

FINANCIAL ACCOUNTING

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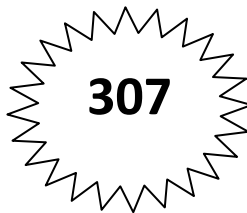
(2011 ADMISSION ONWARDS)



UNIVERSITY OF CALICUT

SCHOOL OF DISTANCE EDUCATION

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Module 1

INTRODUCTION TO ACCOUNTING

Meaning and Definition of Accounting

Accounting has rightly been termed as the language of the business. It records, classifies, analyses and communicates all the business transactions that have taken place during a particular period. It is a system of recording and reporting business transactions in financial terms, to interested parties. According to American Institute of Certified Public Accounts “**Accounting is the art of recording, classifying and summarizing in a significant manner in terms of money, transactions and events which are , in part at least, of a financial character and interpreting the results there of**”. Thus accounting is the art of recording, classifying, summarizing, analyzing and interpreting the financial transactions and communicating the results thereof to the interested person.

Features or characteristics or nature of Accounting

Following are the features of accounting:-

- (1) Accounting is an art.
- (2) Accounting is a science.
- (3) Recording of business transactions.
- (4) Classifying business transactions.
- (5) Summarizing the classified data
- (6) Analysis and interpret the summarized data
- (7) Communicating information to the interested parties.
- (8) Records transaction and events which are financial character.

Objectives of Accounting or functions of accounting

The following are the main objectives:

1. To keep systematic records.
2. To ascertain the operational profit or loss.
3. To ascertain the financial position of the business.
4. To make information available to various users.
5. To protect business properties.
6. To facilitate rational decision making.
7. To ascertain the cost of production and selling price.
8. To control expenditure of business.
9. To satisfy the requirements of law.
10. To calculate the amount due to and due from others.

Importance of accounting (Uses or advantages)

Accounting brings the following advantages:

1. It serves as a historical record.
2. It facilitates the preparation of financial statements.
3. It supplies information to interested persons
4. It helps the management in taking important business decisions.
5. It facilitates comparative study of the performance of business over different periods.
6. It provides evidence in case of disputes.
7. It helps to forecast the future.
8. It provides information for judging the efficiency of business
9. It is useful in getting loans.
10. It helps in valuation of good will.
11. It helps in controlling expenses.
12. It helps in controlling employees.
13. It helps in prevention and detection of errors and frauds.

Scope of Financial accounting

Following activities are included within the framework of financial accounting:

- (1) Book-keeping
- (2) Financial Statements
- (3) Analysis and interpretation of financial statements.
- (4) Financial reporting
- (5) Accounting principles
- (6) Accounting standards.

Limitations of Accounting

Accounting suffers from the following limitations:

1. It is historical in nature.
2. Transactions of non-monetary nature will not be recorded in accounting.
3. Information recorded in accounts is influenced by the personal judgment of the accountant.
4. In accounting valueless assets are also shown.
5. In accounting price changes are not considered.
6. It is not an exact science.
7. Use of different accounting methods reduces the reliability of accounts.
8. Account records show only actual cost figures.

Accounting Concepts or principles

Accounting concepts are those assumptions, principles or conditions on which the accounting system is based. Principles are set of rules to be followed in accounting. The following are important accounting concepts or principles :

1. **Business Entity Concepts:** According to these concepts, a business is treated as separate Entity distinct from its owner. This means that in accounting the business and owner must be treated separately. Thus, when one person invests amount in to the business, it will be deemed to the liability of the business. The concept of separate entity is applicable to all form of business.
2. **Going concern concepts:** According to this, it is assumed that business will exist for a long time. There is no intention t o liquidate the business in the immediate future.
3. **Money measurement concepts: Accounting records only** those transactions which are expressed in monetary terms. Transactions which cannot be expressed in money do not find place in the books of accounts.
4. **Cost Concepts:** According to this concept, all transactions are recorded in the books of accounts at actual price involved.
5. **Dual aspect Concepts:** according to this concept, every transaction has two aspects. These two aspects are receiving aspect and giving aspect. These two aspects have to be recorded. The basis of this principle is that for every debit, there is an equal and corresponding credit.
6. **Realization Concept:** According to this principle revenue is said to be realized when goods or services are sold to be a customer. It emphasizes the fact that the mere receipt of an order for goods or services cannot be taken for the realization of revenue. So advanced payment received from a customer cannot be considered as revenue earned.
7. **Matching Concept:** According to this concept, cost of a business of a particular period is compared with the revenue of that period in order to ascertain net profit or net loss.
8. **Accounting period Concept:** According to this assumption, the life of a business is divided in to different periods for preparing financial statements. Generally business concern adopt twelve months period for measuring the income of the concern. This time interval is known as accounting period.

Accounting conventions

Accounting conventions are the customs and traditions which guide the accountant while preparing accounting statements. Some of the accounting conventions are:-

- (1) **Convention of consistency:** - This convention follows that the basis followed in several accounting periods should be consistent. This means the methods adopted in one accounting year should not be changed in another year. Then only comparison of results is possible.
- (2) **Convention of conservatism:** - This is a convention of playing safe, which is followed while preparing the financial statements. The idea of this convention is to consider all possible losses and to ignore all probable profits.
- (3) **Convention of Materiality:** - Materiality means relevance or importance or significance. It is generally accepted in the accounting circle that the accounting statements and records must reveal all material facts.

- (4) **Convention of full disclosure:** - The accounting convention of full disclosure implies that accounts must be honestly prepared and all material information must be disclosed therein.

Accounting standards

Accounting standards are considered as a guide for maintaining and preparing accounts. They are the rules that ensure uniformity of preparation, presentation and reporting of accounting information.

Accounting standards may be defined as the accounting principles and rules which are to be followed for various accounting treatments while preparing financial statements on uniform basis and which will reveal the same meaning to all the interested groups.

Need for accounting standards (Objects of Accounting standards):

The need for accounting standards arises from limitations of financial statements. The need for accounting standards arises due to the following reasons.

1. To communicate uniform results to external users as well as internal users for decision making.
2. To serve as a tools for information systems catering the needs of management, owners , creditors , Government etc.
3. To facilitate inter firm, intra firm comparison.
4. To make the financial statement more reliable comparable and understandable.

Accounting standard Board of India (ASB)

The institute of Chartered Accountant of India, set up, Accounting Standard Board. The primary duty of ASB is to formulate the accounting standard for India. During the formulation of accounting standards, the ASB considered the applicable laws, usage, customs and the business environment existing in our country. The ASB will give due consideration to International Accounting Standards (IASs) issued by the International Accounting Standard Committee and tries to integrate them to the extent possible.

The body consists of the following members: Company Law Board, CBDT, Central Board of Excise and Customs, SEBI, Comptroller and Auditor General of accounts, UGC, Educational and Professional institutions, and councils of the institutes and representatives of Industry.

The following are the objectives and functions of the ASB:

- (1) To suggest areas in which accounting standards need to be developed.
- (2) To formulate accounting standards.
- (3) To review the accounting standards at periodical intervals.
- (4) To provide guidance on accounting standards.
- (5) To carry out other functions relating to accounting standards.

Accounting Standards in India

ASB of India has issued 32 accounting standards so far. They are as follows

- As1: Disclosure of accounting policies
- As2: Valuation of inventories
- As3: Cash flow statements
- As4: Contingencies and events occurring after the B/S date
- As5: Prior period and extra ordinary items and change in accounting policies
- As6: Depreciation accounting
- As7: Accounting for construction contracts
- As8: Accounting for research and development
- As9: Revenue recognition
- As10: Accounting for fixed assets
- As11: Accounting for effects of changes in foreign exchange rates
- As12: Accounting for govt. grants
- As13: Accounting for investments
- As14: Accounting for amalgamation
- As15; Accounting for retirement benefits in the financial statements of employers
- As16: Borrowing cost
- As17: Segment reporting
- As18: Related party disclosures
- As19: Leases
- As20: Earning per share
- As21: Consolidated financial statement
- As22: Taxes on income
- As23: Accounting for investment in associates in consolidated financial statement
- As24: Discontinuing operations
- As25: Interim financial reporting
- As26: Intangible assets
- As27: Financial reporting of interest in joint ventures
- As28: Impairment of assets.
- As29: Provisions, contingent liabilities and contingent assets
- As30: Financial instruments-recognition and measurements
- As31: Financial instruments-presentation
- As32: Financial instruments disclosure

Accounting process

Accounting process begins when a financial transactions takes place. Firstly day to day transactions are recorded in the journal or subsidiary books. From the journal the transactions move further to ledger. Here entries are posted in the appropriate accounts, and then accounts are balanced to get the effect of debit and credit. These balance moves to a statement called trial balance. From the trial balance, we can prepare trading and profit and loss accounts and balance sheet. The different stages through which the transactions move from journal to final accounts are collectively known as accounting cycles or accounting process.

Journal and ledger

A book of original entry in which transactions are recorded in the order of their occurrence is called journal. Journal is a primary record of business transactions. Recording of transactions in the journal is known as journalizing and recorded transactions are called journal entries

Ledger is a book, which contains various accounts it is said to be secondary books of account. It is a collection of all accounts debited or credited in journal. Ledger is defined as, "a book in which all the personal, real, and nominal accounts of business are kept for permanent records so that up to date statement of an account can be easily known".

Rules of accounting

Accounts are classified in to three namely real accounts, personal accounts and nominal accounts. There are separate rules for each type of accounts they are as follows

1. Real accounts

An account relating to an asset or property is called real account. cash, furniture, plant and machinery etc are examples of real accounts the debit, credit rule applicable to real account is:

Debit what comes in

Credit what goes out

2. Personal accounts

It includes the account of person with whom the business deals. These accounts are classified in to three categories

a) **Natural personal accounts** –the term natural persons mean persons who are creation of god. For e.g.;-Raja's accounts, Gupta's accounts etc

b) Artificial personal accounts-these accounts includes accounts of corporate bodies or institutions

b) **Representative personal account**-these are accounts which represents certain person or group of persons. For example salary due, rent outstanding etc

the rule of personal account is

Debit the receiver

Credit the giver

3) Nominal accounts

Accounts relating to expenses and losses and incomes and gains are called nominal accounts. Salary accounts, commission account etc are examples.

Debit all expenses and losses

Credit all incomes and gains

Posting

The term posting means transferring the debit and credit items from the journal to their respective accounts in the ledger. It is the process of recording the transaction from journal to ledger.

The following rules should be observed while posting transactions in the ledger from the journal:

- a) separate account should be opened in the ledger for posting transactions relating to different accounts recorded in the journal
- b) The concerned account, which has been debited in the journal should also be debited in the ledger
- c) The concerned account, which has been credited in the journal should also be credited in the ledger

SUB-DIVISION OF JOURNAL

The journal is sub-divided into many subsidiary books called special journals. The journal in which transaction of a similar nature is recorded is known as special journal or day book.

The special journals are ruled differently on the basis of the nature of transactions to be recorded. Transactions that cannot be recorded in any of the special journals are recorded in a journal called journal proper or miscellaneous journal.

Advantages of Special Journals

1. **Division of work:** since there are so many subsidiary books, the accounting work may be divided amongst a number of clerks.
2. **Specialization:** when the same work is allotted to a period of time he acquires full knowledge of it and becomes efficient thus the accounting works will be done more efficiently.
3. **Save in time:** the trader can save time and labor by avoiding repetitions
4. **Availability of information:** since separate subsidiary book is kept for each class of transactions, information relating to that will be readily available.
5. **Facility in checking:** checking is facilitated in subsidiary books which will prevent errors and frauds

Important special journals

The journal is sub divided in to the following subsidiary books

1. **CASH BOOK:** For recording all cash transactions
2. **PURCHASES BOOK:** For recording credit purchases of goods

3. **SALES BOOK:** For recording credit sales
4. **PURCHASE RETURNS BOOKS.** For recording the goods returned by the trader to the suppliers
5. **SALES RETURNS BOOK:** For recording the goods returned to the trader by his customer
6. **BILLS RECEIVABLE BOOKS:** For recording all bills received by the trader from his customer
7. **BILLS PAYABLE BOOK:** For recording all the bills given (accepted) to suppliers
8. **JOURNAL PROPER:** For all transactions that do not find a place in any of the above books

TRIAL BALANCE

Trial balance is a statement containing the various ledger balances on a particular date. This statement is prepared to check the correctness of ledger posting and balancing of accounts. If the total of the debit balances is equal to the credit balances. It is implied that posting and balancing of accounts are correct

Features of trial balance

1. It is prepared on a specific date
2. It is not a part of double entry and not an account
3. It is a statement of balance of all accounts or totals of ledger accounts
4. Total of the debit and credit columns of the trial balance must tally
5. If the debit and credit columns are equal it is presumed that accounts are arithmetically accurate
6. Difference in the debit and credit columns indicate that some mistakes have been committed
7. Tallying of trial balance is not a conclusive proof of accuracy of books of accounts;
it serves to prove only the arithmetical accuracy of books

Objectives of trial balance

The following are the objectives of preparing trial; balance

1. To ascertain the arithmetical accuracy of the ledger accounts
2. To help in locating errors
3. To help in the preparation of final accounts

Specimen of trial balance is given below

Trial Balance as on

Account code	Name of the account	Debit Amount(Rs)	Credit Amount(Rs)
	Cash in hand	Xxx	
	Cash at bank	Xxx	
	Sundry debtors	Xxx	
	Sundry creditors		Xxx
	Sales		Xxx
	Sales returns	Xxx	
	Purchases	Xxx	
	Purchase returns		xxx
	Drawing	xxx	
	Capital		xxx
	Bills receivable	xxx	
	Bills payable		xxx
	Stock of goods	xxx	
	Bank loan/overdraft		Xxx
	Carriage inwards	xxx	
	Carriage outwards	xxx	
	Rent paid	xxx	
	Interest paid	xxx	
	Salary paid	xxx	
	Discount received		Xxx
	Commission received		xxx
	Plant and machinery	xxx	
	Buildings	xxx	
	Furniture	xxx	
	Vehicles	xxx	
	Goodwill	xxx	
	Provisions		Xxx
	Outstanding expenses		xxx
	Prepaid expenses	xxx	
	Accrued income	xxx	
	Pre received income		Xxx
	Reserve accounts		Xxx
	Advance from customers		xxx
		XXXX	xxxx

Module 2

CAPITAL AND REVENUE

All accounting items are broadly classified into capital and revenue items. Capital items are further classified into capital expenditure and capital receipts similarly all revenue items are sub divided revenue expenditure and revenue receipts.

Classification of income

Income can be classified into two categories namely capital income and revenue income.

Capital income:

The term capital income means an income which does not grow out of or pertain to the running of the business proper. It is synonymous to the term capital gain. For e.g.: if a building costing 20000 purchased by a business for its use is sold for Rs 25000, Rs 5000 will be taken as capital profit. Capital profit transferred to the capital reserve and is shown in the balance sheet on the liabilities side.

Revenue income:

Revenue income means an income, which arises out of and in the course of the regular business transactions of a concern. For eg: in the course of running the business, the profit is made on sales of goods, income is received from letting out the business property, dividend received on business investment etc is revenue income.

Classification of expenditure

Expenditure can be classified into three categories.

1. Capital expenditure: It means an expenditure, which has been incurred for the purpose of obtaining a long term advantage. It consists of expenditure the benefit of which is not fully consumed in one accounting period, but spreads over several accounting periods. It is nonrecurring in nature. In short expenditure incurred for increasing earning capacity of a business is known as capital expenditure. Examples: purchase of plant and machinery, expenses in connection with acquisition of asset like duty freight, installation charges etc. It is shown on the asset side of the balance sheet.

2. Revenue expenditure: An expenditure that arises out of and in the course of regular business transactions of a concern is termed as revenue expenditure. It includes the money spend on day to day operations of business for current and immediate use. It is repetitive in nature. Its benefit will be realized in the current year itself. Wages, legal expenses, transport charges, freight and carriage etc are some of the revenue expenses. It is charged to the trading and profit and loss account.

3. Deferred revenue expenditure: It is that class of revenue expenditure which is incurred during a particular year but benefit of which may extend to a number of years. The whole amount of such expenditure cannot be treated as the expenditure of the year in which it is incurred. Therefore a portion of such expenditure is charged

every year to profit and loss account and remaining portion is shown on the asset side of the balance sheet.

Classification of receipts:

It can be classified into two categories.

1. **Capital receipts:** it consists of payments made by the shareholders or proprietor of the business or receipts from the sale of fixed assets. Sale of machinery or furniture is capital receipt.
2. **Revenue receipt:** all incomes or receipts that are received by a business in the ordinary conduct of activities are called revenue receipts. Sale of goods, interest and rent received etc are examples.

FINAL ACCOUNTS OF A SOLE TRADER

Final account means accounts. Which are prepared at the final stage to give the financial position of the business It consists of trading account profit and loss account and balance sheet.

TRADING ACCOUNT

Trading account gives the overall result of trading, that is purchasing and selling of goods. The result of trading accounting may be gross profit or gross loss. If the sale proceeds exceed the cost of goods sold the difference is gross profit. Opening stock, purchases, direct expenses, are debited and sales and closing stock are credited to this account.

