to p & L						

10 Instalment–purchase system

Instalment purchase system where an agreement to purchase and sale is made between the buyer and the seller, here there is an immediate sale on signing the agreement. In actual purchase the price of the goods is paid in lump-sum, but in instalment system instead of paying in a lumpsum, it is spread over a period, interest is being paid on the unpaid balance. This interest amount is determined at the time of signing the agreement itself. The possession of the goods is taken by the buyer after signing the contract itself. The basic difference between instalment system and hire purchase system is the transfer of ownership. In instalment system the title or the ownership is immediately passed to the purchaser, but in the hire purchase system until the entire amount to the last instalment is paid the ownership with the vendor. In case the purchaser makes default of any payment, the seller has no right to repossess like in the hire purchase system, but he can recover the amount due to him by filing a suit in the court of law and can recover the unpaid amount since the buyer is the legal owner of the goods he has every right to sell, transfer, exchange or even destroy it.

17.11Different between Hire Purchase and Instalment purchase system

Hire Purchase	Instalment System
1.In Hire purchase system , ownership of the goods lies with the vendor until the buyer pays his last instalment.	In Instalment purchase system the ownership is transferred to the buyer on signing the agreement.
2. The agreement of hire purchase is contract of hire but later on it becomes sale.	The agreement of Instalment purchase is that of agreement of sale.
3. In hire purchase system the relation between the parties is that of Hirer and Hire vendor.	In Instalment purchase system the relation between the parties is that of buyer and seller.
4.The relationship between the parties are that of Bailor and Bailee.	The relationship between the parties are that of debtor and creditor until the last instalment is paid.
5.The hirer has no right to sell the goods until the ownership is transferred to him.	The buyer has all the right, to sell, exchange or transfer the goods at the time of paying instalments.
6.In case of default by the hirer, the hire vendor has the right to repossess the goods.	In case of default by the buyer, the seller cannot repossess the goods, but he can legally recover the dues.
7.In hire purchase both the parties can terminate the agreement and return the goods.	In Instalment purchase the agreement cannot be terminated.
8.The hire purchase system is under Hire purchase Act of 1972.	The Instalment purchase comes under the sale of Goods Act of 1930.
9.The Instalment in hire purchase has hire charges plus capital part and interest.	The Instalment here consists of the part of capital and interest on the outstanding capital.

Accounting Treatment

Journal entries

In the book of Buyer
When the goods is purchased

1year
Jan 1 Asset A/c Dr. (Total cash price) Interest suspense A/c Dr.(Total interest)
To seller A/c . (Total instalment Purchase price)

1. **When the down payment is paid:**
   Seller A/c Dr.
   To cash A/c
2. **When the interest is due for the year**
   Dec 31 Interest A/c Dr.
   To interest suspense A/c

3. When the instalment amount is paid
Dec 31 Seller A/c Dr.
To cash A/c

4. **When depreciation is charged on the asset**
   Depreciation A/c Dr.
   To Asset A/c
5. **When the interest and depreciation is transferred to P&LA/c**
   P&LA/c Dr.
   To Interest A/c
   To Depreciation A/c

Note:ForsecondandsubsequentyearsentriesNo(3),(4),(5)and(6)aretoberepeated

In the books of seller

1. When the goods are sold

Jan1 Buyer A/c Dr. (Total Instalment Purchaser)
To Sales a/c (Total cash price) To Interest suspense A/c (Total interest)

2. When the down payment is received
Cash A/c Dr.
To Buyer A/c

3. When Interest is due for the year

Dec 31	Interest suspense A/c	Dr.
	To Interest A/c	

4. When the Instalment amount is received

	Cash A/c	Dr.
	To Buyer A/c	

5. When the interest is transferred to P&LA/c

	Interest A/c	Dr.
	To P&LA/c	

Note: For second and subsequent years entries no(3),(4), and(5) are to be repeated

UNIT – II
BRANCH ACCOUNTING

Meaning of Branch Accounting

Branch Accounting is a system in which separate accounts are maintained for each branch. These branches are divided by geographical location, and each department has its profit and cost centres.

In this accounting system, separate Trial Balance, Profit & Loss Statements, and Balance Sheets are prepared by each branch.

Types of Branches

Dependent Branch

Hanging branches do not maintain separate accounts. Ultimately, the Head Office collectively manages its profit & loss statements and balance sheets. Only a few pieces of information have been supported by separate branches like Cash Accounting, Debtors Accounting, and Inventory.

Independent Branch

Independent branches maintain separate books of accounts. Ultimately, the branches keep their profit & loss statements and balance sheets separate from their Head Office. Therefore, the head office and branches are treated as separate entities in this case. For example:- If the Head Office sends material to its branch, the Head Office will record sales in the HO book and raise an invoice in the name of the component, and the department will mark this as a purchase in-branch books of accounts.

Advantages of Branch Accounting

- It helps to ascertain the profit & loss of each branch.
- It helps to know each branch's debtors inventory and cash position.
- It helps to determine each branch's wages, rent, salary, and expenses separately.
- Separate accounting of each chapter helps to make decisions according to branch requirements.
- By separate branch accounting, it is easy to track the progress and performance of each unit.
- It helps to control the overall branch operation.

Disadvantages of Branch Accounting

- Due to a separate account for each branch, it requires more work force.
- It requires an individual branch manager for each branch.

 It requires other infrastructure at each location or unit.

 It increases the company's expenses because of a different setup at each location.

 There is a chance of delay in decision-making in this accounting system because of multiple authorities.

 There is a chance of mismanagement in this accounting system because of decentralized operation and minimum control of the head office.

Prepare Branch Account in the books of head office after taking into account the following information also:

	₹
Stock at invoice price on 1st April, 2011	82,000
Stock at invoice price on 31st March, 2012	96,000
Debtors on 1st April, 2011	31,700
Debtors on 31st March, 2012	42,150
Furniture on 1st April, 2011	23,400
Cash sales	4,01,300
Credit sales	3,72,100
Goods invoiced to branch by head office	6,28,000
Furniture purchased on 1st October, 2011 by branch manager, payment having been made out of cash sales and collections from debtors	2.500
Expenses paid by head office	1,32,000
Petty expenses paid by branch	10,450

Depreciation is provided on branch furniture @ 10% per annum on diminishing balance method.

Solution :

In the books of Head Office
Branch Account

Dr.	₹		*Cr.* ₹
To Branch Stock (opening)	82,000	By Branch Stock Reserve (opening)	16,400
To Branch Debtors (opening)	31,700	By Bank (cash deposited by branch)	7,50,000
To Branch Furniture (opening)	23,400	By Goods sent to Branch Account (loading)	1,25,600
To Goods Sent to Branch Account	6,28,000	By Branch Stock (closing)	96,000
To Bank (Branch expenses paid by this office)	1,32,000	By Branch Debtors (closing)	42,150
To Branch Stock Reserve (closing)	19,200	By Branch Furniture (written down value of furniture at branch)	23,435
To Profit and Loss Account (profit at branch)	1,37,285		
	10,53,585		10,53,585

Working Notes :

(i)	*Depreciation on furniture for the year :*	₹
	On ₹ 23,400 @ 10% p.a. for full year	2,340
	On ₹ 2,500 @ 10% p.a. for 6 months	125
	Total	2,465
(ii)	*Written down value of furniture on 31st March, 2012 :*	₹
	Written down value on 1st April, 2009	23,400
	Add : Addition made during the year	2,500
		25,900
	Less : Depreciation for the year	2,465
		23,435

(iii) Collection from branch debtors:

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

	₹		₹
To Balance b/fd	31,700	By Bank —collections (balancing figure)	3,61,650
To Credit Sales	3,72.100	By Balance c/fd	42,150
	4,03,800		4,03,800

(iv)	*Cash deposited by branch with bank*		₹
	Cash sales		4,01,300
	Add : Cash collected from debtors		3,61,650
		₹	7,62,950
	Less : Furniture purchased	2,500	
	Petty expenses	10,450	12,950
			7,50,000

DEPARTMENTAL ACCOUNTS

A departmental business is one which has a number of departments under one roof and under the control of one management. Accounts are prepared for each department. Departmental accounts are accounts relating to the several departments or sections of a business, drawn up in order to ascertain the individual performance. That is, accounts which are prepared to find out the profit or loss of each department are known as departmental accounts.

Department means the section of a large business. Generally, departmental accounts are employed in large business like insurance companies. To compare the trading activities of each department, trading profit and loss account of each department are prepared.

Purposes:

Following are the purposes of preparing departmental accounts.

I) To find out the profit loss of each department.

ii) To find out the efficiency of each department

iii) To formulate new policies in the departments.

iv) To discontinue the unprofitable department.

v) To maximise the overall profitability of the business as a whole. Vi) To measure the profitability of each department.

vii) To compare the results of a particular department with previous year.

viii) To compare the results of a particular department with the other departments of the same concern.

ix) To allow departmental manager commission on the basis of the profits of their departments.

Differences between Branch and Departmental accounts:

1) Location: Branches are located in different places whereas Departments are Located under one roof in a particular place.

2) Control: Branches are controlled by its Head office whereas departments are not so.

3) Opening in foreign countries: Branches may be opened in foreign countries. But there is no foreign department.

4) Types: Branches may be classified into different types but there is no such classification in departments.

5) Purpose: Branch account is to be prepared to know the profit or loss of each branch. But departmental accounts are prepared in order to find out the profit or loss as well as to know the efficiency of the business.

6) Transfer: Some times, Branches may receive goods from its head office but in departments it is not so.

Advantages of Departmental Accounting:

i) Preparation of Departmental accounting helps to find out the profit or loss of each department on a reliable basis.

ii) With the help of profit of each department, efficiency of each department may be calculated.

iii) On the basis of efficiency of the departments, incentive systems may be introduced to its employees.

iv) Departments which have more efficiency may be expanded and departments which have lesser efficiency may be discontinued. So departmental accounts help to take remedial measures.

Accounting procedure:

There are two methods of keeping departmental accounts.

1) Independent Basis:

Under this method, each department prepares its accounts separately. The profit or loss of each department is transferred to general profit and loss account of the concern. It is an expensive one.

2) Columnar Basis:

Under this method, accounts of all departments are maintained together in a columnar form. Various subsidiary books are also prepared in a columnar form for each department.

Departmental Trading and Profit and Loss accounts:

When a concern maintains its books and records on columnar basis, Trading, profit and loss account can be prepared on columnar basis. The problem arises with regard to allocation of expenses.

Direct expenses are debited to trading account. But in case of indirect expenses, they are to be apportioned on some suitable basis. After the allocation, net profit of each department is to be calculated.

Types of expenses:

Departmental expenses are divided into two types.

1) Direct expenses

2) Indirect expenses

1) Direct expenses:

Direct expenses are those expenses which can be identified to a particular department or departments. Example: Wages, carriage inwards etc. These expenses are charged directly to the respective departments.

2) Indirect expenses:

Indirect expenses are those expenses which cannot be identified to particular departments. These expenses are incurred for their common benefit. Indirect expenses are again sub divided into two groups.

i) Examples which can be apportioned:

These expenses are apportioned on some suitable basis among the departments.

Basis Expenses

1. Purchase ratio Carriage, Freight, Duty, Octroi

2. Sales ratio Selling Commission, Bad debts, Discount allowed, Advertisement, Carriage outwards

3. Floor area occupied Rent, Rates, and Lighting expenses

4. Value of machines Depreciation, repairs, etc

5. H.P of machines Power expenses, Electricity

6. Value of stock Insurance on stock

7. No. of employees Welfare expenses, canteen expenses

8. Time Ratio Rent, salary

ii) Expenses which cannot be apportioned:

There are some expenses which cannot be apportioned to different departments on some suitable basis. So these must be shown in the general profit and loss account of the concern.

Following expenses are to be debited to General profit and loss account. These expenses cannot beapportioned on suitable basis.

- Debenture interest
- General manager's salary
- Director's fees
- Income tax
- Dividend paid
- Legal expenses

2.From the following figures, prepare accounts to disclose total profit and the profit of the two

departments, A and B:

Particulars ` Particulars `

Opening Stock:

A

B

Purchases:

A

B

Carriage inward

Discount Received

Salaries:

A

B

General

Rent and rates

Advertising

Insurance

General expenses

Discount allowed

Accountancy charges

15,200

10,800

75,100

69,800

2,860

1,430

9,000

8,500

11,600

6,000

8,100

1,000

5,400

1,800

500

Sales:

A

B

Purchase Returns:

A

B

1,00,000

80,000

1,100

800

The following further information is supplied:

(a) Goods transferred from department A to B were ` 5,000. This has not yet recorded.

(b) General salaries are to be allocated equally.

(c) The area occupied is in the ratio of 3 : 2.

(d) Insurance premium is for comprehensive policy, allocation being inconvenient.

(e) The closing stock of the two departments were: A, ` 17,800 and B, ` 15,600.

UNIT III

PARTNERSHIP ACCOUNTS-I

Introduction

The simplest form of organization is the sole trading organization as it is owned and carried by a person, at his risk. There arises situation where the business needs more capital, more persons, better decision making etc., due to expansion of the business. To meet these requirementstwoormorepersonsjointogethertocarrythebusiness,wheretheyarecalled as joint owners. Theses joint owner's twice some amount of capital to run the business and agree to share the profits in the agreed proportions. The relationship between the interested person is called as partnership.

Partnership is regulated under the Indian Partnership Act, 1932.This Act come into effect from 1st October 1932.According to section A of the Indian partnership Act, 1932 "Partnership is the relation between persons who have agreed to share the profit of the matching for all". Each person of partnership is called as partner, collectively called as Firm. The name under which their business is carried on is called Firm's name.

Essential of Partnership:

1. Partnershipcomesintoexistenceasaresultofanagreementbetweenparties,this agreement can be expressed or implied.
2. Agreement must be to earn profit of the business sand share among its partners.
3. This is created in order to run business lawfully.
4. Such business should be carried on by all or any of the matching for all.
5. Theremustbeatleasttwopersonstorunthepartnershipmaximumoftwenty,but maximum of ten in case of banking business.
6. There must be mutual and implied agency, every partner is an agent as well as principal of the other partners.

Types of partners

In a partnership firm there may different types of partners and some of them are

1. Active partner – Such partners are actively engaged in the business, they are also called as actual partner's f ostensible partners.

2. Sleeping partner – Such partner who does not take part in the conduct of the business, they are also called as dormant partner.

3. Nominal partner – This type partner lends his name to the firm without any actual interest in terms of investing capital.

4. Partner in profit only – This type of partner agreed to be partner for profit amount, he does not takes risk of sharing losses.

Partner by Estoppel – Such partner becomes partner by words, spoken or words written or by represents itself or permits to be represented to be a partner in the firm, who is not a real partner in the firm, who is not a real partner.

5. **Sub – partner –** If a partner agrees to give his share of partner to an outsider, such outsider who gets the share in profit of the firm is called as sub-partner.

Partnership Deed

Partnership is an outcome of an agreement created orally or in writing between two or more persons. It is not essential that agreement must be in writing, but to avoid any disputes between the parties in future, it is better to put in writing. This document which contains the terms and conditions of the partnership in writing is called as partnership deed. It is a stamped document which usually contains the following.

1. The name of the firm.
2. Name and address of the partners
3. Name of the partnership business.
4. The period of the business, if any.
5. The commencement of business.
6. Capital contributed by each partner.
7. Nature of the capital Fixed or fluctuating
8. The proportion of sharing the profits or losses.
9. Amount and period of drawings.
10. Interest on capital, drawings etc.,
11. Commission salary, allowance etc payable to partners, if any.
12. Valuation method of goodwill and its treatments on admission, retirement or death of partners.
13. Procedure by which a partner's account has to be settle and mode of payment.
14. Rights and duties of partners.
15. Under what situation the firm stands dissolved.

The ways of keeping accounts, their audit etc.

Admission of Partners

Admission of a Partner

When a Partnership firm expands, additional capital, managerial expertise and special skills are required. In this case a firm decide to admit a new partner in order to fill this gap. A new partner can be admitted into the firm with the consent of the existing partners. The incoming partner has the right to share the profit and acquires the right to share the assets of the firm, since he has to contribute his capital. But the Indian Partnership Act does not makes it compulsory to bring in capital by the incoming partner.

As a new partner is admitted into the firm, the relation of the existing partners changes. Therefore it becomes necessary for reconstitution of the existing firm. Whenever a new partner is admitted, or a partner retires or dies or partners become insolvent, the firm has to be reconstituted. This reconstitution of partnership mainly leads to the revision of profit sharing ratio of the existing partners. The new partner is not liable for any liabilities of the firm incurred before his admission.

Now it can be said that a new partner is admitted for additional capital or managerial skills or technical know-how in the process of expansion .Such admission reconstitutes the existing firm and he will not be liable for the liabilities before his admission, but the new partner is entitled to the share of profit or loss that arises from the date of his admission.

Thefollowingareproceduresthataretobefollowedbyafirmwhenanewpartnerisadmitted:

1. Adjustment in profit sharing proportion
2. Adjustment for Goodwill
3. Adjustment for Revaluation of the assets and liabilities of the firm.
4. Adjustment relating to the accumulated profits or losses and reserves.
5. Adjustment regarding the Capital

Accounting aspects

1. Calculation of new profit sharing ratio

As already stated, when a new partner is admitted into the firm, the profit sharing ratio is adjusted, since the new partner has to be given his share of profit, which will result in reducing the profit share of existing partners. This reduction is called as sacrifice by the old partners to admit a new person. Thus the profit sharing ratio changes when a new partner is admitted. This New Profit sharing has to be calculated in order to share to future profit or loss. In the absence of any terms in the agreement regarding the profit sharing ratio, it has to be divided equally. But when the agreement specifically mentions the sharing of Ratio, the new ratio has to be computed. When the share of new partner is given, but the sacrificing propositions is not mentioned.