Specimen of Trading account is given below:

Trading account for the year ended.....

To opening stock	xxx	By Sales	xxxx	
To purchases	xxxx	Less returns	xx	
Less returns	xxx		-----	xxxx
	-----	By closing stock		xxx
	xxxx	By gross loss (if loss)		xxx
To Direct expenses:				
Carriage inward	xxx			
Freight	xxx			
Octroi	xxx			
Dock dues	xxx			
Excise duty	xxx			
Royalty	xxx			
Motive power	xx			
Coal, gas, water	xxx			
Factory expenses	xxx			
To Gross Profit (if profit)	xxx			
	xxxxx			xxxxx

PROFIT AND LOSS ACCOUNT

Profit and loss account is prepared to ascertain the net profit or net loss of the business for an accounting period. The amount of gross profit is shown on the credit side. Indirect expenses, operating expenses and losses are shown on the debit side of this account and all incomes and gains are shown on the credit side. If credit side is more than debit side, the difference is net profit.

A Specimen of Profit and Loss account is given below:

Profit and Loss account for the year ended....

To Gross loss b/d	Xxx	By gross profit b/d	Xxx
To salaries	Xxx	By rent received	Xxx
To rent, rates & taxes	Xxx	By discount received	Xxx
To printing & stationary	Xxx	By commission received	Xxx
To Postage	Xxx	By interest	Xxx
To audit fees	Xxx	By other incomes (if any)	xxx
To General expenses	Xxx	By Net loss (if loss)	
To repair	Xxx		
To fire Insurance premium	Xxx		
To legal expenses	Xxx		
To office expenses	Xxx		
To interest on loan	Xxx		
To bad debts	Xxx		
To discount allowed	Xxx		
To commission	Xxx		
To advertising	Xxx		
To travelling expenses	Xxx		
To depreciation	Xxx		
To sundry expenses	Xxx		
To establishment expenses	Xxx		
To loss on sale of assets	Xxx		
To carriage outward	Xxx		
To net profit	xxx		
	XXXX		XXXX

MANUFACTURING ACCOUNT

Manufacturing account is an account prepared by manufacturing concerns to ascertain cost of goods manufactured during a period. All the expenses relating to manufacturing activity are debited. The total represents cost of manufactures, which is transferred to trading account. A specimen of manufacturing account is given below:

Manufacturing account for the year ended....

To opening Work in progress	Xxxx	By closing work in progress	Xxxx
To Raw material consumed:		By sale of scrap	Xxx
Opening stock of raw material xxx		By cost of goods manufactured	xxxx
Add purchase (less return) xxx		(balance, transfer to	
Less closing stock of raw material xx		trading account)	

	Xxxx		
To direct wages	Xxx		
To carriage inward	Xxx		
To freight	Xxx		
To factory expenses	Xxx		
To works manager's salary	Xxx		
To consumable stores	Xxx		
To depreciation of plant	Xxx		
To repairs of plant	Xxx		
To coal, gas, water	Xxx		
To motive power	Xxx		
	xxxx		xxxxx

BALANCESHEET

Balance sheet is a statement showing the assets and liabilities of a business on a particular date. It reveals the financial position of a business. Hence it is also known as position statement. In the words of Francis R Stead, 'balance sheet is a screen picture of financial position of a going business at a certain moment.

Specimen of Balance Sheet is given below:

Balance Sheet as at

Liabilities		Assets	
Current liabilities:		Current Assets:	
Bills payable	xxxx	Cash in hand	xxxx
Creditors	xxxx	Cash at bank	xxxx
Bank over draft	xxxx	Debtors	xxxx
Outstanding expenses	xx	Bills receivable	xxxx
Income received in advance	xx	Marketable securities	xxxx
		Prepaid expenses	xxx
Long term liabilities:		Accrued incomes	xxx
Loan	xxx	Closing stock	xxx
Capital	xxxx	Long term investments	
Add Net profit	xxx	Fixed assets:	xxxx
	-----	Furniture	
	xxxxxx	Vehicles	xxx
Less drawings	xxx	Patent	xxx
	-----	Loose tools	xxx
	xxxxxx	Plant	xxx
		Land and building	xxxx
		Goodwill	xxxx
			xxx
	xxxxxx		xxxxxx

OPENING CLOSING AND ADJUSTING ENTRIES

Opening entries are passed at the beginning of an accounting period. When a businessman starts business with cash and other form of assets, it becomes essential to open the necessary ledger accounts. This is made by passing entries through journal proper.

At the end of every accounting period, all revenue items are closed by transferring to trading and profit and loss account, such entries are known as closing entries. Thus closing are those entries passed at the end of the accounting year to close the accounts relating to incomes, expense, gains and losses.

In the mercantile system of accounting, various adjustments had to be made to accounts of incomes and expenses, so as to show correct figure for the current year. These entries are passed for adjusting the incomes, expenses etc are called adjusting entries

When a sum of money from one account to another account has to transferred it is done by a means of an entry called transfer entry.

TREATMENT OF CERTAIN ITEMS

CLOSING STOCK

If it is given in the adjustment it is shown on the credit side of the trading account and also shown on the assets side of the balance sheet. If it is given in the trial balance, It should be shown only in the balance sheet.

OUTSTANDING EXPENSES:

These are those expenses which remains unpaid at the end of the accounting period. If it is given in the adjustment, it should be added to the concerned expenses on the debit side of the trading account or profit or loss account and it should also be shown in the balance sheet as liability. If it is given in the trial balance, it should be shown in the balance sheet as liabilities.

PREPAID EXPENSES

Prepaid expenses are payments made in the current year but related to the next accounting year. Prepaid expenses are also known as expenses paid in advance or unexpired expenses. If it is given in the adjustment, it should deducted from the concerned expenses on the debit side of trading accounting or profit and loss account and it should also be shown on the asset side of balance sheet. If it is given in the trial balance, it should be taken only in the balance sheet as asset

ACCRUED INCOME

This is the income earned but not received by the end of the accounting year. This is also known as outstanding incomes. If it is given in the adjustment, it should be added to the concerned income on the credit side of the profit and loss account and it should also be shown on the asset side of balance sheet .If it is given in the trial balance, it should be shown only in the balance sheet on the asset side

INCOME RECEIVED IN ADVANCE

It means income which has been received by business before it been earned by the business. It relate to the next accounting period. It is also known as unearned income or income received in advance. If it is given in the adjustment it's should be deducted from the concerned income on the credit side of the profit and loss account and it should also be shown on the liability side of balance sheet. If it is given in the trial balance it should be shown only in the balance sheet on the liability side.

DEPRECIATION

If it is given in the adjustment, it should be shown on the debit side of the profit and loss account and deducted from concerned asset on the balance sheet. If it is given in trial balance, depreciation should be taken only on the debit side of profit and loss account.

BAD DEBTS

When an amount due from debtors is found irrecoverable it is called bad debt .it is a loss the business. If it is given in the adjustment it should be taken on the debit side of the profit and loss account by adding to the bad debt already given in the trial balance and it should also be deducted from debtors on the asset side.

PROVISION FOR BAD DEBTS

The provision given in the trial balance is the provision created in last year; it is taken on credit side of profit and loss account. If there is bad debt and provision required are given, it should be adjusted against the opening provisions. The treatment is as follows.

Bad debt (given in the trial balance)	XXXX
Add: further bad debt (given in the adjustment)	XXX
Provision required (given in the adjustment)	XXX

	XXXX
Less existing provision (given in the trial balance)	XXX

Amount shown on the debit side of the P&L account	XXX

If the existing provision is more than the bad debt and new provisions, then the balance should be shown on the credit side of profit and loss account. Bad debts and new provisions given in the adjustments are also deducted from the debtors account on the asset side of the balance sheet.

LOSS OF STOCK BY FIRE

In case goods are not insured the total loss should be shown on the credit side of the trading account. The same amount should be shown on the debit side of the profit and loss account. If goods are insured and insurance company admitted the claim, the total loss should be credited to the trading account, amount claim not admitted by the insurance company is debited to P&L account and claim admitted is shown on the asset side of balance sheet.

MANAGERS COMMISSION

Commission is shown on the debit side of P&L account. It should also be shown on the liability side of the balance sheet (if it is given in the adjustment). It is calculated as follows.

- a) Fixed percentage of net profit before charging such commission

Commission is calculated as follows

$$\frac{\text{Net profit} \times \text{rate of commission}}{100}$$

- b) Fixed percentage of net profit after charging such commission

Commission is calculated as follows

Net profit x rate of commission

100+ rate of commission

Illustration 1:

Mr. A, who is a sole trader .following is the trial balance as on 31-dec 2011

Cash at bank	61,590	sales	9,36,200
Cash in hand	11,800	12% bank loan	80,000
Drawings	20,000	capital	1,60,000
Bill receivable	39,600	bills payable	5200
Salary	44,000	discount received	2400
		Sundry creditors	1,26, 200
Investment		Income from investment	1980
(Market value Rs 28000)	24,000	Purchase return	7,400
Stock on 1-1-2011	1,27,360		
Land and building	80,000		
Travelling expenses	13,800		
Motor van	32,000		
Furniture	16,000		
Telegram	1,600		
Sundry debtors	1,28,000		
Discount allowed	3,600		
Sundry expense	37,240		
Stationary	3,200		
Bank loan interest	6,000		
Establishment	9,190		
Advertisement	2,000		
Sales return	5,000		
Purchase	6,53,400		
	-----		-----
	<u>13,19,380</u>		<u>13,19,380</u>

Additional information

1. Closing stock is valued at 2,40,000
2. Maintain a reserve of 10% of debtors as reserve for debtors
3. Provide a reserve of 5% on sundry debtors as reserve for discount and 5% on sundry creditors
4. Stock worth Rs 20,000 destroyed by fire on 25-11-2011 in respect of which the insurance company admitted the claim only Rs 15,000
5. The manager of the business is entitled to get a commission of 10% of net profit after calculating such commission
6. Charge depreciation 2.5% on land and building, 10% on furniture, 20% on motor van
7. Salary paid in advance 3000.

Prepare a trading and profit and loss account on 31 Dec 2011.and balance sheet on that date.

Trading and profit and loss account for the year ended 31 Dec 2011

particulars	amount	particulars	Amount
Opening stock	1,27,360	Sales	936200
Purchase	653400	Less return	5000
Less return	<u>7400</u>	Loss of stock on fire	20000
Gross profit	4,17,480	Closing stock	240000
	1191200		1191200
Salary	44000	Gross profit b\d	417840
Less prepaid	3000	Income from investment	1980
Establishment expenses	41,000	Discount received	2400
stationary	9190	Reserve or discount on creditors	6310
Telegram	3200		
Travelling expenses	1600		
Sundry expenses	13800		
Loss by fire	37,240		
Interest on bank loan	6000		
Add outstanding	3600		
Advertisement	9600		
Discount	2000		
Provision for doubtful debts	3600		
provision for discount	12,800		
depreciation	5760		
land and building	2000		
furniture	1600		
motor van	6400		
managers commission	2,48,855		
net profit	<u>428530</u>		<u>428530</u>

Working note:

Net profit after charging commission = 2, 73, 740

Commission $2,73,740 \times 10 / 110 = 24,885$

Balance sheet as at 31st December 2011

Liabilities		Assets	
Sundry creditors 1, 26,200		Cash in hand	11,800
Less provision 63,10		Cash at bank	61,590
-----	1,19,890	Bills receivable	39,600
Bills payable	5,200	Sundry debtors 1,28,000	
Interest on bank loan	3,600	Less provision 12,800	
Commission payable	24,885	-----	
Bank loan	80,000		1,15,200
Capital 1,60,000		Less provision	
Add net profit 2,48,855		For discount 5,760	
-----		-----	1,09,440
4,08,855		Closing stock	2,40,000
Less drawings 20,000		Salary prepaid	3,000
-----	3,88,855	Insurance claim	15,000
		Investment	24,000
		Furniture 16,000	
		Less depreciation 1,600	
		-----	14,400
		Motor Van 32,000	
		Less depreciation 6,400	
		-----	25,600
		Land and building 80,000	
		Less depreciation 2,000	
		-----	78,000
	6,22,430		6,22,430

Illustration 2

The following balances are extracted from the books of accounts of Raman on 31-dec 2011

Purchases	40000	sales	70185
Purchases return	1410	stock (1-1-11)	5730
Capital	50500	drawing	8800
Bad debts	700	bad debt reserve (1-1-11)	1620
Carriage inwards	1155	office expenses	670
Postage and stationary	330	bills receivable	620
Discount (Cr)	115	wages	3140
Sales return	2120	rent received	1050
Building	13000	cash in hand	1105
Cash at bank	6200	salary	4500
Office furniture	1800	postage	410
Commission paid	435	sundry creditors	9490
Sundry debtors	31035	sundry expenses	8470
Building (new)	3500	rates and insurance	650

Prepare trading and profit and loss account for the year ended 31-dec 2011 and prepare balance sheet on that date considering the following:

- 1) Insurance unexpired Rs 120
- 2) Provide interest on capital @ 5%
- 3) Rent not received Rs 100
- 4) Depreciate on old building @2.5%,new @ 2% and office furniture @ 5%
- 5) Write off further bad debts Rs 285
- 6) Increase the provision for bad debts @6% on debtors
- 7) Salary outstanding Rs 285
- 8) Stock on 31-12-2009 valued @ Rs 7145

Solution**Trading & profit and loss account of Raman**

For the year ending 31-dec-2011

particulars	amount	particulars	amount
To opening stock	5730	By sales	70185
Purchases	40000	Less returns	<u>2120</u>
Less returns	1410	By closing stock	68065
To wages	3140		7145
To carriage inwards	1155		
To gross profit	26595		
	75210		75210
To salaries	4500 Add		
outstanding	285	By gross profit	26595
-----		By discount	115
To rates and insurance	650	Rent	1050
Less prepaid	<u>120</u>	Add outstanding	100
	530		1150
To office expenses	670		
To printing and stationary	330		
To postage	410		
To sundry expenses	8470		
To depreciation			
Building(old)	325		
New	70		
Office furniture	<u>90</u>		
To provision for bad and doubtful debts:	485		
Bad debts	700		
Additional bad debt	285		
Add new provision	1845		

	2830		
Less existing provision	<u>1620</u>		
	1210		
To commission	435		
To interest on capital	2525		
To net profit transferred to balance sheet	8010		
	27860		27 860

Balance sheet
As on 31- dec-2011

Sundry creditors		9490	Cash in hand	1105
Capital	50500		Cash at bank	6200
Add net profit	8010		Bills receivable	620
	<u>58510</u>		Sundry debtors	31035
Add interest on capital	<u>2525</u>		Less bad debts	<u>285</u>
	61035			30750
Less drawings	8800	52235	Less new provision	1845
Outstanding salary		285	Closing stock	<u>7145</u>
			Office furniture	1800
			Less depreciation	<u>90</u>
				1710
			Interest accrued	100
			Unexpired insurance	120
			Buildings:	
			Old	130000
			New	<u>3500</u>
				16500
			Less total depreciation	<u>395</u>
				16105
		62010		62010

Illustration 3

From the following trial balance of Mr. Arthur on 31 Dec 1987, prepare trading and profit and loss account for the year ending 31st December 1987, and a balance sheet on that date:

Arthurs drawings	10550	Arthurs capital	119400
Bills receivable	9500	loan @ 6% p.a	20000
Plant and machinery	28800	commission received	5640
Sundry debtors (including Madan for Dishonored cheque Rs 1000)	62000	sales	356430
Wages (manufacturing)	40970	Sundry creditors	59630
Return inwards	2780		
Purchases	256590		
Rent and taxes	5620		
Stock on 1 st Jan 1 1987	89680		
Salaries	11000		
Travelling expenses	1880		
Insurance	400		
Cash	530		
Bank	18970		
Repairs and renewals	3370		
Interest on loan	1000		
Interest and discount	4870		
Bad debts	3520		
Fixtures and fittings	8970		
	-----		-----
	561100		561100
	=====		=====

The following adjustments are to be made:

- Stock in trade in hands on 31 Dec 1987 Rs 128960
- Write off half of Madans cheque
- Create a provision of 5% on debtors.
- Manufacturing wages include Rs 1200 for erection of new machinery

- e) Depreciate plant and machinery by 5% and furniture and fixtures by 10% p.a
 f) Commission not earned but received amounts to Rs 600

Trading and profit and loss account for 31st Dec 1987

	Rs		Rs
To stock	89680	By sales	355430
To purchases	256590	Less returns	2780
To wages	40970		-----
Less plant and machine	1200	By stock	128960

Gross profit	96570		
	<u>482610</u>		<u>482610</u>
	5620	Gross profit	96570
Rent and taxes	11000	Commission	5640
Salaries	1880	Less not earned	600
	1880		-----
Travelling expenses	400		
Insurance	3370		
Repairs			5040
Interest on loan	1000		
Add outstanding	200		