1. Assuming that the remaining profit to be shared by the old partners in the old ratio, where the profit is taken as Rs.1

Illustration1

A & B are sharing profits in the ratio of 4:2.They admits C into partnership for 1/3rd share in future profit. Calculate the new profit sharing ratio.

Solution:

Old ratio = 4:3

Let the profit be =Re .1

Remaining share $= 1 - \frac{1}{3} = \frac{2}{3}$

A's new share $= \frac{4}{7} \times \frac{2}{3} = \frac{8}{21}$

B's new share $= \frac{3}{7} \times \frac{2}{3} = \frac{6}{21}$

C's new share $= \frac{1}{3} \times \frac{7}{7} = \frac{7}{21}$

The new profit sharing ratio 8:6:7

When the share of new partner is given, the sacrifice is done b one of the partners (One of the old partners from whom his proportion of profit in favour of the new partner)

Illustration2

X&Yarepartnersandtheirprofitsharingratiois3:2.TheyadmitZintothefirmwith1/6th

Share in profit which is borne by X. Find out the new profit sharing ratio.

Solution

Old ratio=3:2

Z's share= $\frac{1}{6}$

Z's share of profit borne by X only

X's new share $= \frac{\ }{5} - \frac{1}{6} = \frac{18-5}{30} = \frac{13}{30}$

Y's new share(no change) $= \frac{2\text{x}6}{5\text{x}6} = \frac{12}{30}$

Z's new share $= \frac{1\text{x}5}{6\text{x}5} = \frac{5}{30}$

New Profit sharing ratio =13:12:5

When the share of the new partner is given and sacrifice is done equally by the old partners in favour of the new partner.

Illustration3

P & Q are partners sharing Profit & Loss in 3:2 ratio. R is admitted with 1/6th share in profit which P & Q sacrifice equally. Find out the new profit sharing ratio.

Solution

Old ratio=3:2

R's share $= \frac{1}{6}$

P&Q sacrifice equally i.e, $= \frac{1}{6} \times \frac{1}{2} = \frac{1}{12}$

P's new share $= \frac{3}{5} - \frac{1}{12} = \frac{36-5}{60} = \frac{31}{60}$

Q's new share $= \frac{2}{5} - \frac{1}{12} = \frac{24-5}{60} = \frac{19}{60}$

Z's share $= \frac{1\text{x}10}{6\text{x}10} = \frac{10}{60}$

New Profit Sharing ratio =31:19:10

2. Calculation of Goodwill or adjustment for Goodwill

Goodwill – Goodwill is an intangible asset with some commercial value .Goodwill is the reputation gained by the business over the year. Goodwill arises when a business enjoy more customers than that of the other businesses of same nature. The differential value may arise due to special location, technical efficiency, better quality products, better services, trade- mark etc. The Goodwill is an intangible asset, which is the most intangible of the all the intangible assets. Goodwill is the present value of a firm's anticipated excess earnings.

Definition:

According to Spicer and Pegler."Goodwill may said to be that element arising from the reputation, connection or other advantages possessed by a business which enables it to earn greater profits than the return normally to be expected on the capital represented by the net tangible assets employed in the business".

Methods of valuing goodwill or calculation of goodwill

Goodwill is mainly valued under two methods.

(1) Average profit method
(2) Super profit method

Average profit method – Under average profit method goodwill is computed based on the purchase of certain number of year's profit on the average profit of the number of past years.

Goodwill=Average Profit× No. Of year of purchase

Average Profit= $\frac{\text{Total Profits}}{\text{No .of Years}}$

1. Super Profit method – Under Supper Profit method, the goodwill is valued on the firm's anticipated excess profit. Super profit is nothing but the excess earning over the normal earning i.e. ,excess of average profit over normal profit (normal profit based on normal rate of return of that industry).Super profit with the number of years of purchase gives the amount of goodwill under this method.

Good will =Super profit ×No. of years of Purchase Super Profit = Average Profit – Normal Profit

Normal Profit=Capital employed ×Normal rate of return

19.4Revaluation of Asset and Liabilities

When a new partner is admitted, the assets and liabilities are subjected to be revalued, since there may be profit or loss on revalued, of assets and liabilities which has to be shared by the old partners. This is done to avoid any undue gain or loss to the newly admitted partner. The asset and liabilities would have been valued when the account were closed and appears in the last Balance Sheet. After the last balance sheet dare, the assets and liabilities may be increased or decreased or new assets may be incorporated or eliminated, the same in the case of liabilities on the date of admitting a new partner. The assets and liabilities on the date of last balance sheet is compared with that of assets and liabilities valued on the date of admitting a new partner. The difference or the changes in value are recorded in an Account called as Revaluation A/c or Profit or loss adjustment Account. The balance of Revaluation Account may be either profit or loss on revaluation of the assets and liabilities which is transferred to the old partner's capital A/c in their old profit sharing ratio.

The revaluation of assets and liabilities are done in two forms:

1. When the assets and liabilities are revalued, the new revised values are shown in the books.

   When the assets and liabilities are revalued, the new revised values are not shown in the books

Specimen of Revaluation Account

Revaluation Account

Particulars	Rs.	Particulars	Rs.
To increase in value of Liabilities	xxx	By Decrease in value of Liabilities	xxx
To Decrease in value of Assets	xxx	By Increase in value of Assets	xxx
To Unrecorded Liabilities		By Unrecorded assets	
To Profit (transferred to old partners capital A/c in old ratio)	xxx	By Loss(transferred to old Partners capital A/c in old Ratio)	xxx

Illustration21

XandYarepartnerssharingprofitintheratioof3:1.TheirBalanceSheetason31st Dec 2000 is as under:

Particulars	Rs.	Particulars	Rs.
Capital X	30000	Cash	22500
Y	16000	Bills Receivable	3000
General Reserve	4000	Stock	20000
Sundry Creditors	37500	Debtors	16000
		Furniture	1000
		Building	25000
	87500		87500

On1.1.2001 they admit Z into their firm as new partner on the following arrangements.

(i) Z to bring Rs. 10000 as capital for1/5 share of profit.
(ii) The new firm to have goodwill of Rs.10,000
(iii) StockandFurnituretobereducedby10%andareserveof5%ondebtorsfor doubtful debts to be created.
(iv) Buildings to be appreciatedat20%

Give the necessary ledger account sand Balance sheet.

Solution:

Dr. **Revaluation Account** **Cr.**

Particulars		Rs.	Particulars	Rs.
To Stock		2000	By Buildings	5000
To Furniture		100		
To Reserve for doubtful Debts		800		
To X's Capital A/c	1575			
Y's Capital A/c	525	2100		
(Profitin3:1)				
		5000		5000

Dr. **Capital Account** **Cr.**

Particulars	X	Y	Z	Particulars	X	Y	Z
To X's Capital			1500	By Balance b/d	30000	16000	-
To Y's Capital			500	By General Reserve	3000	1000	-
(Goodwill)				By Revaluation(Profit)	1575	525	-
				By Z's Capital(Goodwill)	1500	500	-
To Balance c/d	36075	18025	8000	By Cash	-	-	10000
	36075	18025	10000		36075	18025	10000

Note: Goodwill account should not be raised in the books, when no consideration is paid for it.The new partner Z's share of Goodwill (Rs.10,000 × 1/5) – Rs,2,000 is adjusted as below;

Z's Capital A/c	Dr.	2,000	
To X's Capital A/c			1,500
To Y's Capital A/c			500
(Being the new partner's share of Goodwill adjusted to the old Partners sacrificing ratio– 3:1)			

Balance Sheet of X, Y& Zas on 1.1.2001

Liabilities		Rs.	Assets		Rs.
Capital			Cash	22500	
	X	36075	(+)R's Capital	10000	32500
	Y	18025			
	Z	8000	Bills Receivable		3000
Creditors		37500	Stock(20000-2000)		18000
			Debtors(16000–800)		15200
			Furniture(1000–100)		900
			Building(25000+5000)		30000
		99600			99600

Retirement and Death of a Partner

Retirement of a partner

A partner can retire from the firm. Indian Partnership Act 1932, states that a partner may retire from a firm with the consent of all the other partners in accordance with the expressed agreement by the partners of by giving notice in writing to all the other partners expressing his/her intention to retire. When a partner retire from the firm, his/her intention to retire. When a partner retires from the firm, he/she is called as the "retiring partner" or "outgoing partner". The retirement may be due to old age, disagreement with the other partners, better opportunity, ill-health etc.

However on retirement of a partner, the other partners or the remaining partners can continue the business, but the old partnership comes to an end, due to the retirement of a partner. A new partnership between the remaining partners is formed. This partnership is said to have dissolved the and a new or reconstituted partnership is formed. The retiring partner has to give a public notice that he has retired from the particular firm and that he will not be held accountable for the debts incurred by the firm after his retirement. A sleeping partner need not give any such notice.

Illustration11

RamandShyamarepartnerssharingprofitsandlossesintheratioof3:2.TheirBalance sheet is as follows:

Liabilities	Rs.	Assets	Rs.
Capital Accounts:		Machinery	30000
Ram	30000	Stock	24000
Shyam	22500	Debtors	22500
Reserve	22500	Bank	9000
Sundry Creditors	11250	Cash	750
	86250		86250

Shyam retires and the following revaluation are made:

(i) DepreciateMachineryby7.5% andstockby15%

(ii) ABaddebtsprovisionisraisedagainstdebtorsat5%andadiscountreserve against creditors at 2%

(iii) The goodwill of the firm is valued at Rs.37500

PrepareRevaluationA/c,Partner'sCapitalA/candBalancesheetafterShyam's retirement.

Solution

Dr. **Revaluation Account** Cr.

Particulars	Rs.	Particulars	Rs.
To Machinery (7.5%@ Rs.30,000)	2250	By Reserve for creditors (2% @ Rs. 11,250)	225
To Stock (15%@ Rs.24000)	3600	By Revaluation Loss:	
To Provision for Bad debts (5%@ Rs.22,500)	1125	Ram 4050	
		Shyam 2700	6750
	6975		6975

Journal Entry(adjustment for Goodwill)

For Goodwill adjusted only to the extent of the retiring partner's share

Ram's Capital A/c Dr. 15,000

To Shyam's Capital A/c 15,000

Dr. **Capital Account** Cr.

Particulars	Ram Rs.	Shyam Rs.	Particulars	Ram Rs.	Shyam Rs.
To Shyam's Capital A/c	15,000		By Balance b/d	30,000	22,500
To Revaluation(loss)			By Reserve	13,500	9,000
To S's loan	4,050	2,700	By Ram's Capital		15,000
To Balance c/d	-	43,800			
	24,450				
		46,500		43,500	46,500

Balance sheet of Ramason (after Shyam's retirement)………

Liabilities	Rs.	Assets		Rs.
Capital Account Ram	24,450	Machinery	30,000	
		(-)Depreciation	2,250	27,750
Shyam's LoanA/c	43,800			
SundryCreditors11250		Stock	24,000	
(-)Reserves@2% 225	11,025	(-)Depreciation	3,600	20,400
		Debtors	22,500	
		(-) Provision	1,125	21,375
		Bank		9,000
		Cash		750
	79,275			79,275

20.4Deathof a Partner

Death of a partner dissolves the partnership but the surviving partners usually carry on the business by purchasing the deceased partner's share. Under these circumstance, similar situation arises as at the time of retirement of a partner, but the difference is retirement maybe planned one, death is a permanent retirement. Generally the date of retire endcoincides with the last date of accounting year, but death may occur during any day of the accounting year.

In short, in case of a retirement of a partner, his share to transferred to this loan account (if not paid in cash immediately) after his retirement. But in case of a death of a partner, the deceased partner's share including a share of profit and goodwill is transferred to his executor's account.

Joint Life Policy

In the event of death of a partner, the partnership firm will have to paya heavy sum of money to his/her legal representative. The firm may not have adequate working capital and hence it unable to pay the representative of the deceased partner. To overcome this situation, the partners would take out a "joint life policy" on the lives of all the partner. Every year premium is payable and in case of death of the partner(s), the Insurance company would pay the sum insured. This would help the firm to pay the representative of the deceased partner. It should be noted that the "amount of Insurance" received is an asset and any profit or loss on such assets should be shared by all the partners including the deceased partner is their profit sharing ratio.

Accounting Treatment of Joint Life Policy

The firm pays Joint Life Policy premium in the name of partners when a partner dies, the firm gets the policy amount from the insurance company and the same has to be paid to the representatives of the deceased partner, this has to be treated by the firm in their books. There are three methods of accounting treatment of Joint Life Policy.

Accounting Treatment of Joint Life policy

Method1

Premium paid is treated Asan 'expense'

[Joint Life policy Account is not maintained]

Method2

Premium paid is treated As an asset

[Joint Life policy is Treated is maintained
At its surrender value]

Method3

When Premium paid Is treated as an asset
And reserve is Maintained

UNIT IV

PARTNERSHIP ACCOUNTS – II

Dissolution,

Dissolution means discontinuance, Dissolution may be of two types.

Dissolution

Dissolution of a partnership [Admission/Retirement/Death Of a Partner]

Dissolution of Firm [Cessation of discontinuation of} Partnership among all Partners

After dissolution of a firm, the partnership firm ceases to exist and no business would be carried on by the partners. But in the case of dissolution of partnership, only the partners change and the firm is reconstituted to carry on the business. Gajal and Arora in their 'Accounting Book' bring out the main grounds for dissolution as

D - Death [Death of a Partner]
I - Incapacity
S - Transfer of 'share' [Partnership share] to some other person
S - 'Serious misconduct' of partnership
O - Completion of 'Object' of the firm, for which it was formed.
L - 'Lunacy' of a partner
U - 'Unexpected Losses' of a firm
T - Expiry of the 'Term' of partnership
I - 'Insolvency' of one/all of the partners
O - Unlawful 'object' of the firm
N - 'Notice' given by all partners.

In this chapter we would be dealing with 'Dissolution of firms' as the dissolution of partnership has been explained in previous chapters.

Modes of Dissolution of a firm

According to sec.40 to 44 of Partnership Act, 1932. The following are the modes of dissolution of a firm.

Compulsory Dissolution (sec.41)

(i) By the adjudication of all the partners or one of the partner as insolvent.
(ii) By the happening of an event which makes it unlawful for the firm to be carried on the business.

Dissolution of agreement: (Sec.42)

A firm may be dissolved with the consent of all the partners or in accordance with a contract among them.

Dissolution by notice: (Sec.43)

Any partner can dissolve the partnership by giving notice in writing to all other partners if the partnership is at will.

Dissolution by court: (Sec.44)

A court may dissolve a firm on any one of following:

(i) Where a partner has becomes unsound mind, [i.e. of in same mind]
(ii) Where a partner becomes permanently incapable of doing his duties
(iii) Where a partner is found guilty of misconduct while carrying on the business.
(iv) Where a partner will fully or persistently commits breach of agreement.
(v) Where a partner transfers all his shares to a third party
(vi) Where the court of law finds that the business cannot be carried without loss.

On any other grounds which the court of law thinks just and equitable to wind up the business.

21.1 Accounting Treatment

Normal Dissolution

The following accounts are usually opened n case of dissolution of a firm:

Accounts in Dissolution

Realisation Account	Capital Account	Cash/Bank Account

Realisation Account

All assets and Liabilities are transferred to this account. When assets are realized they are credited to this account and when liabilities are paid they are debited to this account. The difference would represent either profit or loss on realization, which would be transferred to partner's capital account in their profit sharing ratio.

Capital Account

After incorporating all the adjustments (including transfer of current accounts to capital accounts), the balance would represent either amount due to or due from partners. This capital Account would be closed either by payment of cash or by bringing in cash.

Cash/Bank Accounts

After incorporating all the adjustments relating to cash or Bank, the balance of this account must be equal to the amounts due to or due from partners. Technically, the cash and bank account would close, when payment is made/received from partners.

Journal Entries to close books of accounts :

For closing Assets Accounts:

Realisation A/c	Dr.	xxx	
To Plant & Machinery A/c			xxx
To Furniture & fixtures A/c			xxx
To Stock A/c			xxx
To Debtors A/c			xxx
To Investments A/c			xxx
To Goodwill A/c			xxx
[Being assets transferred to Realisation Account]			

The following points are to be noted while transferring the assets:-

(a) All assets [except cash & bank] are to be transferred at "Book Value" only.

(b) Assets against which provision or reserve are created. These asses should be transferred at gross figure. [i.e without deducting the amount of provision / reserve].
Separate entry has to be passed to transfer the provisions : ie

Provision for Bad & doubtful doubtful debts A/c	Dr.	xxx	
Provision for Depreciation A/c	Dr.	xxx	
To Realisation A/c			xxx

(a) Cash and bank balance would be transferred to Realisation Account if the firm is dissolved due to sale of business, unless specifically mentioned.

(b) When an of the assets is being taken over by a partner

Partner's Capital A/c	Dr.	xxx	
To realization A/c			xxx
[Being asset taken by a partner]			

(c) Treatment of Goodwill.