Interest and discount	1200		
Bad debts	4870		
Bad debts	3620		
Add dishonored cheque			
Of Madan	500		
Provision for bad debt	4120		
(5% on 61000)	3050		
Depreciation			
Plant	1500		
Fixtures	897		
	2397		

Net profit transferred	63703		
To capital account	63703		
	<u>101610</u>		<u>101610</u>

Balance sheet of Mr. Arthur

	Rs		Rs
Arthurs capital:		Plant	30000
Balance	119400	Less depreciation	1500
Add profit	63703		-----
	-----	Fixtures and fittings	8970
Less drawings	10550	Less depreciation	897
	-----		-----
	172553	Closing stock	128960
Loan	20000	Bills receivable	9500
Creditors	59630	Debtors	62,000
Outstanding creditors:		Lee Dishonor (50%)	500
For interest on loan	200	Less provision	3050
For commission received			-----
in advance	600		18970
	800	Bank	530
		Cash	

	252983		252983

Illustration 4

The following is the trial balance of Mr. Ramlal as at 31st Dec 2011

	Dr	Cr
Ramlals capital	----	86690
Stock as on 1 st Jan 2011	46800	----
Sales	-----	389600
Return inwards	8600	----
Purchases	321700	----
Return outwards	----	5800
Freight and carriage	18600	----
Rent and taxes	5700	----
Salary and wages	9300	----
Sundry debtors	24000	----
Sundry creditors	----	14800
Bank loan @ 6% p.a	----	20000
Bank interest	9000	----
Printing and advertisement	14600	----
Misc income	-----	250

Cash at bank	8000	----
Discount earned	-----	4190
Furniture and fittings	5000	----
Discount allowed	1800	----
General expenses	11450	----
Insurance	1300	----
Postage and telegram	2330	----
Cash in hand	380	----
Travelling expenses	870	----
Drawings	40000	----
	-----	-----
	521330	521330
	=====	=====

The following adjustment should also be made:

- a) Included amongst the debtors is Rs 3000 due from Abraham and included amongst creditors Rs 1000 due to him
- b) Provision for bad and doubtful debts be created at 5% and reserve for discount 2% on sundry debtors
- c) Depreciation on furniture and fittings at 10% shall be written off
- d) Personal purchases amounting to Rs 600 has been included in the purchase day book
- e) Interest on bank loan shall be provided for the whole year
- f) A quarter of the amount of printing and advertising is to be carried forward to the next year.
- g) Credit purchase invoice amounting to Rs 400 had been omitted from the books
- h) Stock on 31-12-2011 was Rs 78600

Prepare trading and profit and loss account for the year ended 31-12-1987 and balance sheet as on 31 Dec 2011

Solution**Trading and profit and loss account of Sri Ramlal.**

	Rs		Rs
Opening stock	46800	By sales	389600
Purchases	321700	Less returns	8600
Add omitted invoice	400		-----
	-----	By closing stock	78600
	322100		
Less returns	5800		

	316300		
Less drawings	600		

	315700		
To freight and carriage	18600		
Gross profit c/d	78500		
	<u>459600</u>		<u>459600</u>
Rent and taxes	5700	Gross profit b/d	78500
Salary and wages	9300	Misc income	250
Bank interest	900	Discount	4190
Add due	300		

	1200		
Printing and advertising	14600		
Less prepaid	36500		

	10950		
Discount allowed	1800		
General expenses	11450		
Insurance	1300		
Postage and telegram	2330		
Travelling expenses	870		
Provision for bad debts	1150		
Reserve for discount on debtors	437		
Depreciation on furniture	500		
Net profit	35953		
	<u>82940</u>		<u>82940</u>

Balance sheet as on 31 Dec 2011

	Rs		Rs
Capital	86690	Furniture and fittings	5000
Add net profit	35953	Less depreciation	500
	-----		-----
	122643		4500
Less drawings:		Sundry debtors	24000
Cash	40000	Less amount due from A	1000
Goods	600	Less reserve for bad debtors	1150
	-----		-----
	82043		21850
	40600	Less reserve for discount	437
Sundry creditors	14800		-----
Less amount due to A	600		21413
	-----	Stock	78600
	14200	Printing and stationary	3650
Bank loan	20000	Cash in hand	380
Bank interest due	300	Cash at bank	8000

	116543		116543
	=====		=====

ACCOUNTS FOR NON PROFIT CONCERN

Nonprofit organization or non trading organization are those organizations which are established not for earning profits but for promoting art, culture, sports, education etc. Medical institution, Charitable trusts, welfare societies, educational institutions etc are examples of non trading organizations

The final accounts of non trading organizations include the following:

- 1) Receipts and payment account
- 2) Income and expenditure account
- 3) Balance sheet

1) Receipts and payment account

Receipts and payment account is a summary of all cash transactions for a particular period. It is prepared from the cashbook at the end of the year. It contains of all cash receipts and payments. It does not include outstanding items. The features of receipts and payment accounts are follows

- 1) It is a real account
- 2) It is a classified summary of cashbook
- 3) It starts with opening cash and bank balance and ends with the closing cash and bank balances
- 4) All receipts and payment s are included in this items
- 5) The receipts are entered on the debit side and payments are entered on the credit side
- 6) It does not show the profits or losses during the period

2) Income and expenditure account

It is a revenue account prepared by a nonprofit organization to ascertain surplus or deficit for a particular period. It is a nominal account. In this account only revenue receipts and revenue expenses are recorded. All revenue expenses of the current year are recorded on the debit side and revenue incomes of the current year are recorded on the credit side, the difference between incomes and expenditure represents surplus or deficit.

3) Balance sheet

A balance sheet contains of assets and liabilities. Assets or capital expenditure, outstanding incomes prepaid expenses etc are shown on the asset side. Capital receipts or liabilities, capital fund, outstanding expenses, incomes received in advance are shown on the liability side of the balance sheet, generally surplus is shown by adding it to the capital fund.

Difference between receipts and payment account and income and expenditure account

- 1) The receipts and payment account is only classified summary of the cashbook. It is in the nature of real account. On the other hand income and expenditure account is equal to the profit and loss account of trading concerns and in the nature of nominal accounts.
- 2) The receipts and payment account is generally begins with the opening cash balance. But the income and expenditure account does not begins with any such balances

- 3) Receipts and payment account contains both capital and revenue items but income and expenditure contains revenue items only
- 4) Receipts and payment account may contain income and expenditure not only current period but also of the previous period .but income and expenditure accounts deals with current period items
- 5) In the receipts and payment account, receipts are shown on the debit side and payment are shown on the credit side in the income and expenditure account, income are shown on the credit side and expenses are shown on the debit side
- 6) Receipts and payment account is prepared on cash basis but income and expenditure account is prepared on accrual basis

Treatment of some items

1) Subscription

It is a recurring income for nonprofit organizations. This is one of the main sources of revenue. This is shown on the credit side of income and expenditure account. Adjustment should be made to show the correct income for the period.

Subscription received for certain specific purpose like subscription for tournament fund, subscription for construction of pavilion etc should be capitalized (that is shown on the liability side of the balance sheet)

2) Donations

The amount received from a person, firm or company by way of gift is called a donation. Donations may be specific donation or general donations.

Specific donations: if the donations are for a specific purpose, example donation for building, donation for library, donation for furniture etc it must be treated as capital receipts and should be shown on the liability side of the balance sheet. The expenditure incurred on this account should be deducted and the balance should be shown until it is completely used up.

- a) **General donations:** when the donations are given for a general purpose, it is the amount which will determine whether it is a capital or revenue receipts. Donation of a comparatively small amount must be treated as income. But if the amount of such donation is big , it must be treated as capital receipts and it should be shown on the liability side of the balance sheet.

3) Grants

Grant received from central, state or local bodies for routine expenses are treated as income. Grant for specific purpose such as constructions of buildings, purchase of x-ray equipments etc is capitalized

4) Legacy

It is the amount received by the nonprofit organizations as per the will of a deceased person. It is a capital receipt and is shown on the liability side of the balance sheet, but if the amount is small it may be treated as income and may be shown on the credit side income and expenditure account

In the absence of any specific information legacy must be preferably be capitalized.

5) Endowment fund

The fund meant for permanent means of support is known as endowment fund. It is a capital receipt

6) Entrance fees

This is the amount of fee collected on the admission of members. Accountants differ on the treatment of entrance fees. Many feel that since the amount is collected only once and as it is of non recurring in nature it should be capitalized and taken to the liability side of the balance sheet but others argue that though it is paid by each member only once, the clerk or institution receives fairly regularly every year because of regular entrance of members. So it should be shown as an income in the credit side of income and expenditure account. In the absence of specific instruction in the question, students may treat it any way but they must append a note justifying the choice made

7) Sale of old assets

The amount realized from the sales of old assets should be treated as capital receipts and should be credited to asset account. But loss or profit on its sales should be treated as revenue and is taken to income and expenditure account

8) Sale of newspapers and periodicals etc

The amount received on selling newspapers, periodicals, etc should be treated as income and is credited to income and expenditure account

9) Expenditure stock items

Items like stationery sports ,materials like bats balls etc are called expenditure stock items .the value of that type of items which remains unused should be deducted from the total amount spent so that only the amount actually used up is debited to income and expenditure account . Treatment is as follows:

Stock of stationery (opening)	xx	
Add purchase during the year	xx	

	xxx	
Less stock of stationery (closing)	xx	balance sheet (asset side}

Stationery item used during the year	xxx	(debited in the I and E account)

10) Sale of scraps, grass etc

These are treated as revenue receipts and shown on the income side

11) Life membership fee

Life membership may, sometime, be granted to members on their making a lump sum payment in lieu of annual subscription. As the service has to be rendered for a long time without further payment, it must be treated as capital receipts and should be capitalized.

12) Payment of honorarium

Amount paid to a person for the specific service rendered by him is called honorarium. For example payment made to singers ,dancers etc is shown on the expenditure side

13) Special purpose fund

If there is any special purpose fund example tournament fund, charity fund, prize fund, endowment fund etc. and there are certain items of expenses and incomes relating to that fund. Then income and expenses should not be shown in the income and expenditure account but income should be added to the fund and expenses deducted from such fund on the liability side of the balance sheet

Illustration 1

Following is the receipts and payments accounts of majestic club. Calicut for the year ending 31st December, 2003

Receipts	Amount	Payments	Amount
Balance b/d	2100	Rent	9500
Subscriptions	56800	Salaries	25000
Interest	400	Sundry expenses	3500
Donation(general purpose)	6000	Investment purchased	25000
Donation for building fund	55000	Newspapers	800
Misc receipts	620	Sports equipment(30-06-2003)	30000
Sale of grass	200	Balance c/d	27320
	121120		121120

Subscription outstanding at the end of the year 2002 were Rs 4500 and at the end of the year 2003 were Rs 6500.salary outstanding at the end of 2002 and at the end of 2003 were Rs 2500 and 3000 respectively

On 31st December 2002 the club had investments worth Rs 15000, furniture Rs 12000 and sports equipment valued at Rs 40000

Prepare income and expenditure account for the year ended 31 Dec 2003 and a balance sheet as on that date after depreciating furniture by 10% and sports equipment by 20%

Solution**Balance sheet as on 31st Dec 2002**

Salary outstanding	Rs 2500	Cash in hand	Rs 2100
		Subscriptions outstanding	4500
Capital fund (balancing figure)	71100	Investment	15000
		Furniture	12000
		Sports equipment	40000
	<u>73600</u>		<u>73600</u>

Income and expenditure account for the year ended 31st December 2003

Expenditure		Amount	Income		Amount
Rent		9500	Subscriptions:		
Salaries	25000		Received	56800	
Add outstanding	3000		Add outstanding 2003	6500	
	-----			-----	
	28000			63300	
Less outstanding 2002	2500	25500	Less outstanding 2002	4500	
Sundry expenses		3500		-----	58800
Newspaper		800	Interest		400
Depreciation:			Donation		6000
Furniture	1200		Misc receipts		620
Sports equipment	11000	12200	Sale of grass		200

Excess of income over expenditure		14520			
		<u>66020</u>			<u>66020</u>

Balance sheet as on 31st Dec 2003

Liabilities	Rs	Assets	Rs
Salary outstanding	3000	Cash in hand	27320
Donation for building fund	55000	Subscription outstanding	6500
Capital fund	71100	Investments	15000
Add surplus	14520	Add addition	25000
	-----		-----
		furniture	12000
		less depreciation	1200

		Sports equipment	40000
		Add addition	30000

			70000
		Less depreciation	11000
	<u>143620</u>		59000
			<u>143620</u>

Illustration 2

From the following receipts and payment account of an institution and further information supplied prepare an income and expenditure account for the year ended 31st December 2003 and a balance sheet as on that date

Receipts and payment account

Receipts	Rs	Payment	Rs
Balance 1-1-2003	10000	Expenses	
Subscription :		2002	1200
2002	200	2003	2000
2003	2100		-----
2004	150	Cost of lease on land	4000
	-----	Interest paid	400
	2450	Refreshment	2000
Entrance fees	800	balance as on 31-12-2003	8350
Locker rent	700		
Income from refreshments	4000		
	<u>17950</u>		<u>17950</u>

Balance sheet as on 31st December 2002

Liability	Rs	Assets	Rs
Fund	32000	Building	30000
Subscriptions received		Outstanding debtors	
Advance	600	For subscriptions	380
Outstanding expenses	1400	For locker rent	240
Loan	5000	Cash in hand	10000
Income and expenditure account	1620		
	<u>40620</u>		<u>40620</u>

Adjustments

- 1) Expenses due but not paid
- 2) Subscription due but not received Rs 800
- 3) Salary due but not paid Rs 200
- 4) Depreciation on building Rs 2000
- 5) The entrance fees is to be capitalized

Solution

Income and expenditure account
For the year ended 31st December 2003

Expenditure	Rs	Income	Rs
Expenses(2003)	2000	Subscription(2003)	2100
Add outstanding	500	Add subscription received	
	-----	In 2002 for 2003	600
Interest paid	400	Add outstanding (2003)	
Salary outstanding	200		
Refreshment expenses	2000		800
Depreciation on building	2000		----
Excess of income over expenditure		Locker rent	700
(surplus)	860	Less outstanding for 2002	240

		Income from refreshments	4000

	7960		7960

Balance sheet

As on 31st December 2003

Liabilities	Rs	Assets	Rs
Capital fund	32000	Building	30000
Add entrance fees	800	Less depreciation	2000
	-----		-----
	32800		28000
Subscription received		Leasehold land	4000
In advance	150	Outstanding debtors	
Outstanding expenses		For subscription:	
For 2002	200	For the year 2002:	180
For 2003	500	For the year 2003	800
	-----		-----
	700	Cash in hand	8350
Outstanding salary	200		
Loan	5000		
Income and expenditure			
Account			
Balance	1620		
add surplus(2003)	860		

	2480		
	41330		41330

Illustration 3

Given below are the balance sheet as on 1st January 2011 and receipt and payment accounts for the year ending 31-Dec 2011 of a club. You are required to prepare income and expenditure account for the year ended 31 Dec 2011 and the balance sheet on that date.

Balance sheet as at 1st Jan 2011

	Rs		Rs
Subscriptions received in advance	350	Cash in hand	1500
Sports material bill outstanding	1200	Sports material	3000
Creditors	500	Stationery stock	200
Tournament fund	700	Salary paid in advance	800
Capital fund	26500	Subscription due	700
		Fixed deposit(tournament fund)@ 5%	700
		Furniture	2450
		Building	20000
	<u>29350</u>		<u>29350</u>

Receipts and payment account for the year ended 31st Dec 2011

	Rs		Rs
Balance	1500	Salaries to staff	8540
Subscription		Honorarium	560
2010-----200		Electricity and power and	5650
2011-----7300		Water charges	2220
2012-----500	8000	Printing and stationery	520
Entrance fees	400	Entertainment	5080
Sale of sports material	150	Rent,rates,tax	400
Donation for building	10000	Sundry creditors for 2010	1070
Subscription for tournament	2500	Sports material	400
Receipts from		Extension of building	6700
Billiard room	3400	Tournament expenses	2300
Card room	2000	Balance	3860
Tennis court	5450		
Swimming pool	15000		

Notes:

Half of the entrance fees shall be capitalized

- 1) Interest on fixed deposit is available on 31st Dec each year
- 2) Subscription in arrears on Dec 31,2001.Rs.150
- 3) Stock of stationary on 31st Dec. Rs100

Solution**Income and Expenditure account**

Expenditure		Rs	Income		Rs
Salaries	8540		Subscription	7300	
Add advance paid in 2000	800		Add received in last year	350	
	-----	9340	Add outstanding this year	150	
Honorarium		560		-----	7800
Electricity		5650	Entrance fees		200
Water charges		2220	Sale of sports material		150
Printing stationary	520		Billiard room fees		3400
Add opening	200		Card room fees		2000
Less closing	100		Tennis court fees		5450
	-----	620	Swimming pool fees		15000
Entertainment		5080			
Rent, rates, taxes		1070			
Sports material	6700				
Less last year	1200				
Add opening	3000				
	-----	8500			
Surplus		960			
		<u>34000</u>			<u>34000</u>

Balance sheet as on 31 Dec 2001

Liabilities		Rs	Assets		Rs
Subscription in advance		500	Cash in hand		3860
Creditors for 2000		100	Fixed deposit		700
Building fund		10000	Interest accrued		35
Tournament fund:			Subscription due:		
Opening balance	700		2000	500	
Add received this year	2500		2001	150	
Add interest on fixed deposit	35			-----	650
	-----		Stock of stationary		100
	3235		Building	20000	
Less expenses	2300		Add extension	11500	
	-----	935		-----	31500
Capital fund			Furniture		2450
Opening balance	26600				
Add entrance fee	200				
Surplus	960				
	-----	27760			
		<u>39295</u>			<u>39295</u>

Illustration 4

Following is the receipt and payment account of Kennedy club for the year ending 31st Dec. 2011

Receipt and payments account

Dr

cr

Receipt	Rs.	Payment	Rs.
Balance b/d	2500	Salaries	800
Subscriptions	5500	Rent	900
donation	650	Postage & telegram	150
		Stationary	90
		investment	4000
		Sundry expenses	350
		Balance c/d:	
		Cash at bank	1650
		Cash in hand	710
	<u>8650</u>		<u>8650</u>

You are required to prepare an income & expenditure account after making following adjustments:

1. Subscriptions outstanding at 31st December, 2011 amounted to Rs. 500. Subscriptions received include Rs. 200 for 2012
2. Salaries unpaid at 1st January, 2011 Rs. 150 and at 31st December, 2011 Rs. 100
3. Rent was prepaid to the extent of Rs. 75 at 31st December, 2011
4. One-half of the donations should be capitalized

Solution**Kennedy club****Income & expenditure account****For the year ended 31st December, 2011**

Dr.

Cr.

expenditure	Rs.	Income	Rs.
Salaries	800	Subscriptions	5500
Less relating to 2010	150	Less relating to 2010	200
	-----		-----
	650		5300
Add: outstanding	100	Add: out standing	500
	-----		-----
	750		5800
Rent	900	Donation (½)	325
Less: prepaid	75		

	825		
Postage & telegram	150		
Stationary	90		
Sundry expense	350		
Excess of income over expenditure (surplus)	3960		
	<u>6125</u>		<u>6125</u>

Illustration 5

From the following particulars, calculate the subscription amount to be credited to the income and expenditure account for the year ending 31st December .2011

	Rs
Subscriptions received in 2011	16500
Subscriptions outstanding on 1 st January, 2011	900
Subscriptions outstanding on 31 st December, 2011	1300
Subscriptions received in advance on 1 st January, 2011	750
Subscriptions received in advance on 31 st December 2011	540

Solution

	Rs.
Subscriptions received in 2011	16500
Add: outstanding on 31 st December, 2011	1300
,, received in advance on 1 st January, 2011 (i.e., received during 2010. For 2011)	750
	18550
Less: outstanding on 1 st January, 2011	900
“ ” : received in advance on 31 st December 2011 (i.e., received in 2010. For 2011)	540
	1440
Amount to be credited to income and expenditure account	17,110

Illustration 6

From the given particulars ascertain the amount to be credited to income and expenditure account for the year ending 31st December, 2011

	Rs.
Subscription received during the year	9350
Subscription outstanding on 1 st Jan. 2011 Rs. 900 Of which Rs. 810 were received in 2011	
Subscription received in advance on 1 st Jan. 2011	350
Subscription received in advance on 31 st Dec. 2011	150
Subscription outstanding on 31 st Dec. 2011	250

Solution

Subscription received during 2011	9350
Add: outstanding Subscriptions for the current year (2011)	250

“ ”: Subscription received in advance as at the beginning Of the year (i.e., received in 2010, for 2011)	350	-----
		9950
Less: Subscription received in advance as at the end of the Year (i.e., received in 2010, for 2011)	150	
Less: Subscription outstanding for 2010, received in 2011	810	960
	-----	-----
Amount to be credited to income and expenditure account		8990
		=====

Illustration 7

From the following particulars, arrive at the amount of salaries to be debited to the income and expenditure account for the year ending 31st march, 2011

	Rs.
Salary paid during the year	1800
Salary unpaid on 31 st march 2011	550
Salary unpaid on 1 st April 2010	740
Salary prepaid on 1 st April 2010	430
Salary prepaid on 31 st march 2011	570

Solution

Salary paid during the year	1800
Add: Salary unpaid on 31 st march 2011	550
,, ,, : Salary prepaid on 1 st April 2010	430

	2780
Less: Salary prepaid on 31 st march 2011	570
“ ”: Salary unpaid on 1 st April 2010	740

	1310

Salary to be debited to income & expenditure account	1470
	=====

ACCOUNTING FROM INCOMPLETE RECORDS-SINGLE ENTRY SYSTEM

Single entry system is a system of accounting, which does not follow the double entry system. Under this system, accounts relating to debtors and creditors are maintained. Kohler defines single entry system as “a system of book keeping which as a rule only records of cash and personal accounts are maintained, it is always incomplete double entry varying with circumstances”

Features of single entry system

- 1) Maintenance of personal accounts
- 2) Maintenance of cashbook
- 3) Dependence on original vouchers
- 4) It does not follow strict double entry system
- 5) No uniformity. The system may differ from firm to firm.
- 6) Suitability. The system suitable in case of small firms, partnership firm etc

Merits

- 1) It is simple method of accounting
- 2) It is economically
- 3) It is suitable for small enterprises
- 4) It is possible to record transactions quickly

Demerits

- 1) Arithmetical accuracy cannot be checked
- 2) Nominal accounts are not maintained
- 3) It does not record of all assets and liability
- 4) Financial position of business cannot be judged
- 5) True profit cannot be ascertained
- 6) It is not suitable to limited companies
- 7) It is not acceptable to income tax authorities

Computation of profit

The profit or loss in case of a business maintaining accounts according to single entry system can be computed by two methods namely, statement of affairs method and conversion method.

Statement of affairs method or net worth method

According to this method, the profit or loss made by the business is computed by comparing the capital of the business on two different dates. The following procedure is followed

- 1) A statement of affairs at the beginning of the year is prepared to ascertain capital at the beginning.
- 2) Closing statement of affairs is prepared to ascertain capital at the end
- 3) Profit is ascertained by

Capital at the end	xxx
Add: drawings	xx

	xxxx
Less further capital introduced	xx

	xxxx
Less capital at the beginning	xxx

Profit made during the year	xx
	=====

Illustration 1

A keeps his books by single entry system. His position on 1st Jan 2011 was as follows

Cash at bank-Rs 5000	Machinery and plant –Rs 6500
Cash in hand-Rs 1000	Bills receivable-Rs 2600
Stock-Rs 7000	creditors Rs 2500
Sundry debtors-Rs 8400	Bills payable –Rs 4000

On 31st Dec 2011 his position was as under

Cash at bank-Rs 4300	Machinery and plant –Rs 6500
Cash in hand-Rs 1700	Bills receivable-Rs 3200
Stock-Rs 9000	Creditors-Rs 1600
Sundry debtors-Rs 6000	Bills payable –Rs 3200

During the year a introduced further capital of Rs 2000, and his drawings were Rs. 800 per month

Depreciate machinery and plant by 5% and create a reserve for bad and doubtful debts at 5%.from the above information prepare a statement showing the profit and loss made by him for the year ended 31st Dec 2011

Solution

Statement of affairs as on 1st Jan 2011

Liabilities	Rs	Assets	Rs
Creditors	2500	Bank	5000
Bills payable	4000	Cash in hand	1000
Capital(balance)	24000	Stock	7000
		Debtors	8400
		Machinery	6500
		Bills receivable	2600
	30500		30500

Statement of affairs as on 31 dec 2011

Liabilities	Rs	Assets	Rs
Creditors	1600	Bank	4300
Bills payable	3200	Cash in hand	1700
Capital(balance)	25275	Stock	9000
		Debtors (6000-5%)	5700
		Machinery (6500-5%)	6175
		Bills receivable	3200
	<hr/>		<hr/>
	30075		30075

Statement of profit for the year ended 31st Dec 2011

Capital as on 31 st Dec 2011	25275
Add: drawings (800 x12)	9600
	<hr/>
	34875
Less: further capital introduced	2000
	<hr/>
	32875
Less capital as on 1-1-2011	24000
	<hr/>
Profit made during 2011	887

Illustration 2

Sri C Sharma commenced business on 1-jan-2003 with a capital of Rs 25000: Rs 20000 brought in cash and the balance in the form of machinery. On 1st October 2003 he introduced Rs 10000 in the business for which Rs 6000 were borrowed from his wife during the year. He withdraw at the rate of Rs 500 a month his position on 31st Dec 2003 was as follows

ASSETS

Stock of goods Rs 12500: sundry debtors Rs 10500: machinery Rs 6000: cash at bank Rs 3000: cash in hand Rs 500: bills receivable: Rs 3800 and furniture Rs 10000

LIABILITIES

Sundry creditors Rs 8500: loan from wife Rs 6000: bills payable Rs 1500

Ascertain his profit for the year ended 31 Dec 2003

Solution**STATEMENT OF AFFAIRS****As at 31-12-2003**

liabilities	Rs	asset	Rs
Sundry creditors	8500	Stock	12500
Loan from wife	6000	Sundry debtors	10500
Bills payable	1500	Machinery	6000
Capital(balancing figure)	30300	Cash at bank	3000
		Cash in hand	500
		Bills receivable	3800
		Furniture	10000
	<u>46300</u>		<u>46300</u>

Statement of profit or loss for the year ended 31-12-2003

Capital at the end (31-12-2003)	Rs
Add drawings during the year	30300
	<u>6000</u>
	36300
Less additional capital introduced	<u>4000</u>
Less capital at the beginning(1-1-2003)	32300
Profit earned during the year(2003)	<u>25000</u>
	7000

Illustration 3

Sri Shankar keeps his books on single entry and following info is disclosed from his records

	31-12-2002(Rs)	31-12-2003(Rs)
Balance at bank	(Cr)2500	5500
Sundry debtors	14000	21000
Furniture	29000	27500
Stock in trade	15000	20000
Investments	6000	6000
Cash in hand	200	500
Sundry creditors	25000	29000
Bills payable	1000	600
Loan from tea pankaj	4000

Sri V Shankar transferred Rs 300 per month from the business to his private bank account by way of drawings. In addition, he withdraws Rs 6000 for his daughter's marriage and Rs 500 for charitable purpose. He also withdraws goods worth Rs 2500 for domestic purpose.

In august 2003 he had received a lottery price of Rs 6000 of which he invested Rs 3000 in to the business. He sold some private property for Rs 8000 and processed were utilized for the business

He wants his furniture to be depreciated at 10% per annum and a reserve for doubtful debts be created at 6%.he had not paid 2 months' salary to his accountant at the rate of 400 per month and 2 months' rent of the shop was unpaid amounting to Rs 500.interest earned but not received by him was Rs 2100.prepare a statement of profit and loss for the year ending 31-12-2003.

Solution

To calculate the opening capital, the statement of affairs as at 31-dec-2002 is prepared thus:

Statement of affairs as at 31-12-2002

Liabilities	Rs	Assets	Rs
Bank overdraft	2500	Sundry debtors	14000
Sundry creditors	25000	Furniture	29000
Bills payable	1000	Stock in trade	15000
Capital (bal.fig)	35700	Investment	6000
		Cash in hand	200
	<hr/> 64200		<hr/> 64200

Similarly, a statement of affairs at Dec 31, 2003 will show the closing capital, thus:

Statement of affairs as at 31-12-2003

Liabilities	Rs	Assets	Rs
Sundry creditors	29000	Cash at bank	5500
Bill payable	600	Sundry debtors	21000
Loan from T. Pankaj	4000	Furniture	27500
Capital (bal. fig)	46900	Stock in trade	20000
		Investment	6000
		Cash in hand	500
	<u>80500</u>		<u>80500</u>

Then arrive at the Profit or loss made by him during the year, a statement of profit or loss is prepared, thus:

	Rs	Rs
Capital at the end (31-12-2003)		46900
Add drawing during the period		<u>12600</u>
		59500
		<u>11000</u>
Less additional capital introduced		
		48500
Less capital at the beginning(31-12-2002)		<u>35700</u>
Profit subject to adjustments		12800
Less depreciation on furniture of 10%	2750	
Reserve for Doubtful debts at 6%	1260	
Out standing salary	800	
Out standing rent	<u>500</u>	
		<u>5310</u>
		7490
Add interest earned but not received		2100
Net profit, transferred to capital		<u><u>9590</u></u>

CONVERSION METHOD

Conversion of single entry in to double entry involves the complete process of journalizing, posting, balancing and preparation of trial balance. Then final accounts are to be prepared .if any information is missing, it should be ascertained by preparing the relevant accounts before preparation of final accounts

Following steps are taken

- 1) Prepare statement of accounts in the beginning so as to ascertain capital in the beginning
- 2) Prepare cashbooks, cashbook reveals missing figure cash or bank balance at the beginning or at the end as the case may be. Sometimes cashbook reveals the amount of sundry expenses or drawings or cash purchases(if credit side is shorter than debit) or cash sales or sundry incomes or capital introduced(if debit side is shorter than credit side)
- 3) Then prepare I(1)total debtors account (2) total creditors account,(3) bills receivable account (4) bills payable account(these accounts help in finding out credit sales, credit purchases, debtors or credit balances
- 4) After preparing these accounts, calculate total sales by adding credit sales and cash sales total purchases by adding cash purchases and credit purchases
- 5) Information relating to nominal accounts can be ascertained from the cashbook. Real accounts and amounts outstanding are given by way of information. These accounts can be completed
- 6) After these it will be possible to prepare final accounts in the usual manner

Specimen

TOTAL DEBTORS ACCOUNT

	Rs		Rs
Opening balance of creditors	Xxx	Cash received from debtors	Xxx
Credit sales	Xxx	Bills receivable received	Xxx
Bills receivable dishonored	Xxx	Discount allowed	Xxx
		Allowances claimed	Xxx
		Return inwards	Xxx
		Bad debts	Xxx
		Transfer to/from creditors	Xxx
		Closing balance of debtors	Xxx
	xxx		Xxx

TOTAL CREDITORS ACCOUNT

	Rs		Rs
Cash paid to creditors	Xxx	Opening balances of creditors	Xxx
Bills payable accepted	Xxx	Credit purchases	Xxx
Discount received	Xxx	Bills payable dishonored	Xxx
Allowances received	Xxx		
Return outwards	Xxx		
Transfer to/ from debtors	Xxx		
Closing balance of creditors	Xxx		
	<u>Xxx</u>		<u>Xxxx</u>
	xxxx		

BILLS RECEIVABLE ACCOUNT

	Rs		Rs
Opening balance	Xxx	Cash	Xxx
Sundry debtors (B/R received)	Xxx	(realization of bill)	
		Sundry debtors (bill returned dishonored)	xxx
	<u>Xxx</u>	Closing balance	Xxx
	xxxx		<u>Xxxx</u>

BILLS PAYABLE ACCOUNTS

	Rs		Rs
Cash paid (on account of bills payable)	Xxx	Opening balance	Xxx
Sundry creditors (B/P dishonored)	Xxx	Sundry creditors (bills accepted)	Xxx
Closing balance	Xxx		
	<u>Xxx</u>		<u>Xxxx</u>
	xxxx		

Illustration 4

Ascertain credit sales and purchases from the following figures

Debtors	Rs	creditors	Rs
Opening balances	10800	opening balances	5900
Cash received	36850	cash paid	24800
Discount allowed	2000	discount received	450
Bad debts written off	450	returns	540
Returns	800	bills payable issued	2860
Bills receivable received	8400	closing balances	6200
Bills receivable dishonored	600		
Closing balance	8700		

Solution**Total debtors account**

	Rs		Rs
Balance b/d	10800	Cash	36850
Bills receivable (dishonored)	600	Discount allowed	2000
Credit sales(balancing figure)	45800	Bad debts	450
		Returns	800
		Bills receivable	8400
		Balance c/d	8700
	<u>57200</u>		<u>57200</u>

Total creditors accounts

	Rs		Rs
Cash	24800	Balance b/d	5900
Discount received	450	Credit purchases	
Returns	540	(balancing figure)	28950
Bills payable	2860		
Balance c/d	6200		
	<u>34850</u>		<u>34850</u>

Illustration 5

From the following particulars extracted from the books of a trader kept under the single entry system you are asked to find out the figure for credit sales and credit purchases by preparing the total debtors account and total creditors account show also the bill receivable account and bills payable account.