(i) Good will treatment does not have much impact in cases of dissolution. If it appears in the balance Sheet and it is treated like any other asset and is transferred to realization account at the book value.

(ii) If the goodwill does not appear in the balance sheet, it is not calculated.

(iii) If same amount is realized for Goodwill, then it is credited to Realisation Account.

Cash A/c	Dr.	xxx	
To realization A/c			xxx
[Being cash realised for Goodwill]			

(i) If any of the partner's agree to pay for goodwill then it is recorded by the following entry;

Partner's Capital (or) Current A/c	Dr.	xxx	
To Realisation A/c			xxx
[Being Goodwill taken by partner]			

For closing liabilities :

All liabilities are to transferred to Realisation account at their book value.

Liabilities A/c	Dr.		
To Realisation A/c			
[Being transfer of liabilities to realisation account]			

Liabilities can be discharged by any of the following ways.

(i) When cash is paid for any liability

Realisation A/c	Dr.	xxx	
To Cash / Bank A/c			xxx

[Being cash paid for payment of liability]

(ii) When any of partner agrees to discharge the liabilities Realisation A/c Dr.
xxx
To Partner's Capital (or) Current A/c xxx
[Being Liability take over by partner]

Normal dissolution

Illustration 1

Ram, Rahim and Suresh share profit in the ratio 3 : 2 : 1. On 31st December, 2008 their Balance Sheet was as follows:

Liabilities	Rs.	Assets	Rs.
Creditors	**12000**	**Machinery**	**25000**
Genera Reserve	**3000**	**Stock**	**11000**
Capital :		**Debtors**	**9500**
Ram	**20000**	**Goodwill**	**13000**
Rahim	**15000**	**Cash**	**1500**
Suresh	**10000**		
	60000		**60000**

On the above date, the firm was dissolved. The assets, except cash, realized Rs. 60,000. The creditors were settled at Rs. 11,500. Dissolution expenses amounted to Rs. 800. Give necessary ledger A/c's

Solution

Realisation Account

Dr. Cr.

Particulars	Rs.	Particulars	Rs.
To Machinery	25000	By Creditors	12000
To Stock	11000	By Cash [assets realized]	60000
To Debtors	9500		
To Goodwill	13000		
To Cash [Creditors paid] To	11500		
	800		

Cash [Realisation Exp]			
To Partner's capital A/c [Realisation of profit]	1200		
	72000		72000
Ram 600			
Rahim 400			
Suresh 200			

Capital Account

Dr. Cr.

Particulars	Ram Rs.	Rahim Rs.	Suresh Rs.	Particulars	Ram Rs.	Rahim Rs.	Suresh Rs.
To Cash A/c (cash paid to partners)	22100	16400	10700	By Balance b/d	20000	15000	10000
				By General Reserve	1500	1000	500
				(3 : 2 : 1)	600	400	200
	22100	16400	10700		22100	16400	10700
				By Realisation A/c			

Cash Account

Dr. Cr.

Particulars	Rs.	Particulars	Rs.
To Balance b/d	1500	By Realisation A/c (Creditors paid)	11500
To Realisation A/c (Assets realised)	60000	By Realisation A/c (Realisation Exp)	800
		By Partners Capital A/c	49200
	61500	Ram 22100	61500
		Rahim 16400	
		Suresh 10700	

Illustration 3

S & W are partners in firm sharing profit and loss in the ratio of 4:3. They have decided to dissolve the partnership on 31.3.2009 on which date their Balance Sheet stood as under:

Liabilities	Rs.	Assets		Rs.
Capital : S	160000	Plant		120000
W	60000	Debtors	90000	
Bank Loan	20000	(-) Provision	4000	86000
Creditors	80000	Trade Marks		12000
		Furniture		4000
		Stock		60000
		Cash		28000
		Advertisement expenses		10000
	320000			320000

The realization showed the following results:

(i) Debtors realized 90% of book value
(ii) Trade mark Rs.8000
(iii)Goodwill was sold for Rs.10000
(iv) Plant and stock were taken over by S for Rs.144000 and Rs.36000 respectively
(v) An unrecorded asset estimated at Rs.6000 was sold for Rs.2000

Discounts amounting to Rs.800 were allowed b creditors while paying their claims. Expenses of realization amounted to Rs.4000. prepare Realisation A/c, Bank A/c and partners capital account assuming that settlement was made on 1.4.0

Solution

Realisation Account

Dr. Cr.

Particulars	Rs.	Particulars	Rs.
To Plant A/c	120000	By Provision for bad debts	4000
To Furniture A/c	4000	By Creditors A/c	80000
To Debtors A/c	90000	By Cash A/c (debtors Rs.90000 X 90%)	81000
To Trade Marks A/c	12000	By Cash A/c (Trademark)	8000
To Stock	60000	By Cash A/c (Goodwill)	10000
To Cash A/c (Creditors Rs.80000-Rs.800)	79200	To S's Capital A/c (Rs. 144000 + Rs.36000)	180000
To Cash A/c (Exp)	4000	By Cash A/c (Unrecorded asset)	2000
		By Loss transferred to S's Capital (1/5) 3360 W's Capital (1/5) 840	4200
	369200		369200

Note: Bank loan should not be transferred to Realisation account. It has be paid off directly.

Partner's Capital Account

Dr. Cr.

Particulars	S Rs.	W Rs.	Particulars	S Rs.	W Rs.
To Advertisement expense (Rs.10000 in 4:1)	8000	2000	By Balance b/d	160000	60000
			By Cash A/c (Bal.fig)	31360	-
To Realisation A/c (Plant & Stock)	180000	-			
To Realisation A/c (loss)	3360	840			
To Cash A/c (Bal.fig)	-	57160			
	191360	60000		191360	60000

Cash Account

Dr. Cr.

Particulars	Rs.	Rs	Particulars	Rs.	Rs.
To Balance b/d		28000	By Realisarion A/c Creditors	79200	83200
			Realisation Exp	4000	
To Realisation A/c Debtors	81000				
Trademark	8000		By Bank loan A/c		
Goodwill	10000		By W's Capital A/c		20000
Unrecorded assets	2000				57160
To S's capital A/c		101000			
		160360			160360

21.1 Insolvency of a Partner Garner Vs Murray

If a partner capital account shows a debit balance on the date of dissolution of the firm, he has to pay the debit balance to the firm to settle his account. But, if such a partner is insolvent, i.e., unable to settle his debts to the firm his deficiency that he is not able to bear will be borne by the other solvent partners in accordance with the decision in Garner Vs. Murray. In this case, it was ruled that in the absence of any agreement to the contrary, the deficiency on account of the insolvent partner's capital account should be borne by the other solvent partners in proportion to their capitals which settle in the books of the firm before the dissolution of the firm. The loss on account of the insolvency of a partner is a capital loss and hence borne by other solvent partners in proportion to their capitals. Prior to this decision, the share of deficiency was borne by the partners in their profit-sharing ratio. Another ruling in Garner Vs. Murray is that the solvent partners should bring in cash equal to their loss on realization.

Applicability of Garner Vs. Murray in India

In the absence of any specific provision in the Indian Partnership Act, 1932 and any decision of a court in India, it is a common practice to seek guidance from the English Law.

Therefore, it has became a practice in India to follow the decision of Garner Vs. Murray in the absence of any specific agreement between the partners with regard to sharing the deficiency of an insolvent partner.

Illustration 7

The following is the balance sheet of the firm as on 31.03.2010 as follows:

Liabilities	Rs.	Assets	Rs.
Creditors	204800	Bank	11000
Loan Account - P	60000	Debtors	192120
Q	24000	Stock	128000
Current Account - P	42400	Plant and Machinery	57200
Q	5000	Land and Buildings	16800
Capitals Account - P	120000	Current Account - R	19880
Q	80000		
R	40000		
	576200		576200

It was decide to dissolve the firm on the date. The assets except bank balance realized Rs.453520. The firm had to pay Rs.3000 for an outstanding bill not recorded earlier in the books. R became insolvent and a sum of Rs.2000 was realized from his estate.

Prepare necessary ledger account. Close the books of the firm as per Garner Vs. Murray rule.

Solution

Realisation Account

Dr. Cr.

Particulars	Rs.	Particulars	Rs.
To Debtors	192120	By Creditors	204800
To Stock	128000	By Bank (assets)	453520
To Plant and Machinery	57200	By Loss transferred	
To Land and Buildings	168000		
To Bank (Exp)	3000		
To Bank (Crs.)	204800	P's Current A/c 31600	94800
	753120	Q's Current A/c 31600	753120
		R's Current A/c 31600	

R's Capital Account

Dr. Cr.

Particulars	Rs.	Particulars	Rs.
To R's current A/c (Transfer)	51480	By Balance b/d By Bank By Deficiency P's Current A/c 5688 Q's Current A/c 3792	40000 2000 9480
	51480		51480

Current Accounts

Dr. Cr.

Particulars	P Rs.	Q Rs.	R Rs.	Particulars	P Rs.	Q Rs.	R Rs.
To Realisation A/c	-	-	19880	By balance b/d	42400	5000	-
To Realisation A/c	31600	31600	31600	By capital A/c	-	-	51480
To R's Capital [Deficiency	5688	3792	-	By Bank	31600	31600	
To Capital	37612	1208	-				
	74000	36600	51480		74000	36600	51480

Capital Account (Solvent Partners)

Dr. Cr.

Particulars	P	Q	Particulars	P	Q
To Bank A/c	156712	81208	By balance b/d	120000	80000
			By Current A/c	36712	1208
	156712	81208		156712	81208

Cash Account

Dr. Cr.

Particulars	Rs.	Particulars	Rs.
To Balance b/d	11000	By realisation	3000
To Realisation A/c (Assets)	453520	By realisation A/c	204800
		By P's Loan A/c	60000
To P's Current A/c	31600	By Q's Loan A/c	24000
To Q's Current A/c	31600	By P's capital	156712
To R's Capital A/c	2000	By Q's capital	81208
	529720		529720

Insolvency of two partners

Illustration 8

P, Q, R and S are partners sharing profits in the ratio of 4:3:2:1. Their position statement was as follows:

Liabilities	Rs.	Assets	Rs.
Capital P Q Bank Loan Creditors	30000 20000 20000 40000	Buildings Stock Cash Capital - R S	44000 60000 1500 3500 1000
	110000		110000

The firm is dissolved. All assets realized Rs. 82000. Liabilities are paid Rs. 58500 in full settlement. Outstanding Creditors are also paid Rs. 500. Expenses of Dissolution are Rs. 600. S became insolvent and R Paid Rs.3000.**Realisation Account**

Dr. Cr.

Liabilities	Rs.	Assets	Rs.
To Buildings To stock To Bank (O/s Liabilities) To Bank(O/s Creditors) To Bank – expenses	44000 60000 58500 500 600	By Creditors By Bank Loan By Bank(Assets) By Realisation loss b/d	40000 20000 82000 21600
	163600	P 8640 Q 6480 R 4320 S 2160	163600

Capital Account (Insolvent Partners)

Dr. Cr.

Particulars	R Rs.	S Rs.	Particulars	R Rs.	S Rs.
To balance b/d To Realisation A/c (Loss)	3500 4320	1000 2160	By Bank By P's capital By Q's capital	3000 2892 1928	- 1896 1264
	7820	3120		7820	3160

R's Deficiency = Rs.4820 to P and Q in the ratio of 3:2

S's Deficiency = Rs.3160 to P and Q in the ratio of 3:2

Capital Account (solvent Partners)

Dr. Cr.

Particulars	P Rs.	Q Rs	Particulars	P Rs.	Q Rs.
To Realisation A/c (Loss)	8640	6480	By Balance b/d	30000	20000
To R's Capital	2892	1928	By Bank A/c	8640	6480
To S's Capital	1896	1264			
To Bank (Bal.Fig.)	25212	16808			
	38640	26480		38640	26480

Cash Account

Dr. Cr.

Particulars	Rs.	Particulars	Rs.
To Balance b/d	1500	By Realization(Exp.)	600
To R's capital	3000	By Realization A/c (58500+500)	59000
To Realization (Assets)	82000	By Capital A/c - P 25212	
To P's capital	8640	(Bal. Fig) Q 16808	42020
To Q's capital	6480		
	101620		101620

Insolvency of all Partners

Illustration 9

The balance sheet M, V, A as on 31.12.2009 is given below.

Liabilities	Rs.	Assets	Rs.
Capital M	10000	Debtors	40000
V	6000	Bank	2000
M's Loan	20000	Furniture	6000
Creditors	80000	A's Capital	2000
	116000		116000

Bank Account

Dr. Cr.

Particulars	Rs.	Particulars	Rs.
To Balance b/d	2000	By Realization A/c (Exp.)	6000
To Realization (Assets)	64000	By Creditors (Bal. Fig)	63000
To M's capital A/c (private)	3000		

	69000		69000

Creditors Account

Dr. Cr.

Particulars	Rs.	Particulars	Rs.
To Bank A/c	63000	By balance b/d	80000
To deficiency (Bal. fig)	17000		
	80000		80000

Deficiency Account

Dr. Cr.

Particulars	Rs.	Particulars	Rs.
To V's capital A/c To A's capital A/c	6000 32000	By M's capital By Creditors A/c	21000 17000
	38000		38000

21.2 Piecemeal Distribution

In Dissolution of a firm, it is assumed that all the amount due to the creditors and partners are settled on the date of dissolution itself; but this assumption is unrealistic and practically impossible because the process of realizing the assets and payment of liabilities takes some time.

In such a case, when there is a gradual realization of assets it is necessary to avoid the unpleasant consequences of a partner's account being overdrawn. Distributing cash of various realization of assets in such a way that the final unpaid balance of the capital of each partner is left in is profit-sharing ratio. The final profit or loss on realization can be determined only after all the assets are realized and all the liabilities are paid off. The partners get their capital gradually as and when the amount is received after settlement of third party liabilities. The Following order of payment is followed in gradual realization.

1) The debts of the firm to third parties have to be aid.
2) Amount due to partner as loan to be paid (if any)
3) Then, the capital of the partners to be paid out of the remaining amount.

The Payment are made by adopting any one of the following two methods

1) Proportionate Capital method
2) Maximum Loss method

1.Proportionate Capital Method

It is also known as "Highest Relative Capital Method". According to this method the partner who has the higher relative capital, that is whose capital is greater in proportion to his profit- sharing ratio, is first paid off. For determining the amount by which the capital of each partner is in excess of his relative capital, the least capital is taken as base and the capital of other partners are made to proportionate to their profit sharing ratio. This is called as their hypothetical capital. The amount of hypothetical capital of each partner is deducted from the amount of actual capital. The resultant amount will be the excess capital held by him. This excess amount is paid to these partners in the "Excess Capital Proportion Ratio". After this payment the partner's capital will be on their profit sharing ratio and further realization amount is distributed in the profit sharing ratio. When the final realization is distributed, the balance of unpaid capital is the "Loss on Realization".

Illustration 10

From the Balance Sheet of A, B and C who share the profits and losses in 2:2:1 ratio, prepare the statement distribution of cash.

Liabilities	Rs.	Assets	Rs.
Sundry Creditors	30000	Cash	4000
Capital A	30000	Sundry Debtors	44000
B	24000	Stock	44000
C	8000		
	92000		92000

The firm was dissolved and the assets were realized gradually. Rs. 20000 was received first, Rs.30000 was received next and Rs.180000 finally.

Solution

Note: Proportionate capital method is adapted in this problem, so the partners A & B have a greater proportion in their capitals compared to partner C. C has the least capital of Rs.8000, so his capital is taken as the base for computing excess capitals of A & B.

Refer working notes in the next page

Statement of distribution of cash

Particulars	Sundry Creditors	Capitals A	B	C
Capital as per Balance Sheet	30000	30000	24000	8000
Less: Cash in Hand	4000	-	-	-
Balance due	26000	30000	24000	8000
Less: I Realization (Rs.20000)	20000	-	-	-
Balance due	6000	30000	24000	8000
Less: II Realization (Rs.30000) Rs.6000 to Creditors	6000	-	-	-
Rs.22000 to A & B in 7:4	-	14000	8000	-
Rs.2000 to A, B & C in (2:2:1)	-	800	800	400
Balance due	-	15200	15200	7600
Less: III Realization (Rs.18000 in 2:2:1)	-	7200	7200	3600
Loss on Realization	-	8000	8000	4000
Profit sharing ratio		2	2	1

Working notes:

Capital of C is taken as the basic capital = Rs.8000 (since being the least capital of A , B & C)

Capital of the Firm based on C's Capital = Rs. 40000

	A	B	C
Capital as per balance sheet	30000	24000	8000
Less: Capital based on C's Capital (Rs.40000 in 2:2:1)	16000	16000	8000
Surplus capital (Excess Capital)	14000	8000	-

Total surplus Rs.22000 (Rs. 14000+Rs.8000) will be shared in their excess capital proportion ratio i.e. 7:4

Illustration 11

The following is the balance sheet of A, B and C on 31.12.2009. On that date they decided to dissolve the partnership

Liabilities	Rs.	Assets	Rs.
Sundry Creditors	2000	Sundry Asset	49000
A's Loan	5000		
Capital A	15000		
B	18000		
C	9000		
	49000		49000

The assets realized the following sums in instalments:

I – Rs.1000, II – Rs.3000, III – 3900, IV – Rs.6000 and finally V – Rs.20100. The Expenses of realization amounted to Rs.100 only. The partners share profit and losses in the ratio of 2:2:1. Show how the distribution of cash is made.