Balance, 1st Jan 2011	Rs
Total debtors	18700
Total creditors	8500
Bills receivable	1400
Bills payable	900
Cash received from customers	46500
Cash paid to creditors	24720
Discount allowed to customers	1450
Discount received from suppliers	950
Bad debts written off	850
Returns to suppliers'	435
Returns from customers	945
Cash received against bills receivable	4660
Cash paid against bills payable	2230
Bad debts previously written off, now received	450
Bills receivable dishonored	500
Balance 31 st December, 2011	
Total debtors	17800
Total creditors	9400
Bills receivable	350
Bills payable	1050

Solution**Bills receivable account**

	Rs		Rs
Balance b/d	1400	Cash	4660
Sundry debtors (balancing figure)	4110	Sundry debtors (bills dishonored)	500
	5510	Balance c/d	5510
Balance b/d	350		

Bills payable account

	Rs		Rs
Cash	2230	Balance b/d	900
Balance c/d	1050	Sundry creditors (balancing figure)	2380
	3280	Balance b/d	1050

Total debtors account

	Rs		Rs
Balance b/d	18700	Cash	46500
Bills receivable (dishonored)	500	Discount	1450
Sales-credit (balancing figure)	52455	Bad debts	850
	71655	Returns	945
		Bills receivable	4110
		Balance c/d	17800
			71655

Total creditors account

	Rs		Rs
Cash	24720	Balance b/d	8500
Discount	950	Purchases-credit	29385
Returns	435	(balancing figure)	
Bills payable	2380		
Balance c/d	9400		
	37885		37885
		Balance b/d	940

Illustration 6

From the following data ascertain total sales

	Rs
Balance of debtors on 1-1-2011	24000
Sales returns	10000
Cash received from customers	90000
Discount allowed t them	6000
B/R received	34000
Bad debts	3000
B/R dishonored	7000
Balance of debtors as on 31-12-2011	20000
Cash sales	50000

Total debtors account

	Rs		Rs
Balance b/d	24000	Cash	90000
B/R(dishonored)	7000	Discount	6000
Sales(credit balancing figure)	132000	B/R	34000
		Bad debts	3000
		Sales returns	10000
		Balance c/d	20000
	163000		163000

Total sales=132000+50000=182000

Illustration 7

From the following, ascertain total purchases:

	Rs
Balances of creditors on 1-1-2011	14000
Cash paid to creditors	10000
B/P given	10000
Discount allowed by them	500
Return outward	3000
Creditors as on 31-12-2011	25000
Cash purchases	10000

Solution**Total creditors account**

	Rs		Rs
Cash	10000	Balance b/d	14000
B/P	10000	Purchases(credit balances)	34500
Discount	500		
Returns	3000		
Balance b/d	25000		
	48500		48500

Total purchases= 34500+10000=44500

Illustration 8

A commenced as a business as a cloth merchant on 1-1-2011 with a capital of rs 10000.on the same date he purchased furniture and fitting for cash 3000

From the following particulars obtained from his books kept by single entry, you are required prepare trading and profit and loss account for the year ending 31st December 2011 and a balance sheet on that date:

Sales (inclusive of cash Rs 7000)	17000
Purchases (inclusive of cash Rs 4000)	15000
A's drawings	1200
Salary to staff	2000
Bad debts written off	500
Business expenses	700

A took cloth worth Rs 500 from the shop for private use and paid Rs 200 to his son, but omitted to record these transactions in his books on 31st December 2011.his sundry debtors were Rs 5200.and sundry creditors Rs 3600.stock in hand on 31st Dec 2011 was Rs 6500

A's trading & profit and loss account for the year ending 31st Dec 2011

purchases	15000		Sales	Rs 17000
less drawings	500	14500	Closing stock	6500

Gross profit c/d		9000		
		<u>23500</u>		<u>23500</u>
		2000		9000
Salaries		500	Gross profit b/d	
Bad debts		700		
Business expenses		5800		
Net profit		<u>9000</u>		<u>9000</u>

A's balance sheet as on 31 December 2011

Sundry creditors		Rs 3600	Cash	Rs 2800
Capital	10000		Sundry debtors	5200
Less drawings	1900		Closing stock	6500
	-----		Furniture	3000
	81000			
Add net profit	5800			
	-----	<u>13900</u>		
		17500		<u>17500</u>

Working notes:**Sundry debtors account**

Sales-credit	Rs <u>10000</u>	Cash (balancing figure)	Rs 4300
		Bad debt	500
		Balance c/d	<u>5200</u>
	<u>10000</u>		<u>10000</u>

Sundry creditors account

	Rs		Rs
cash (balancing figure)	7400	Purchases – credit	11000
balance c/d	3600		
	<u>11000</u>		<u>11000</u>

Cash account

	Rs		Rs
Capital	10000	Furniture	3000
Sales	7000	Purchases	4000
Debtors	4300	Drawings(1200+200)	1400
		Salaries	2000
		Business expenses	700
		Creditors	7400
		Balance c/d(balance)	2800
	<u>21300</u>		<u>21300</u>

Illustration 9

Sunil keeps his books on single entry system. From the following information provided by him prepare a trading and profit and loss account for the year ended 31st December 2011 and a balance sheet on that date

Particular	31-12-2010	31-12-2011
Furniture	10000	12000
Stock	6000	3000
Sundry debtors	12000	13000
Prepaid expenses	500
Sundry creditors	5000
Outstanding expenses	1400	2200
cash	2400	800

Receipts and payment account during the year was as follows

Received from debtors	40500
Paid to creditors	19000
Carriage inwards	4500
Drawings	10000
Sundry expenses	12500
Furniture purchased	2000
Other information	

There were considerable amount of cash sales. Credit purchases during the year amounted to Rs 24000. create a provision of 10% on debtors for doubtful debts.

CASH BOOK

Receipts	Rs	Payments	Rs
Balance b/d	2400	Creditors	19000
Debtors	40500	Carriage inwards	4500
Sales(balancing figure)	5900	Drawings	10000
		Sundry expenses	12500
		Furniture	2000
		Balance c/d	800
	<u>48800</u>		<u>48800</u>
Balance b/d	800		

Total debtors account

	Rs		Rs
Balance b/d	12000	Cash	40500
Sales (balancing figure)	41500	Balance b/d	13000
	<u>53500</u>		<u>53500</u>
Balance b/d	13000		

Total creditors account

	Rs		Rs
Cash	19000	Balance b/d	5000
Balance c/d	10000	Purchases	24000
	<u>29000</u>		<u>29000</u>
		Balance b/d	10000

Balance sheet as on 31-12-2010

Liabilities	Rs	Assets	Rs
Outstanding expenses	1400	Cash	2400
Sundry creditors	5000	Debtors	12000
Capital(balancing figure)	24000	Furniture	10000
		Stock	6000
	<u>30400</u>		<u>30400</u>

Trading and profit and loss account*For the year ended 31st December 2011*

	Rs		Rs
Opening stock	6000	Sales:	
		Cash	5900
		Credit	41500
Purchases	24000		-----
Carriage inwards	4500	Closing stock	3000
Gross profit c/d	15900		<u> </u>
	<u>50400</u>	Gross profit b/d	15900
Sundry expenses	12500		
Less prepaid	500		

	12000		
Less outstanding 2010	1400		

	10600		
Add outstanding 2011	2200		

	12800		
Provision for doubtful debts	1300		
Net profit transferred to capital	1800		
	<u>15900</u>		<u>15900</u>

Balance sheet as at 31 December 2011

Liabilities	Rs	Assets	Rs
Sundry creditors	10000	Furniture	12000
Outstanding expenses	2200	Stock	3000
Capital(opening)	24000	Sundry debtors	13000
Add net profit	1800	Less provision for	
	-----	Doubtful debts	1300
	25800		-----
Less drawings	10000	Prepaid expenses	500
	-----	Cash	800
	15800		-----
	28000		28000

Illustration 10

From the following data, ascertain total sales.

Balances of debtors on 1-1-2011	Rs. 24000
Sales return	10000
Cash received from the customers	90000
Discount allowed to them	6000
B/R received	34000
Bad debts	3000
B/R dishonored	7000
Balance of debtors on 31-12-2011	20000
Cash sales	50000

Solution

Total Debtors A/c			
To balance b/d	24000	By cash	90000
„ B/R (dishonored)	7000	„ Discount	6000
„ credit sales (Bal. fig.)	132000	„ B/R	34000
		„ Bad debts	3000
		„ sales returns	10000
		„ balance c/d	20000
	163000		163000

Total sales = 132000+50000 = 182000

Illustration 11

A, B and C were in partnership and towards the end of 2011 most of their records were destroyed by fire. The balance sheet as on 31st Dec. 2010 was as follows

	Rs		Rs
Creditors	5500	Cash	2400
Capital		Debtors	3600
A	4500	Stock	6500
B	3000	Machinery	1440
C	1500	Fixtures & fitting	600
	-----	Advance Payments	35
	9000	Current Account (C)	170
Current Accounts			
A	145		
B	100		

	245		
	14745		14745

The partner's drawings during 2011 have been provided at A Rs.1400; B Rs. 1000 and C Rs.650; on 31st Dec. 2011, the cash was Rs.3200, Debtors Rs.4045 stock Rs. 5900, Advance payment Rs. 25 and creditors Rs.6040. machinery is to be depreciated by 10% per annum and fixtures and fitting at 7.5%, 5% interest is to be allowed on capital. The partners share profits in the proportion of $\frac{1}{2}$, $\frac{1}{3}$ and $\frac{1}{6}$.

You are required to prepare a statement showing the net trading profit for the year 2011 and the division of the same between partners, together with the balance sheet as on 31st Dec.2011

Solution

Statement of affairs of M/s A, B AND C
As on 31st Dec 2011

Liabilities	Rs	Assets	Rs
Creditors	6040	Cash in hand	3200
Capital:		Debtors	4025
A 4500		Advance payment	25
B 3000		Stocks	5900
C 1500		Fixtures and fitting	600
-----	9000	Less: 7.5% dep.	45

			555
		Machinery	1440
		Less: depreciation	144

			1296
		Combined current account of A B & C	39
	<hr/>		<hr/>
	15040		15040

Statement of profit and loss of A, B and C

For the year ended 31st Dec 2011

	Rs	Rs
Combined current accounts of A , B & C on 31-12-2011(Dr)		-39
Add: Drawing :-		
A	1400	.
B	1000	
C	650	3050
	<hr/>	<hr/>
LESS : combined current accounts of A , B and C on 1-1-2011		3011
A (Cr)	145	
B (Cr)	100	
	<hr/>	
	245	
C (Dr)	170	75
	<hr/>	<hr/>
Profit made during the year before allowing interest on capital		2936
Less: interest on capital (5%)	255	
A (4500 X 5/100)	150	
B (3000 X 5/100)	75	
C (1500 X 5/100)		450
		<hr/>
		2486
		<hr/>
Net profit made during the year		
Share of profit		1243
A's share = $2486 \times \frac{1}{2} =$		828
B's share = $2486 \times \frac{1}{3} =$		415
C's share = $2486 \times \frac{1}{6} =$		

Balance sheet of M/s A, B and C as at 31st Dec. 2011

liabilities	Rs	Assets	Rs
Creditors	6040	Cash	3200
Capital :		Debtors	4025
A	4500	Advance payment	25
B	3000	Stock	5900
C	1500	Fixtures & fitting	600
	-----	Less: depreciation	45
A's Currents A/c			555
as on 1-1-11	145	Machinery	1440
Add: profit	1243	Less: depreciation	144
Add: interest	225		-----
	-----	C's current A/c	
	1613	as on 1-1-11	170
Less drawing	1400	add: drawing	650
	-----		-----
	213		820
B's current A/c :		Less: interest	75
As on 1-1-11	100		-----
Add: profit	150		745
Add: interest	828	Less: profit	415
	-----		-----
	1078		330
Less : drawing	1000		

	78		

	15331		15331
	=====		=====

Illustration 12

Mrs. SAJINA keeps her books of accounts under single entry system. From the following prepare Trading and profit & loss account for the year ended 31-03-2011 together with balance sheet as on that dates

Cash book analysis shows the followings:-

Interest charges	100	balance at bank on 31-03-2011	2425
Personal withdrawals	2000	cash in hand as on 31-03-2011	75
Staff salaries	8500	received from debtors	25000
Other business exp.	7900	cash sales	15000
Payments to creditors	15000		

Further details available are:

	As on 1-4-2010	as on 31-3-2011
Stock in hand	9000	10220
Creditors	8000	5500
Debtors	22000	30000
Furniture	1000	1000
Office premises	15000	15000

Provide 5% interest on X's capital balance as on 1-4-2010. Provide Rs. 1500 for D/D, 5% depreciation on all fixed assets. 5% group commission to staff has to be provided for on N/P after meeting all expenses and the commission.

Solution

Trading and profit and loss a/c for the year ended 31-03-2011

Opening stock	Rs. 9000	Sales	Rs. 48000
Purchase	12500	Closing stock	10220
Gross profit c/d	36720		
	58220		58220
	=====		=====
Interest	100	Gross profit b/d	36720
Salaries	8500		
Expenses	7900		
Provision for doubtful debts	1500		
Interest on capital	1750		
Depreciation:			
Furniture	50		
Office premises	750		
Group commission	770		
Net profit c/d	15400		
	36720		36720

Balance sheet as on March 31 2011

Liabilities		Rs	Assets		Rs
Capital	35000		Premises	15000	
Add: interest	1750		Less: depreciation	750	
Add: net profit	15400			-----	14250
	-----		Furniture	1000	
	52150		Less: depreciation	50	
Less: Drawing	2000	50150		-----	950
	-----		Stock on hand		10220
Creditors		5500	Debtors	30000	
Group commission		770	Less: prov. For D/D	1500	
				-----	28500
			Cash in bank		2425
			Cash in hand		75
		<u>56420</u>			<u>56420</u>

Working note:**(1)****CASH BOOK**

2009		Rs.	2008		Rs.
March 31	To debtors	25000	March 31	By Balance b/d	4000
	Sales	15000		(balance)	
			2009	Interest	100
			March 31	Drawing	2000
				salaries	8500
				expenses	7900
				creditors	15000
				balance c/d:	
				bank	2425
				cash in hand	75
		<u>40000</u>			<u>40000</u>

(2) **Statement of affairs as at April 1.2010**

Liabilities	Rs.	Assets	Rs
Capital (balance)	35000	Stock in hand	9000
Bank overdraft	4000	Debtors	22000
Creditors	8000	Furniture	1000
		Office premises	15000
	<u>47000</u>		<u>47000</u>

(3)

Total Debtors Account

	Rs		Rs
Opening balance	22000	Cash	25000
Credit sales (bal. fig)	<u>33000</u>	Closing balance	<u>30000</u>
	55000		55000

Total sales = cash sales + credit sales
 = Rs.15000+33000=48000

(4)

Total creditors account

Cash	15000	Opening balance	8000
Closing balance	<u>5500</u>	Purchase	<u>12500</u>
	20500		20500

(5)

Gross profit	Rs.36720
Less: all expenses except commission	20550

Net profit before commission	16170
Commission 16170 x 5/105	770

Net profit after commission	15400
	=====

Trial balance

debtors	Rs.	Creditors	Rs.
Opening stock	9000	Creditors	5500
Debtors	30000	Cash sales	15000
Furniture	1000	Credit sales	33000
Premises	15000	capital	35000
Interest charges	100		
Drawing	2000		
Staff salaries	8500		
Business expense	7900		
Purchase	12500		
Cash in hand	75		
Cash at bank	2425		
	<u>88500</u>		<u>88500</u>

Module 3

HIRE PURCHASE AND INSTALLMENT SYSTEM

Hire Purchase system

It is a system of purchase under which the buyers enters into agreement with the seller to pay the price in installments. The buyer gets the possession of goods immediately on paying the down payment but does not get ownership. He becomes the owner only after the last installment is paid. Under this system the buyer fails to pay any installment, the seller has the right to tack back the goods.

Difference between hire purchase and sale

The main difference between hire purchase agreement and sale are given below:

1. Under the sales ownership is transferred at the time of purchase. But under hire purchase ownership is transferred only after payment of the last installment
2. In the case of sale payment of price is generally made in lump sum. In the case of hire purchase payment of price is always made installment
3. In the case of sales buyer can dispose of the goods in any way he likes. But a buyer under hire purchase agreement has no such right before he becomes the owner on payment of the installment.
4. In the case of sale on credit the seller can sue the buyer for the payment of the price outstanding. Bur a seller under hire purchase system can take back the goods in case of default by the buyer in payment of any installment
5. In case of sale, the buyer's position is like that of an owner. But the position of an under hire purchase is like that of a bailee in respect of the goods until he becomes the owner.
6. In case of sale on immediate cash, the price does not include any interest. But under hire purchase the installment includes interest.

Accounting for hire purchase transactions

In the books of hire purchaser

There two methods for making entries of the hire purchase transactions in the books of hire purchaser.

- 1) When asset is recorded at full cash price and
- 2) When asset is recorded at the cash price actually paid

When asset is recorded at full cash price

Under this method the asset is recorded at the full price. Thus this method treats the hire purchaser as owner of the asset.