Solution

Calculation of Proportionate Capital

		A	B	C
Capital	(X)	15000	18000	9000
Profit Sharing Ratio		2	2	1
Capital (Divided by Profit sharing ratio)		7500	9000	9000
Taking Rs.7500 as base(Y) (Rs.7500 multiply in 2:2:1)		1500	15000	7500
Excess Capital/Surplus(X-Y)		Nil	3000	1500
Excess Capital Ratio(ECR)			2 :	1

Statement of distribution of cash

Particulars	Creditors	A's loan	A (Rs.)	Particulars B(Rs.)	C(Rs.)
Balance as per balance sheet Less: I Reduction	2000 1000	5000 -	15000 -	18000 -	9000 -
(Rs.1000) Balance due Less: II Realization(Rs.3000) Rs.1000 to Sundry Creditors, Rs.2000 to A's Loan	1000 1000	5000 2000	15000 -	18000 -	9000 -
Balance due Less: III Realization(Rs.3900) Rs.3000 to A's Loan Rs.9000 to B & C in 2:1 (ECR)	- - -	3000 3000 -	15000 - -	18000 - 600	9000 - 300
Balance due Less: IV Realization(Rs.6000) Rs.3600 to B & C in 2:1 (ECR) Rs.2400 to A, B, C in 2:2:1	- - -	- - -	15000 - 960	17400 2400 960	8700 1200 480
Balance due Less: V Realization (Rs.20100in 2:2:1)	- -	- -	14040 8040	14040 8040	7020 4020
Loss on Realization Profit sharing ratio	-	-	6000 2	6000 2	3000 1

Maximum Loss Method

In the process of gradual distribution of cash under the maximum loss method, it is assumed that each instalment realized is considered to be final payment and there is no further realization. Outstanding assets and claims are considered to be worthless. So partner's accounts are adjusted on that basis. The maximum loss is the difference between the total amounts due to partners and the amount available. The maximum loss is ascertained at every stage of realization and the same is distributed among the partner's in their profit-sharing ratio. In this process there is a possibility of partner having debit balance which is presumed deficiency and the partner as insolvent and this deficiency is shared by solvent partners in their capital ratio. This process is applied in all stages of realization. The balance unpaid capital is the loss on realization, which will be I their profit sharing ratio.

Illustration12

X, Y and Z are partners in a firm, who are sharing profits and losses in the proportions of 3:2:1 respectively. The following is the balance sheet as on 31.12.2009. On that date they decided to dissolve the partnership

Liabilities	Rs.	Assets	Rs.
Sundry Creditors	10000	Cash	120000
X	45000	Sundry Debtors	10000
Y	45000		
Z	30000		
	130000		130000

The firm is dissolved and the realizations of assets were as follows

Realization	**Amount Realised**
	Rs.
I	15000
II	22500
III	37500

Prepare a statement showing how the distribution of cash has been made under maximum loss method

Solution

Statement of distribution of cash

Particulars	Sundry	X	Capitals	Z
Balance as per balance sheet Less: Cash in hand	10000 10000	45000 -	45000 -	30000 -
Balance due (A) I Realization (Rs.15000) Less: Maximum Loss: Rs.105000 In 3:2:1 (Total of Capitals – Realization) (Rs. 120000 – Rs. 15000)	- -	45000 52500	45000 35000	30000 17500
(+/-)Deficiency of X's capital Between Y and Z in 3:2	- -	(-) 7500 (+)7500	10000 4500	12500 3000
(B) Balance due (C)=(A-B) II Realization (Rs.22500)		-	5500	9500
Less: Maximum Loss (Rs. 105000-22500 = Rs.82500 in 3:2:1)	- -	45000 41250	39500 27500	20500 13750
Balance due (E)=(C)-(D)	-	3750	12000	6750
III Realization (Rs. 37500) Maximum Loss (Rs.82500-Rs.37500 = Rs.45000 in 3:2:1	- -	41250 22500	27500 15000	13750 7500
Balance due/Loss on Realization (E-F) Profit sharing ratio	-	18750	12500	6250
		22500	15000	7500

UNIT V
OBJECTIVES AND CHARACTERISTICS OF FINANCIAL STATEMENTS

The accounting process ends with the preparation of the financial statement. The information about the financial position of any company is provided with the help of financial statements. The main objective of preparing the financial statement is to present a true and fair view of the financial performance and position. Accounting data is summarised in such a way that the profitability of the business is clearly visible. It also serves as an information tool for all the parties concerned with the firm. To guarantee consistency in reporting, these statements; which include an income statement, balance sheet, and statement of cash flows, must be prepared in accordance with predetermined and established accounting principles and conventions.

Objectives of Financial Statements:

1. To provide useful information to the management of an organisation for the purpose of planning, controlling, analysing, and decision making.

2. To provide information to prospective investors to attract them, so that they can take rational decisions regarding their investment based on the reports.

3. To demonstrate a company's creditworthiness to lenders and creditors, as financial reports help them in evaluating the ability of a company in repaying their money.

4. To provide information to the shareholders and public at large about the various aspects of the entity.

5. To disclose how an organisation is procuring and using various resources.

6. To facilitate the statutory audit.

7. To abide by different legal and governmental regulations

8. To disclose information about the economic resources of an entity claims to these resources (liability and owner's equity), and to show how these resources and claims have undergone changes over a period of time.

9. To supply details on the cash flows that a business is exposed to, including their timeliness and volatility.

10. To determine the liquidity position of an organisation, which in turn can be used to evaluate whether an organisation can continue as a going concern.

Users of Financial Statements:

Who are the Users of Financial Statements?

There are many users of the financial statements produced by an organization. The following list identifies the more common users and the reasons why they need this information. In short, there are many possible users of financial statements, all having different reasons for wanting access to this information.

Company Management

The management team needs to understand the profitability, liquidity, and cash flows of the organization every month, so that it can make operational and financing decisions about the business.

Competitors

Entities competing against a business will attempt to gain access to its financial statements, in order to evaluate its financial condition. The knowledge they gain could alter their competitive strategies.

Customers

When a customer is considering which supplier to select for a major contract, it wants to review their financial statements first, in order to judge the financial ability of a supplier to remain in business long enough to provide the goods or services mandated in the contract.

Employees

A company may elect to provide its financial statements to employees, along with a detailed explanation of what the documents contain. This can be used to increase the level of employee involvement in and understanding of the business.

Governments

A government in whose jurisdiction a company is located will request financial statements in order to determine whether the business paid the appropriate amount of taxes.

Investment Analysts

Outside analysts want to see financial statements in order to decide whether they should recommend the company's securities to their clients.

Investors

Investors will likely require financial statements to be provided, since they are the owners of the business and want to understand the performance of their investment.

Lenders

An entity loaning money to an organization will require financial statements in order to estimate the ability of the borrower to pay back all loaned funds and related interest charges.

Rating Agencies

A credit rating agency will need to review the financial statements in order to give a credit rating to the company as a whole or to its securities.

Suppliers

Suppliers will require financial statements in order to decide whether it is safe to extend credit to a company.

Unions

A union needs the financial statements in order to evaluate the ability of a business to pay compensation and benefits to the union members that it represents.

An accounting standard is a set of written rules that govern the accounting process. The ICAI, which is our country's accounting professional body, issued accounting standards. Unification of accounting standards eliminates non-comparability and improves financial statement reliability. Sets basic accounting policies and disclosure requirements. Accounting standards increase intra and inter-enterprise comparability. A firm's success is commonly assessed using such comparisons.

What are Accounting Standards?

Accounting standards are written statements of standardised accounting rules and procedures used in practice to ensure that financial statements are prepared in a uniform and consistent manner

In other words, accounting standards are a collection of norms that businesses must follow, established by legislation, statute, or a professional organisation

In no way can these standards take proceed over the provisions of applicable laws, and the business environment in a given jurisdiction

Importance of Accounting Standards

- Accounting makes information available to a wider range of information users
- Accounting information can serve the interests of diverse users if it is standardised and contains all of the important information in its entirety
- Alternative accounting treatment and valuation standards are available to corporate entities that are specifically applicable
- Accounting standards broaden the scope of those alternatives that meet the fundamental qualitative attributes of a true and fair view of the financial statements while maintaining the integrity of the financial information

The Benefit of Accounting Standards

- They establish the standards on which financial statements should be prepared and provide guidance on how
- Because they are dependable, it instils confidence in the minds of those who use accounting information

- It assists accountants in adhering to uniform accounting principles and assists auditors in conducting audits
- It guarantees uniformity in creating and presenting financial statements by adhering to a set of standardised procedures and processes

The accounting standards list has been mentioned below.

Generally Accepted Accounting Principles (GAAP)

The General Accepted Accounting Principles are some typical accounting techniques that have gained global acceptability

These accounting principles define terms, treat ambiguous entries, and even prescribe industry-specific regulations and procedures

GAAP exists to ensure basic consistency in financial statements across all enterprises

It helps external users of financial statements understand a company's accounts

GAAP also allows intra- and inter-firm comparisons, which aids investors

Imposing GAAP also ensures that the financial statement depiction is truthful and fair

These rules will prevent management from tampering with accounts

The fairness of the financial accounts is assured if GAAP regulations are strictly observed

But there is no universal accounting code

GAAP is not global

Geographical locations, industries, and accounting bodies all have GAAP details

Because of this, several countries and accounting authorities tailor GAAP to their industry and economy

International Financial Reporting Standards (IFRS)

The name is self-explanatory

IFRS is an international standard for accounting and financial reporting

The International Accounting Standards Board (IASB) is an independent accounting organisation situated in London (IASB)

As we all know, several countries have their GAAP

Each country has its own GAAPs. India has IAS. Unanimity is lacking

It also affects multinational corporations with branches worldwide

So the IFRS was created to provide a global accounting standard

Around 120 nations now use IFRS. Soon, more will follow

As a result, all companies worldwide will report their accounts following the same rules

As a result, nations will be more compatible and uniform

India has yet to embrace IFRS for its domestic or foreign enterprises

But, following worldwide trends, this will happen soon

Indian Accounting Standard (Ind-AS)

The Institute of Chartered Accountants of India (ICAI) published Indian Accounting Standards (IAS), which are used in the country's financial reporting (ICAI)

These are similar to International Financial Reporting Standards (IFRS) and are titled and numbered comparable to the IFRS

They are based on and adapted from the generally accepted accounting principles (GAAP), with adjustments necessary for the Indian economy

These standards deal with accounting issues in dispute, and they specify the accounting treatment, rules, and directions that must be followed

They are comprehensive to prevent any confusion or uncertainty

There are a total of 32 Indian Accounting Standards in existence

Applicability of Accounting Standards

Accounting standards apply to all organisations, except those that are solely charitable and do not engage in any commercial, industrial, or business activity –

Sole proprietorship

Partnership firm

Societies

Trusts

Hindu undivided family

Association of persons

Cooperative societies

Companies

International Financial Reporting System

Limitation of Accounting Standards

The application of accounting standards decides between different alternative accounting treatments difficult

It is strictly adhered to and does not allow for greater flexibility in the application of accounting standards

The accounting standard does not have the authority to override the statute

The standards are required to be farmed within the confines of the current legal framework

Conclusion

World economics has been transformed through globalisation, liberalisation, and privatisation raising capital globally, i.e. across boundaries, has become increasingly important as multinational firms seek funding to fund operations and drive the economy. Foreign accounting norms and regulations differ between countries, making it challenging to comply with them. To foster economic growth and confidence among international analysts and investors, financial statements made by enterprises must be comparable on similar parameters. As a result, efforts to globalise accounting standards are gathering momentum.

What are the requirements of international accounting standards?

Requirements

a statement of financial position (balance sheet)

a statement of comprehensive income. ...

a statement of changes in equity.

a statement of cash flows.

Notes, including a summary of the significant accounting policies.

What Are International Financial Reporting Standards (IFRS)?

International Financial Reporting Standards (IFRS) are a set of accounting rules for the financial statements of public companies that are intended to make them consistent, transparent, and easily comparable around the world.

The IFRS is issued by the International Accounting Standards Board (IASB).

The IFRS system is sometimes confused with International Accounting Standards (IAS), which are the older standards that IFRS replaced in 2001

Standard IFRS Requirements

IFRS covers a wide range of accounting activities. There are certain aspects of business practice for which IFRS set mandatory rules.

Statement of Financial Position: This is the balance sheet. IFRS influences the ways in which the components of a balance sheet are reported.

Statement of Comprehensive Income: This can take the form of one statement or be separated into a profit and loss statement and a statement of other income, including property and equipment.

Statement of Changes in Equity: Also known as a statement of retained earnings, this documents the company's change in earnings or profit for the given financial period.

Statement of Cash Flows: This report summarizes the company's financial transactions in the given period, separating cash flow into operations, investing, and financing.4

Who Uses IFRS?

IFRS is required to be used by public companies based in 167 jurisdictions, including all of the nations in the European Union as well as Canada, India, Russia, South Korea, South Africa, and Chile. The U.S. and China each have their own systems.1

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Accounting standards play a crucial role in the field of accounting by providing a framework for consistent and transparent financial reporting. These standards are established to ensure that financial statements are prepared in a uniform manner, facilitating comparability across different companies and industries. The role of accounting standards includes:

Uniformity and Consistency: Accounting standards help maintain uniformity and consistency in financial reporting. By providing a set of rules and guidelines, they ensure that companies present their financial information in a standardized format. This consistency allows investors, creditors, and other stakeholders to make meaningful comparisons between different entities.

Transparency: Accounting standards aim to enhance the transparency of financial reporting. Transparent financial statements provide a clear and accurate representation of a company's financial position, performance, and cash flows. This transparency builds trust among stakeholders and helps them make informed decisions.

Credibility: Adopting and adhering to accounting standards enhances the credibility of financial statements. External users, such as investors and creditors, are more likely to trust the information presented when they know that it follows established accounting principles.

Global Comparisons: In an increasingly globalized business environment, accounting standards help facilitate comparisons between companies operating in different countries. International accounting standards, such as the International Financial Reporting Standards (IFRS), contribute to the harmonization of accounting practices worldwide.

Investor Confidence: Reliable financial information, produced in accordance with accounting standards, contributes to investor confidence. Investors are more likely to allocate capital to companies that provide transparent and consistent financial reporting, reducing the perceived risk associated with investing.

Regulatory Compliance: Accounting standards often serve as the basis for regulatory requirements. Companies are usually required to follow specific accounting standards set by regulatory bodies in their jurisdiction. Compliance with these standards is essential for meeting legal and regulatory obligations.

Facilitation of Auditing: Auditors rely on accounting standards as a benchmark when assessing the accuracy and fairness of financial statements. Standardized financial reporting makes the audit process more efficient and effective, helping auditors identify potential issues and areas of concern.

Decision-Making: Internal users, such as management, use financial information for decision-making purposes. Accounting standards provide a structured framework for preparing financial statements, aiding management in making informed decisions about resource allocation, strategy, and operations.

In summary, accounting standards play a fundamental role in promoting consistency, transparency, and credibility in financial reporting. They provide a common language for businesses, investors, and other stakeholders, contributing to the overall functioning and stability of financial markets.

Ind AS (Indian Accounting Standards) and IFRS (International Financial Reporting Standards) are two sets of accounting standards, but they differ in their application and adoption. Here are the key differences between Ind AS and IFRS:

Scope and Applicability:

Ind AS: These accounting standards are applicable in India and are issued by the Accounting Standards Board (ASB) of the Institute of Chartered Accountants of India (ICAI). Ind AS are primarily based on IFRS, with some modifications to suit the Indian context.

IFRS: These are global accounting standards issued by the International Accounting Standards Board (IASB). IFRS is widely adopted across many countries around the world, including in the European Union.

Regulatory Authority:

Ind AS: Regulated and enforced by the Ministry of Corporate Affairs (MCA) in India.

IFRS: Governed by the IASB, an independent international standard-setting body.

Timeline of Adoption:

Ind AS: The adoption of Ind AS in India began in phases from April 1, 2016, for certain classes of companies. Initially, it applied to companies meeting specified criteria, and subsequently, it was extended to cover more entities.

IFRS: Adopted by many countries around the world over several years, with some countries transitioning gradually and others adopting IFRS in a more comprehensive manner.

Differences in Standards:

Ind AS: While based on IFRS, Ind AS includes some modifications to address specific Indian legal and economic requirements. Certain standards may have differences in wording or interpretation to suit the Indian context.

IFRS: The global set of accounting standards issued by the IASB, applicable in various jurisdictions with minimal modifications.

Entities Covered:

Ind AS: Applicable to certain classes of companies in India, including listed companies and specific unlisted companies based on thresholds.

IFRS: Applied globally, covering a broad range of entities, including listed companies, private entities, and not-for-profit organizations in jurisdictions that have adopted IFRS.

Convergence with IFRS:

Ind AS: Introduced in India as part of the convergence process to align the country's accounting standards with global best practices. The idea was to converge with, and eventually adopt, IFRS.

IFRS: A set of standards that has evolved globally, aiming for a single set of high-quality global accounting standards.

It's important to note that the information provided here is based on my knowledge up to January 2022, and there may have been developments or changes since then. Additionally, accounting standards are subject to periodic updates and revisions by their respective standard-setting bodies.