Accounting entries in the books hire purchaser as follows:

- 1) When the asset is acquired on hire purchase

Asset account	Dr.	
		To hire vendor a/c (cash price)

- 2) When down payment is made
 - Hire vendor a/c Dr.
 - To cash a/c
- 3) When interest becomes due
 - Interest a/c Dr.
 - To hire vendor a/c
- 4) When installment is paid
 - Hire vendor a/c Dr.
 - To cash
- 5) When depreciation is charged on asset
 - Depreciation a/c Dr.
 - To asset
- 6) For closing interest
 - P & L a/c Dr.
 - To interest
- 7) For closing depreciation
 - P & L a/c Dr.
 - To Depreciation a/c

In the books of hire vendor

Accounting entries are as follows:

- 1) When the asset is sold
 - Hire purchase a/c Dr.
 - To hire purchase sales a/c
- 2) When down payment received
 - Cash a/c Dr.
 - To hire purchase a/c
- 3) When interest become due
 - Hire purchase a/c Dr.
 - To interest
- 4) When installment received
 - Cash A/c Dr.
 - To hire purchaser
- 5) For closing interest
 - Interest a/c Dr.
 - To P & L a/c

Illustration 1

On 1st Jan. 2008 A Ltd purchased from B Ltd .five tracks under hire purchase system. Rs 50000 being paid on delivery and the balance in five installments of Rs 75000 each payable annually on 31st Dec. the vendor charges 5% p.a interest on yearly balances. The cash price of five trucks was Rs. 375000

Show how this transaction should be recorded in the books of A Ltd, if A Ltd writes off depreciation at 10% p.a on the written down value.

In the books of A Ltd

Trucks account

2008	To B Ltd	375000	2008	By depreciation	37500
Jan 1			Dec 31	By balance c/d	337500
		<u>375000</u>			<u>375000</u>
	To balance b/d	3 37 500			33750
2009		337500	Dec 31	By depreciation	303750
Jan 1	balance b/d	<u>337500</u>		By balance c/d	<u>337500</u>
2010		303750			30380
Jan 1	balance b/d	<u>303750</u>	Dec 31	By depreciation	<u>273370</u>
		273370		By balance c/d	<u>303750</u>
2011		<u>273370</u>			27340
Jan 1	balance b/d	246030	Dec 31	By depreciation	<u>246030</u>
		<u>246030</u>		By balance c/d	<u>273370</u>
2012		246030			24600
Jan 1	balance b/d	<u>246030</u>	Dec 31	By depreciation	241430
				By balance c/d	
					<u>246030</u>

B Ltd

2008			Jan 1	By trucks	375000
Jan 1	To cash	50000			
Dec 31	To cash	75000	Dec 31	By interest	16250
	To balance b/d	266250			
					<u>391250</u>
		<u>391250</u>			266250
2009	To cash	75000	Jan 1	By balance b/d	13310
Dec 31	To balance c/d	204560	31 st Dec.	By interest	<u>279560</u>
					204560
2010		<u>279560</u>			10230
Dec 31	To cash	75000	Jan 1	By balance b/d	
	To balance c/d	139790	31 st Dec	By interest	
					<u>214790</u>
		<u>214790</u>			139790
2011	To cash	75000	Jan 1	By balance b/d	6990
Dec 31	To balance c/d	71780	31 st Dec	By interest	
					<u>146780</u>
		<u>146780</u>			146780
2012			Jan 1		
Dec 31	To cash	75000	31 st Dec	By balance b/d	71780
				By interest	3220
					<u>75000</u>
		<u>75000</u>			<u>75000</u>

Interest account

2000 Dec31	To B Ltd.	<u>16250</u>	31 st Dec	By P&L a/c	<u>16250</u>
2000 Dec 31	To B Ltd.	<u>13310</u>	31 st Dec	By P&L a/c	<u>13310</u>
2000 Dec 31	To B Ltd.	<u>10230</u>	31 st Dec	By P&L a/c	<u>10230</u>
2000 Dec 31	To B Ltd.	<u>6990</u>	31 st Dec	By P&L a/c	<u>6990</u>
2000 Dec 31	To B Ltd.	<u>3220</u>	31 st Dec	By P&L a/c	<u>3220</u>

CALCULATION OF INTEREST

1. Calculation of interest when cash price and rate of interest and amount of installment are given – total interest is the difference between hire purchase price and cash price. Interest for each year is calculated on the amount of outstanding cash price
2. Calculation of interest when cash price and amount of installment are given. In the case , total interest apportioned to each year on the ratio of installment price outstanding
3. When rate of interest and installment are given but total cash price is not given. In this method, interest is calculated from the last year firstly and then previous year and at last fist year. For this purpose. Rate of interest must be converted on cash to on installment.

Illustration 2

X purchased a radiogram on HP system. He is required to pay Rs 800/- down, Rs. 400/- at the end of first year and Rs. 300/- at the end of second year and Rs.700/- at the end of third year. Interest is charged at 5% p. a. calculate cash price and interest of each installment

year	installment	Interest paid	Cash price
1 st year down payment	800	No interest	800
First year end	400	$400+254+667*5/105=63$	337
Second year	300	$330+667*5/105=46$	254
Third year end	700	$700*5/105=33$	<u>667</u> <u>2058</u>

Default and re possession

When hire purchaser is not able to make the payment in time, then default is committed by him and the owner takes back the possession of goods. There are two possibilities:

- 1) When seller takes back the possession of complete goods
- 2) When seller takes possession of only part of the total assets sold

When seller takes back the possession of complete goods

In the case accounting treatment is as follows:

In the books of purchaser:

- 1) All entries are passed as usual up to the date of default.
- 2) Buyer closes the account of seller by passing the entry:
 Hire vendor account Dr
 To assets account
- 3) Any balance left in asset account is closed by transferring to P & L account.

In the books of seller

- 1) All entries are passed as usual up to the date of default.
- 2) Seller closes the purchaser account by passing:
 Re possessed goods account Dr.
 To hire purchaser
- 3) Re possessed goods account or goods returned account is debited with all expenses incurred and re sale price is credited and if any balance, it is transferred to P & L account.

When seller takes possession of the total assets sold

In the case accounting entries are similar to those of complete repossession. The additional precautions to be taken are:

- 1) Both the buyer and seller do not closes seller's account and buyer's account in their respective books. The entry for repossession is passed with the agreed value of assets taken by the vendor.
- 2) The buyer finds out the value of asset still left with him using the normal rate of depreciation. This account shows the balance of asset, which is left, to him
- 3) After crediting the asset account with the value of asset taken away by the seller and after keeping the balance of asset left, the difference by the asset account is transferred to P&L account

Illustration 3

A Machinery is sold on hire purchase. The terms of payment is four annual installment of Rs.6000 at the end of each year commencing from the date of agreement. Interest is charged @ 20% and is included in the annual payment of Rs. 6000

Show machinery account and hire vendors account in the books of the purchaser who defaulted in the payment of the third yearly payment where upon the vendors re-possessed the machinery. The purchaser provides depreciation on the machinery @ 10% p. a on written down value method. All workings should form part of your answer

Solution**CALCULATION OF CASH PRICE**

No. of installment	Amount due after payment of installment	Amount of installment	Total amount	Interest 20/120	Opening Balance
	Rs.	Rs.	Rs.	Rs.	Rs.
1	-----	6000	6000	1000	5000
2	5000	6000	11000	1833	9167
3	9167	6000	15167	2528	12639
4	12639	6000	18639	3106	15533

Cash price of the machinery is Rs. 15533

MACHINERY ACCOUNT

YEAR		Rs.	YEAR		Rs.
I	To hire vendors	15533	I	By depreciation a/c	1553
		<u>15533</u>		By balance c/d	13980
					<u>15533</u>
II	Balance b/d	13980	II	By depreciation a/c	1398
		<u>13980</u>		By balance c/d	12582
					<u>13980</u>
III	Balance b/d	12582	III	By depreciation a/c	1258
		<u>12582</u>		By hire vendor a/c	11000
				By profit & loss a/c (loss in default	324
					<u>12582</u>

HIRE VENDOR A/C

YEAR		Rs.	YEAR		Rs.
I	To bank a/c	6000	I	By machinery a/c	15533
	To balance c/d	12639		By interest a/c	3106
		<u>18639</u>			<u>18639</u>
II	To bank a/c	6000	II	By balance b/d	12639
	To balance c/d	9167		By interest a/c	2528
		<u>15167</u>			<u>15167</u>
		11000			9167
III	To Machinery a/c		III	By balance b/d	1833
	(transfer)			By interest a/c	
		<u>11000</u>			<u>11000</u>

Illustration 4

P purchased a truck on hire purchase system for Rs. 56000 payment to be made, Rs15000 down and 3 installments of Rs.15000. each at the end of each year. Rate of interest is charged at 5% per annum. The buyer is depreciating the asset at 10% p.a on written down value method.

Because of financial difficulties, P after having paid down payment and first installment at the end of the first year could not pay second installment and sellers took possession of the truck sellers after expanding Rs. 357 on repairs of the asset sold it away for 30110.

Open ledger accounts in the books of both parties to record transactions.

Solution**IN THE BOOKS OF P
TRUCK ACCOUNT**

Year1		Rs.	Year I		Rs.
Jan1	To hire vendor	56000	Dec 31	By depreciation @10%	5600
				By balance c/d	
					50400
		<u>56000</u>			<u>56000</u>
II				By depreciation	
Jan 1	To balance b/d	50400	II	" hire vendor	5040
			Dec 31	" P & L A/c	29453
				(balancing figure)	15907
		<u>50400</u>			<u>50400</u>

HIRE VENDOR

Year I		Rs.	Year I		Rs.
JAN 1	To bank a/c	15000	Jan 1	By truck a/c	56000
Dec 31	To bank a/c	15000		By interest	2050
	" balance c/d	28050			
		<u>58050</u>			<u>58050</u>
II			II		
Dec 31	To truck a/c	29453	Jan 1	By balance b/d	28050
			Dec 31	By interest a/c	1403
		<u>29453</u>			<u>29453</u>

**IN THE BOOKS OF HIRE VENDOR
P's ACCOUNT**

Year I		Rs.	Year I		Rs.
Jan 1	To hire sales a/c	56000	Jan 1	By Bank a/c	15000
Dec 31	To interest a/c	2050	Dec 31	By Bank a/c	15000
		58050	,,	By balance c/d	28050
					58050
II Jan 1	To balance b/d	28050	II		
Dec 31	By interest a/c	1403	Dec 31	By goods repossessed a/c	29453
		29453			29453

GOODS REPOSSESSED A/C

Year II		Rs.	Year II		Rs.
Dec 31	To P	29453	Dec 31	By sales	30110
	To cash (expenses)	357			
,, ,,	P & L a/c	300			
		30110			30110

P & L ACCOUNT

		Goods repossessed A/c	Rs. 300
--	--	-----------------------	------------

Illustration 5

Roman transport co. purchased five trucks from Ramos Auto Ltd., on the January, 2011 on hire purchase system. The cash price of each truck is Rs. 120000. The mode of payments was as follows:

- (i) 15% of cash price down
- (ii) 25% of cash price at the end of each year for 4 year

Roman transport co. writes off 15% depreciation annually on diminishing balance. The payment due to 31st December 2011 could not be made. Ramos Auto Ltd. agree to leave three Trucks with the buyer on the conditions that the value of the other two Trucks would be adjusted against the amount due, the trucks being valued at cost less 25% depreciation on diminishing balance.

Show the necessary accounts in the books of Roman Transport co.

Solution

TN THE BOOKS OF ROMAN TRANSPORT CO.

TRUCK ACCOUNT

2011		Rs.	2011		Rs.
Jan 1	To Ramons Auto Ltd.	600000	Dec 31	By Depreciation A/c	90000
				By balance c/d	510000
		<u>600000</u>			<u>600000</u>
2012					
Jan 1	To balance b/d	510000	2012	By Depreciation A/c	76500
			Dec 31	„ Ramos Auto Ltd	135000
				Profit & loss A/c	
				(loss on default)	
				(bal. fig)	38400
				By balance c/d	260100
		<u>510000</u>			<u>510000</u>
2013					
Jan 1	To Balance b/d	260000			

RAMOS AUTO LTD. ACCOUNT

2011		Rs.	2011		Rs.
Jan 1	To bank (15% of 600000)	90000	Jan 1	By Truck a/c	600000
	To bank a/c		Dec 31	By interest a/c	36000
Dec 31	To balance a/c	150000			
		396000			
		<u>636000</u>			<u>636000</u>
2012	To truck a/c		2012		
Dec 31	To balance c/d	135000	Jan 1	By balance b/d	396000
" "		288000			
		<u>423000</u>		By interest	27000
					<u>423000</u>

Working note:**Calculation of value of 2 Trucks taken up Ramos Auto Ltd.**

	Rs.
Cost of 2 Trucks	240000
Less: depreciation @ 25% for 2011	60000

	180000
Less: depreciation @ 25% for 2012	45000

Value on 31-12-2012	135000

Calculation of value of 3 trucks retained by Roman Transport Co.

Cost of 3 trucks	360000
Less: depreciation @ 15% for 2011	54000

	306000
Less: depreciation @ 15% for 2012	45900

	260100

Illustration 6

P purchased 4 cars of Rs. 14000 each on hire purchase system the hire purchase price for all the 4 cars was Rs. 60000 to be paid Rs. 15000 down and 3 installment of Rs. 15000 each at the end of each year interest is charged @ 5% p.a, buyer depreciates cars @10% p.a on straight line method.

After having paid down payment and first installment, buyer could not pay 2nd installment and seller took possession of three cars at an agreed value to be calculated after depreciating cars at 20% p.a on written down value method one car was left with the buyer

Seller after spending Rs. 1200 on repairs sold away all the three cars to X for Rs. 35000 open ledger accounts in the books of both parties

Solution

Calculation of value of asset taken by the seller			
	Number of cars taken by the seller	= 3	
	Cost price 3 x 14000	= 42000	
Less: depreciation	:		
First year	8400		
Second year	6720		
	-----	15120	

Value of assets taken		26880	
		=====	
Value of car left with buyer			
Number of car	= 1		
Cost price	= 14000		
Less: depreciation:			
First year	1400		
Second year	1400		
	-----	2800	

Value of asset left		11200	
		=====	

In the books of P
Asset account

1 st year		By depreciation	5600
To hire vendor	56000	By balance c/d	50400
	<u>56000</u>		<u>56000</u>
Second year			
To balance b/d	50400	By depreciation	5600
		By hire vendor	26880
		By P&L account	6720
		By balance c/d	11200
	<u>50400</u>		<u>50400</u>

Hire vendor account

First year			
To cash account	15000	By Assets account	56000
To cash	15000	By interest account	2050
To balance c/d	28050		
	<u>58050</u>		<u>58050</u>
To asset	26880	By balance b/d	26880
To balance c/d	2573	By interest	1403
	<u>29453</u>		<u>29453</u>

In the books of seller
P's account

First year		By cash a/c	15000
To sales account	56000	By cash a/c	15000
To interest	2050	By balance c/d	28050
	<u>58050</u>		<u>58050</u>
Second year			
To balance c/d	28050	By repossessed stock	26880
To interest	1403	By balance c/d	2573
	<u>29453</u>		<u>29453</u>

Repossessed stock account

To P's account	26880	By cash	35000
To cash	1200		
To P&L account	6920		
	<u>35000</u>		<u>35000</u>
	<u><u>35000</u></u>		<u><u>35000</u></u>

INSTALMENT SYSTEM

It is a system of a sale in which the price of the article is paid in installments along with interest on unpaid balances. Under this system the buyer gets the possession and ownership of the goods at the time of signing agreements.

Difference between hire purchase and installment system

- 1) Hire purchase is agreements of hiring where as an installment system is an agreement of sale.
- 2) In the case of hire purchase system the ownership in the goods sold passes to the buyer only on payment of the last installment. But in the case of installment system ownership passes to the buyer immediately at the time of sale
- 3) If the buyer fails to pay any installment, the hire vendor can possess the goods. But in installment system, the seller cannot possess the goods
- 4) The buyer can return goods sold to the seller, in the case of hire purchase. But in the installment system, goods once sold cannot be returned
- 5) In the case of hire purchase system, the buyer cannot hire, sell, transfer or pledge the goods until the full amount is paid. In the installment system, the buyer can hire sell, transfer or pledge the goods before the payment of last installment
- 6) The risk of bad debt is relatively less in hire purchase transactions, but the risk of bad debt is relatively more in installment system

Module 4

DEPARTMENTAL ACCOUNTS

Departmental accounts are accounts relating to different department of a business and are used to ascertain the trading results of each department separately. Such accounts disclose not only the profits of each of the department but also the profits of the whole business.

OBJECTIVES OF DEPARTMENTAL ACCOUNTS

The main objectives of departmental accounts are:

- (1) To know the trading result of the various departments.
- (2) To compare the trading result of one department with those of other departments.
- (3) To reward the departmental managers on the basis of the trading results.
- (4) To help the management to formulate the business policies for the various departments.
- (5) To help the business in formulating proper policies relating to the expansion of the business.

Advantages of Department Accounts

The main advantages of Departmental accounting are as follows:

- (1) It provides an idea about the affairs of each department.
- (2) It helps to evaluate the performance of each department.
- (3) It helps to reward the Departmental managers and staff on the basis of performance.
- (4) It facilitates control over the working of each department.
- (5) It helps to compare the result of one department with those of other departments.
- (6) It helps the management to formulate the right business policies for the various departments.
- (7) It will help in the preparation of departmental budgets.
- (8) It helps to calculate stock turnover ratio of each department.

Accounting Procedure

A departmental organization can record its transactions in two ways:

- (1) **Unitary method:** - Under this method, the accounts of each department are kept separately. The results of the various departments are finally combined together in one general P & L account.
- (2) **Tabular or columnar method:-** Under this method, the accounts of each department are kept in columnar form with a separate column for each department and also with a separate column for the total. The tabular method is more popular and is adopted by almost all the departmental undertaking.

Under this method, at the end of the accounting year, Trading and P & L account (columnar) is prepared with separate amount column for each of the department and also for the total. The trading and P & L of a departmental organization kept in the columnar basis is called Departmental Trading and P & L account. In trading account, opening stock, purchases, direct expenses and Gross profit are debited and sales and closing stock credited. Indirect expenses have to be apportioned between the departments and debited to the P&L account.

Allocation of expense:-

Expenses incurred for a particular department should be directly charged to that department. But common expenses should be apportioned to the different department on suitable basis. Following basis for apportionment may be adopted:

- (1) **Expenses on purchase:-** Such as freight, carriage in wards, discount received, import duty, octopi etc should be apportioned in the ratio of net purchases (excluding inter departmental purchases) of each department.
- (2) **Expenses on sales:-** Such as selling commission, bad debts, discount allowed, reserve for bad debts , reserve for discount on debtors, sales tax, carriage outwards, advertisement etc, he subject should be apportioned in the ratio of net sales (excluding interdepartmental sales) of each department.
- (3) **Expenses on building:-** These should be apportioned on the basis of area or floor space occupied by each of the departments.
- (4) **Expenses on machines:-** Such as depreciation, repairs etc should be apportioned on the basis of the value of machines used in each department. In the absence of information, these expenses should be apportioned on the basis space occupied by machines in each department.
- (5) **Lighting and heating-** These expenses should be apportioned on the basis of meter readings of the various departments. In the absence of meter readings, they should be apportioned on the basis of light points of each department. In the absence of light points, these expenses should be apportioned on the basis of the space occupied by each department.
- (6) **Insurance premium:-** It should be apportioned on the basis of the value of the subject matter insured. For example, insurance premium on stocks insured should be apportioned on the basis of stocks held by each department.
- (7) **Labour welfare expenses:** - Such as recreation expenses, canteen expenses etc should be apportioned on the basis of the number of workers working in each department.

- (8) **Workmen's compensation insurance:-** This expenses should be apportioned in the ratio of wages of each department.
- (9) **Other expenses:-** Such as interest on capital, interest on debentures, general manger's salary, audit fee, directors' fee, bank charges, legal charges, sundry office expenses etc can be allocated on any appropriate basis, say, on the basis of sales or cost of sales or quantity of goods sold or equally. Alternatively, these expenses need not be allocated. They can be charged to General Profit and Loss account the following.

Allocation of incomes

Common incomes should be allocated among different departments on the following basis:

- (1) **Discount received and reserve for discount on creditors:-** They should be allocated on the Basis of net purchases of each department.
- (2) **Commission earned on sales:-** It should be allocated on the basis of net sales of each department.
- (3) **Other incomes: -** Such as dividend received, transfer fees etc can be allocated equally. Alternatively, they can be credited to General P & L account.

Inter departmental transfers

Transfer of goods or services by one department to another department are called inter departmental transfers.

When one department transfers goods to another department, the transaction should be considered as a sale for the supplying department and a purchase for the receiving department. As such, the supplying department should be credited and the receiving department should be debited with the value of goods supplied. Similarly, when one department renders service to another department, the department rendering the service should be credited and the department receiving the service should be debited with the value of service rendered.

Goods may be transferred either at cost price or at selling price. If goods are transferred at selling price by the transferor department and such goods are unsold at the end of the accounting year by the transferee department, then profit charged on such unsold goods by the transferor department is treated as unrealized profit and it should be debited to the general profit and loss account as stock reserve. In the balance sheet stock reserve should be deducted from closing stock. If unrealized profit is contained in the opening stock, such reserve should be credited to the general profit and loss account.

Illustration 1

The following trial balance for the year ended 31-mar-1990 was extracted from the books of Sir Bhikam Singh

	Dr (Rs)	Cr(Rs)
Capital on 1-4 1989		50000
Drawings account	10000	
Stock on 1-4-1989:		
Radios	45000	
Watches	21000	
Sales:		294000
Radios		146000
Watches		
Purchases:	225000	
Radios	115000	
Watches	12600	
Salaries	8900	
Publicity expenses	3200	
Rent rates and taxes	10600	
Commission	5000	
Misc expenses	12400	
Furniture and fixtures sundry debtors	16800	
4% Govt of India loan	10000	8800
Sundry creditors		400
Interest		800
Provision for bad and doubtful debts	4500	
Cash balance		
	500000	500000

Prepare the departmental P&L account for the year ended 31-march 1990 after taking in to account the following

- 1) The stock as on 31 march 1990 was radios :Rs 30000,watches:24000
- 2) An amount of Rs 1200 out of sundry debtors has to be written off as bad and doubtful debts has to be increased thereafter to 10% of the debts outstanding.
- 3) The following expenses are outstanding as on 31 march 1990
Publicity: Rs 1300, salaries: Rs 1200, commission: Rs 1700
- 4) Provide 10% depreciation on furniture and fixtures
- 5) Revenue Items to be allocated in the ratio of 2:1 as between radios and watches

Solution**DEPARTMENTAL PROFIT AND LOSS ACCOUNT** For the year ended 31 march 1990

	RADIOS	WATCHES	TOTAL		RADIOS	WATCHES	TOTAL
Opening stock	45000	21000	66000				
Purchases	225000	115000	340000	By sales	394000	146000	404000
Gross profit c/d	54000	34000	88000	Closing stock	30000	24000	54000
	<u>324000</u>	<u>170000</u>	<u>494000</u>		<u>324000</u>	<u>170000</u>	<u>494000</u>
Salaries	9200	4600	13800				
Publicity	6800	3400	10200	Gross profit b/d	54000	34000	88000
Rent rates and taxes	2133	1067	3200	Interest	267	133	400
Commission							
Misc expenses	8200	4100	12300				
Depreciation on furniture	3333	1667	5000				
Bad debts	827	413	1240				
Provision for bad and doubtful debts	800	400	1200				
Net profit	507	253	760				
	22467	18233	40700				
	<u>54267</u>	<u>34133</u>	<u>88400</u>		<u>54267</u>	<u>34133</u>	<u>88400</u>

Illustration 2

M/s Gulati and sons has two departments' cloths and readymade clothes. Readymade clothes are manufactured by the firm itself out of clothes supplied by the cloth dept at its usual selling rate .from the following figures prepare dept trading and P&L account and general P&L account for the year ending 31 Dec 1989.

	Cloth dept (Rs)	Readymade cloth dept(Rs)
Opening stock on 1-1-1989	360000	60000
Purchases	2900000	20000
Sales	3500000	700000
Transfer to readymade cloth dept	450000	-----
Manufacturing expenses	-----	140000
Closing stock on 31-12-1989	100000	48000

General expenses incurred for both the dept were 100000, 120000.the stocks in the readymade cloth depts. May be considered as consisting of $66\frac{2}{3}\%$ cloth and $33\frac{1}{3}\%$ other expenses. The cloth dept earned profit at the rate of 18% in 1988.

Solution

Departmental trading and profit and loss account for the year ending 31-12-1989

	Cloth	Readymade clothes		Cloth	Readymade clothes
Opening stock	36000	60000	Sales	3500000	700000
Purchases	2900000	20000	Transfer to readymade dept	450000	
Transfer from cloth dept		450000	Closing stock	100000	48000
Manufacturing expenses					
Gross profit		140000			
	790000	78000			
	<u>4050000</u>	<u>748000</u>		<u>4050000</u>	<u>748000</u>
			Gross profit b/d		
General expenses(3500000:700000)	100000	20000		790000	78000
Dept profit transferred to general profit and loss account	690000	58000			
	<u>790000</u>	<u>78000</u>		<u>790000</u>	<u>78000</u>

General profit and loss account for the year ending 31-12-1989

	Rs		Rs
Stock reserve(closing)	6400	Profit :	
		cloth dept	690000
Net profit	748800	Readymade dept	58000
		Stock reserve(opening)	7200
	<u>755200</u>		<u>755200</u>

Working note

GP ratio: cloth dept = $790000 / 3950000 \times 100 = 20\%$

Stock reserve closing = $48000 \times \frac{2}{3} \times 20\% = 6400$

Stock reserve opening = $60000 \times \frac{2}{3} \times 18\% = 7200$

Illustration 3

X Ltd has two departments A&B. from the following particulars prepare the consolidated trading account & departmental trading accounts for the year ending 31st December 2009

	A Rs	B Rs
Opening stock (at cost)	20000	12000
Purchase	92000	68000
Sales	140000	112000
Wages	12000	8000
Carriage	2000	2000
Closing Stock:		
(i) purchase goods	4500	6000
ii) Finished Goods	24000	14000
Purchased goods transferred:		
By B to A	10000	
By A to B	8000	
Finished goods transferred:		
By B to A	35000	
By A to B		40000
Return of finished goods:		
By B to A	10000	
By A to B		7000

You are informed that purchased goods have transferred mutually at their respective departmental purchase cost and finished goods at departmental market price and that 25% of the finished stock (Closing) at each department represented finished goods received from the other department.

Solution**Trading account for the year ending December 31 2009**

	A Rs.	B Rs.	Total		A Rs.	B Rs.	Total
To opening stock	20000	12000	32000	By sales	140000	112000	252000
" purchases	92000	68000	160000	" transfer of purchased goods		8000	10000
" carriage	2000	2000	4000	" return of finished goods	7000	10000	
" wages	12000	8000	20000	Transfer of finished goods		40000	35000
" transfer of purchase goods	10000	8000		" closing stock:			
" Transfer of purchase goods	35000	40000		Purchased goods	4500	6000	10500
" return of finished goods				Finished goods	24000	14000	38000
Gross profit	10000	70000		By G/P	223500	187000	300500
" (before adjustment for transfer of stock)	42500	42000	84500		42500	42000	84500
To stock Res.							
Net profit	223500	187000	300500				
	875	1800	2675				
	41625	40200	81825				
	42500	42000	84500				

Working note:

Inter departmental stock: A $24000 \times 25/100 = 6000$

B $14000 \times 25/100 = 3500$

G/P ratio: B $42000 / (112000 + 35000 - 7000) \times 100 = 30\%$

Stock reserve - B = $6000 \times 30/100 = 1800$

G/P ratio A = $42000 / (140000 + 40000 - 10000) \times 100 = 25\%$

Stock reserve A = $3500 \times 25/100 = 875$

Illustration 4

Shari Gangram sells two products manufactured in his own factory. The goods are made in two departments A & B for which separate sets of account are maintained. Some of the manufactured goods of department A are used as a raw material by Department B and vice versa.

From the following particulars, you are required to ascertain the total cost of goods manufactured in department A & B:

	Departt.A	Departt.B
Total Units manufactured	1000000	500000
Total Cost of manufacture	Rs.10000	Rs.5000

Department A transferred 250000 units to department B and the latter transferred 100000 units to the former

Solution

Suppose a is the cost of department A and b the total cost of department B

$$a = \text{Rs } 10000 + \frac{1}{5} b$$

$$b = \text{Rs } 5000 + \frac{1}{4} a$$

$$a = \text{Rs } 10000 + \frac{1}{5}(5000 + \frac{1}{4} a)$$

$$= 10000 + 1000 + \frac{1}{20} a$$

$$a - \frac{1}{20} a = 11000$$

$$19 a = 11000 \times 20$$

$$a = \frac{(11000 \times 20)}{19} = 11579$$

$$b = 5000 + \frac{1}{4} a$$

$$= 5000 + \frac{1}{4} (11579)$$

$$= 5000 + 2895$$

$$= \text{Rs } 7895$$

Total cost of goods manufactured

	Depts. A	Depts.B
Cost as determined	11579	7895
Less: transferred to the department (1/4 & 1/5)	2895	1579
	-----	-----
	8684	6316
	=====	=====

Illustration 5

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

Department A 1000 units

Department B 2000 units at a total cost of Rs 100000

Department C 2400 units

Stocks on 1st January were:

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

The sales were:

Department A 1020 units @ Rs 20 each

Department B 1920 units @ Rs 22.50 each

Department C 2496 units @ Rs 25 each

The rate of gross profit is the same in each case. Prepare departmental trading account

Solution

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

Sales: Deptt. A 1000 units @ Rs 20 each	20000
Deptt. B 2000 units @ Rs 22.50 each	45000
Deptt. C 2400 units @ Rs 25 each	60000

Total sales	125000
Less: cost of purchase	100000

Gross profit	25000

Gross profit as a percentage = $25000/125000 \times 100 = 20\%$

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

	Selling price		gross profit	cost
Deptt. A	Rs 20		Rs. 4	16
Deptt. B	Rs. 22.50		Rs. 4.50	18
Deptt. C	Rs. 25		Rs. 5	20
Units of closing stock	opening stock	+	purchases	- sales
Deptt. A	120	+	1000	- 1020 = 100
Deptt. B	80	+	2000	- 1920 = 160
Deptt. C	152	+	2400	- 2496 = 56

Departmental trading account can now be prepared as follows:

	Deptt A	Deptt B	Deptt C		Deptt A	Deptt B	Deptt C
To opening stock	1920	1440	3040	By sales	20400	43200	62400
To purchase	16000	36000	48000				
To gross profit	4080	8640	12480	By closing stock	1600	2880	1120
	<u>22000</u>	<u>46080</u>	<u>63520</u>		<u>22000</u>	<u>46080</u>	<u>63520</u>

Illustration 6

From the following balances extracted from the books of B.N Pai prepare departmental trading and general P&L account for the year ended 31st October 2011 and balance sheet as on that date after adjusting the unrealized departmental profits if any:

		Dr. Rs	Cr. Rs
1. capital			300000
2. land and building		125000	
3. furniture		25000	
4. opening stock	Dept A	30000	
	Dept B	40000	
5. purchase	Dept A	1000000	
	Dept B	1500000	
6. sales	Dept A		2000000
	Dept B		3200000
7. general expenses		1400000	
8. sundry debtors		200000	
9. sundry creditors		-----	100000
10. drawings		280000	
11. cash & bank		1000000	

Additional information

- 1) Closing stock dept A Rs 130000 including goods from dept B Rs 40000 at cost to dept A
Dept B Rs 260000 including goods from dept A Rs 90000 at cost to Dept B
- 2) Sales of dept A includes transfer of goods to Dept B of the value of Rs 200000 and sales of
dept B includes transfer of goods to dept A of the value of Rs. 300000 both at market price to
transferor dept.
- 3) Opening stock of dept A & dept B includes goods of the value of Rs 10000 and Rs 15000
taken from Dept B & Dept A respectively at cost to transferor Dept.
- 4) Depreciation land & building by 5% and furniture by 10% p.a.

Solution

Balance sheet of B.N.Pai
As at 31st October 2011

Capital:		Land & buildings :	
As per last balance sheet	300000	As per last balance sheet	125000
Add: profit for the year	1557750	Less: depreciation	
	-----	for the year	6250
	1837750		-----
Less: drawing	280000	Furniture :	118750
	-----	As per last balance sheet	25000
	1557750	Less: depreciation for	
Sundry creditors	100000	The year	2500

		Stock in trade	390000
		Less: stock reserve	73500

		Sundry debtors	200000
		Cash and bank balance	1000000

	<u>1657750</u>		<u>1657750</u>

Departmental trading account and general P&L account of B.N.Pai.

	Deptt A Rs.	Deptt B Rs.	Total Rs.		Deptt A Rs.	Deptt B Rs.	Total
Opening stock	30000	40000	70000	Sales	1800000	2900000	4700000
Purchase	700000	1300000	200000	Transfers	200000	300000	-----
Transfers	300000	200000	-----				
Gross profit c/d	1100000	1920000	3020900	Closing stock	130000	260000	390000
	<u>2130000</u>	<u>3460000</u>	<u>5090000</u>		<u>2130000</u>	<u>3460000</u>	<u>5090000</u>
General expenses			1400000				
Depreciation:							
Land & buildings		6250		Gross profit b/d			1100000
Furniture		2500	8750	Deptt A			1920000
				Deptt B			
Reserve on closing stock:							
Trans. From deptt A							
Trans. From deptt B		49500					
		24000	73500				
Net profit transferred to capital a/c							
			1537750				
			<u>3020000</u>				<u>3020000</u>

BRANCH ACCOUNTS

A branch is a segment of a business. It is a chain of shops functioning in different localities under the control of the head office. The system of operating business at several places through one's own establishments is called branch organization. Branch accounts are accounts relating to different branches and are used to ascertain the trading result of each branch separately.

Need or objectives of branch account

The various objects of maintaining branch account are:-

- (1) To ascertain profit or loss of each branch.
- (2) To ascertain the financial position of each branch.
- (3) To help in controlling branches.
- (4) To assess the progress and performance of each branch.
- (5) To ascertain the requirements of stock and cash for each branch.
- (6) To ascertain whether the branch should be expanded or closed.

Types of branches

Branches may be divided into

- (1) Dependent branches (branch not keeping full system of accounting)
- (2) Independent branches (branch keeping full system of accounting)
- (3) Foreign branches.

Dependent branches

Dependent branches are branches, which don't maintain its own set of books. All records have to be maintained by the head office. The following are the features of such a branch:

- 1) These branches sell only such goods, which are supplied by the head office
- 2) The head pays all branch expenses
- 3) The branch manager out of petty cash book pays some petty expenses.
- 4) Such branches are instructed to deposit daily cash proceeds in to bank account opened in the name of head office
- 5) Sales are generally made on cash basis but some branches are authorized to make credit sales also.
- 6) Branches keep only some memorandum records
- 7) There are four methods of accounting for dependent branches namely
 - a. Debtors system
 - b. Stock and debtors system
 - c. Final account system
 - d. Wholesale branch system

DEBTORS SYSTEM

Under this method, head office opens only one account for each branch called branch account. Its purpose is to ascertain the profit or loss made by each branch. Such branch account is nominal in nature

Accounting entries are

- 1) To record opening balances of branches assets
 - Branch account Dr
 - To branch stock a/c
 - To branch debtors a/c
 - To branch petty cash
 - To branch other assets
- 2) To record opening balances of branch liabilities
 - Branch liabilities a/c Dr
 - To Branch account
- 3) When goods sent to the branch
 - Branch a/c Dr
 - To goods sent to branch a/c
- 4) For expenses paid by head office
 - Branch a/c Dr
 - To bank a/c
- 5) For remittance sent by the branch
 - Bank a/c Dr
 - To branch a/c
- 6) For the branch assets at close
 - Branch asset a/c Dr
 - To branch a/c

- 7) For the branch liabilities at close
 Branch a/c Dr
 To branch liabilities
- 8) For transfer of profit of the branch
 Branch a/c Dr
 To general profit and loss a/c

Specimen of a branch account is given below

Branch Account

To balance :(opening assets)		By balance: (opening liabilities)	
Stock	xxxx	Creditors	xxx
Debtors	xxxx	Outstanding expenses	xxx
Petty cash	xxxx	By bank (remittance ie amount of cash sales + amount received from debtors)	xxxx
Fixed assets	xxxx	By goods sent to branch (returns by branch)	
Prepaid expenses	xxx	By balance: (closing assets)	xxx
To goods sent to branch	xxxxx	Stock	
To bank:		Debtors	xxx
For expenses	xxxx	petty cash	
Petty cash	xxx	fixed assets	xxx
	-----	prepaid expenses	xxx
To balance: (closing Liabilities)			
Creditors	xxxx		
Outstanding expenses	xxxx		
To General P &L (if profit)	xxxx		
	xxxx		xxxx

Treatment of items in branch account

- (1) Branch expenses paid by branch from out of petty cash: - These need not be shown in the branch account. The opening balance of petty cash will appear on the debit side of profit and loss account. The cheque sent by the head office to the branch for petty expenses will also appear on the debit side. The closing balance of petty cash (i.e. opening+ amount sent by head office- petty expenses) will appear on the credit side.

If petty cash is maintained on the imp rest system, actual expenses incurred will be reimbursed and appear on the debit side of branch account as to bank account

- (2) Depreciation on fixed assets: - It is not shown in the branch account. The asset is shown on the credit side after deducting the amount of depreciation.
- (3) Bad debts, discount allowed etc: - These need not be shown in the branch account but appear on the credit side of debtors account.
- (4) Sales returns from branch debtors: - it will not appear on the branch account but appear on the credit side of debtors account.
- (5) Purchase of fixed assets by the branch: - The fixed assets purchased by the branch should be treated as closing branch fixed asset and should be credited to the branch account. If it is purchased for cash, it should also be deducted from the remittance on the credit side of the branch account. If it is purchased on credit, it should also be treated as a closing branch liability and appear on the credit side of branch account.
- (6) Sale of fixed assets: - The effect of this is to reduce the value of branch assets at close and increase the remittance from the branch in case the sale is for cash. If the sale is for credit it will increase the debtors balance instead of increase in remittance.

Illustration 1

The Vijayalakshmi Trading Company Ltd Bangalore has a branch at Mangalore. The head office pays all expenses except petty expenses which were met by the branch. All cash received by the branch was remitted to the head office daily. The following are the transactions between head office and branch during the year ending 31st December 2011.

	Rs
Stock at branch 1 st January 2011	7,000
Branch debtors on 1 st January 2011	2,000
Petty cash on 1 st January 2011	200
Goods sent to branch during the year	30,000
Cash sales	40,000
Credit sales	20,000
Cash received from the debtors	16,000
Goods returned by the branch	1,000
Returns from customers	1,500
Cheque sent to branch for expenses:	
Salary	3,000
Rent	1000
Petty cash	500
	4,500
Stock at branch on 31 st December 2011	4,000
Branch debtors on 31 st December 2011	4,500
Petty cash at branch on 31 st December 2011	300

Prepare the Mangalore Branch account in the Bangalore office books.

Solution :

Mangalore branch account

To branch stock	7,000	By goods sent to branch (returns)	1,000
To branch debtors	2,000		
To branch petty cash	200	By bank (remittance)	56,000
To goods sent to branch	30,000	By branch stock	4,000
To bank:		By branch debtors	4,500
Salary 3,000		By branch petty cash	300
Rent 1,000			
Petty cash 500			
-----	4,500		
To general profit and Loss account	22,100		
	65,800		
	65,800		
			65,800

Illustration 2

Active Associates, Mysore, is having its branch in Mercara. Goods are invoiced to branch at cost. Branch has been instructed to send all cash daily to the head office. All expenses of the branch are paid by the head office except petty expenses, which are met by the branch. From the following particulars prepare branch account in the books of Active Associates, Mysore.

Balances on 1 st January 2011:	Rs.
Stock in hand at branch	12,000
Sundry debtors at branch	9,000
Petty cash in hand at branch	400
Office furniture at branch	1,200
Outstanding salaries of the branch	200
Insurance of the branch prepaid up to 31 st March 2011	200
Transactions during the year ended 31 st December 2011:	
Goods sent to branch	64,000
Goods returned by the branch	800

Goods returned by customers	480
Cash received from debtors	30,000
Cash sales	50,000
Credit Sales	30,000
Discount allowed to debtors	300
Payment for the branch made by the head office:	
Salaries	2,000
Rent paid	1,800
Insurance for one year paid up to 1 st April 2012	800
Petty expenses paid by the branch	280
Balances on 31 st December 2011:	
Stock at branch	10,000
Rent still owing	100
Write off 10% depreciation on office furniture.	

Mercara Branch account

To branch stock	12,000	By outstanding salaries (opening)	200
To branch debtors	9,000	By goods sent to branch (returns)	800
To branch petty cash	400	By bank (remittance) (50000+30000)	80,000
To branch furniture	1,200	By branch stock (closing)	10,000
To branch prepaid	200	By branch debtors (closing)	8,220
Insurance		By branch petty cash (closing)	
To goods sent to branch	64,000	(400- 280)	120
To bank:		By branch furniture (closing)	1080
Salaries 2,000		By branch prepaid insurance	
Rent 1,800		(closing) 800x 3/12	200
Insurance 800	4,600		
To outstanding rent	100		
(closing)	9,120		
To general profit & loss			
	1,00,620		1,00,620

Branch debtor's account

To balance (opening)	9,000	By cash	30,000
To sales (credit)	30,000	By returns	480
		By discount	300
		By balance (closing)	8,220
	39,000		39,000

INVOICE PRICE METHOD

Sometimes the head office may send goods at a price higher than the cost price. This inflated price is generally termed as invoice price. The difference between the invoice and the cost price is the loading. In this case three additional entries are also to be passed in addition to the usual entries..

- 1) To remove loading on opening stock
 Stock reserve account Dr
 To branch account
- 2) To remove loading in goods sent to branch
 Goods sent to branch a/c Dr
 To branch a/c
- 3) To remove loading on closing stock
 Branch account Dr
 To stock reserve

Illustration 3

The Bundy shoes limited are having its branch at Ajmer. Goods are invoiced to branch at shoes at 20% profit on sale. Branch has been instructed to send all cash daily to the head office. All expenses are paid by the head office, except petty expenses. Which are met by the branch manager .from the following particulars prepare branch accounts in the books of Bundy shoes ltd

Stock on 1 st Jan 2004(invoice price)	15000
Sundry debtors on Jan 1st	9000
Cash in hand on 1 st Jan	400
Office furniture on 1 st Jan	1200
Goods invoiced from the head office (invoice price)	80000
Goods returned to head office	1000
Goods returned by debtors	400
Cash received from debtors	30000
Cash sales	50000
Credit sales	30000
Discount allowed to debtors	30
Expenses paid by the head office	
Rent	1200
Salary	2400
Stationery	300
Petty expenses paid by the manager	280
Depreciation is to be provided on branch furniture At 10% p.a	
Stock on 31 st December 2004 at invoice price	14000

Branch account

	Rs		Rs
To balance		By bank remittances(cash sales+ amount received from debtors)	80000
Stock	15000	By balance:	
Debtors	9000	Stock	14000
Cash	400	Debtors	8490
Furniture	1200	Cash	120
To goods sent to branch	80000	Furniture	1080
Less returns	1000	Stock reserve	3000
	-----	Goods sent to branch	15800
	79000		
To bank			
Rent	1200		
Salary	2400		
Stationary	300		
	3900		
To Stock reserve	2800		
To profit	11190		
	<u>122490</u>		<u>122490</u>

Debtors account

	Rs		Rs
To balance b/d	9000	By cash	30000
To sales credit	30000	By returns	480
		By discount	30
		By balance b/d	8490
	<u>39000</u>		<u>39000</u>

Illustration 4: A head office in Mumbai sends goods to its branch at Bangalore marked 20% above cost. From the following particulars show how the Bangalore branch account will appear in the head office books.

Balances on 1 st July 2011 at the branch:	RS
Stock at invoice price	3,600
Debtors	6,000
Petty cash	60
Goods supplied to the branch	60,000
Remittance from the branch:	
Cash sales	12,000
Amount received from debtors 42,000	54,000
Cheque sent to the branch:	
Salary	1,800
Rent and taxes	300
Petty cash	220
	2,320
Stock at branch on 31 st December 2011	6,000
Debtors at branch on 31 st December 2011	9,000
Petty cash at the branch on 31 st December 2011	40

Mangalore branch account

To branch stock account (opening)	3,600	By bank (remittance)	54,000
To branch debtors (opening)	6,000	By branch stock (closing)	6,000
To branch petty cash (opening)	60	By branch debtors (closing)	9,600
To goods sent to branch	60,000	By branch petty cash (closing)	40
To bank		By stock reserve (loading on opening stock) $3600 \times 20 / 120$	600
Salary 1800	2,320	By goods sent to branch (loading on goods sent) $60000 \times 20 / 120$	10,000
Rent 300	1,000		
Petty cash 220	7,260		
To stock reserve (loading on closing stock) $6000 \times 20 / 120$	80,240		80,240
To general profit and loss			

Note: petty expenses met by the petty cashier = 220

Stock and debtors system

In case of this system, the head office maintains a number of accounts for branch transactions in place of in branch account. The various accounts are:

- 1) Branch stock account
- 2) Branch debtors account
- 3) Branch expenses account
- 4) Branch adjustment account
- 5) Branch profit and loss account
- 6) Branch cash account
- 7) Branch fixed asset account
- 8) Goods sent to branch account

Accounting entries are as follows:

- 1) When goods sent to branch at invoice price
Branch stock a/c Dr
 To goods sent to branch a/c
- 2) For cash sales
Cash a/c Dr
 To branch stock a/c
- 3) For credit sales
Branch debtors a/c Dr
 To branch stock
- 4) For bad debts and allowances allowed to debtors
Cash a/c Dr
 To branch debtors
- 5) Cash paid by branch debtors and remitted to head office
Cash a/c Dr
 To branch debtors
- 6) For removing loading on goods sent
Goods sent to branch a/c
 To branch adjustment a/c
- 7) For removing loading on closing stock
Branch adjustment a/c Dr
 To stock reserve a/c
- 8) Expenses paid by head office
Branch expenses a/c Dr
 To cash a/c

- 9) Transfer branch expenses
 Branch adjustment a/c Dr
 To branch expenses a/c
- 10) For net profit disclosed by branch adjustment
 Branch adjustment a/c Dr
 To general profit and loss a/c

Illustration 5

A opened as branch in Bangalore on 1st January 2004. goods were invoiced at selling price which is cost plus 25%. from the following particulars relating to the year 2004. you are required to prepare accounts under stock and debtors system

Goods sent to branch	300000
Sales:	
Cash	100000
Credit	140000
Goods returned by customer	3000
Cash received from customer	80000
Discount allowed	1000
Cash remitted to branch	
Rent	1500
Branch salaries	6000
Sundry expenses	1000
Defective goods written off	1000
Goods returned by branch	12000
Stock at the end	50000

Branch stock a/c

	Rs		Rs
To goods sent to branch	300000	By branch cash a/c	
To branch debtors – goods returned	3000	Cash sales	100000
		By branch debtors	
		Credit sales	140000
		By goods sent to branch	
		Returned	12000
		By branch adjustment a/c	
		Defective	1000
		By balance c/d	50000
	<hr/>		<hr/>
	303000		303000

Branch debtors a/c

	Rs		Rs
To branch stock		By branch stock	
Credit sales	1400000	Cash received	80000
		By branch stock	
		Returns from debtors	3000
		Branch expenses	1000
		Balance c/d	56000
	<u>140000</u>		<u>140000</u>

Branch expenses account

	Rs		Rs
To cash:		Branch adjustment	
Salaries	6000	Transfer	9500
Rent	1500		
Sundry expenses	1000		
Branch debtors	1000		
	<u>9500</u>		<u>9500</u>

Branch adjustment account

	Rs		Rs
Branch expense account	9500	Goods sent to branch	
Branch stock	1000	loading	60000
Stock reserve			
Loading	10000		
To goods sent to branch			
Loading in returns	2400		
Branch p/l account	37100		
	<u>60000</u>		<u>60000</u>

Goods sent to branch account

	Rs		Rs
To branch stock	12000	Branch stock	300000
Branch adjustment	60000	Branch adjustment	2400
Trading a/c transfer	<u>230400</u>		<u> </u>
	302400		302400

Final Account system:-

Under this system head office opens

- (1) Branch trading and profit and loss account
- (2) Branch account. It is personal account in nature.

Illustration 6: A merchant at Mangalore has a branch at Mysore to which he charges goods at cost plus 25%. The Mysore branch keeps its own sales ledger and transmits all cash received to the head office every day. All expenses are paid from the head office.

The transactions for the branch were as follows:

Stock on 1-1-2011	22,000
Debtors on 1-1-2011	200
Petty cash on 1-1-2011	200
Sales (cash)	5,300
Goods sent to branch	40,000
Collection on ledger account	42,000
Goods returned to Head office	600
Bad debts	600
Allowance to customers	500
Returns inward	1,000
Cheques sent to branch:	
Rent	1,200
Wages	400
Salary and other expenses	1,800
Stock 31-12-2011	26,000
Debtors on 31-12-2011	4,000
Petty cash 31-12-2011 including miscellaneous income of Rs 50 not remitted	250

Prepare branch trading and profit and loss account for the year ended 31-12-2011 and also prepare the branch account.

Solution**Mysore branch Trading and Profit and Loss account for the year ended 31-12-2011**

To opening stock – at cost 22000x100/125	17,600	By sales: Credit sales 47,900 Cash sales 5300	
To goods supplied by the head office – at cost 40000x100/125 32000		Less returns 1,000	52,200
	31,520	Closing stock – at cost 26,000x25/125	20,800
Less returns at cost 480	400		
To wages			
	23,480		
To gross profit	<u>73,000</u>		<u>73000</u>
	1,800	By gross profit	23,480
To salaries	1,200	By miscellaneous income	50
To rent	600		
To bad debts	500		
To allowance	19,430		
To net profit	<u>23530</u>		<u>23530</u>

Branch debtors' account

To balance (opening)	200	By cash	42,000
To sales (Credit, balancing figure)	47,900	By sales return	1000
		By discount	600
		By allowance	500
		By balance (closing)	4,000
			48,100

Mysore branch account (personal account)

To branch stock (opening)	17,600	By goods sent to branch	480
To branch debtors (opening)	200	By bank	
To branch petty cash (opening)	200	By balance (balancing figure)	47,300
To goods sent to branch	32,000		25,050
To bank	3,400		
To general profit and loss	19,430		
	72,830		72,830

Whole sale branch system

This system is adopted when the head office supplies goods to the branch at a price which it supplies to wholesalers. Thus under this system, branch is treated at par with wholesale branch.

Illustration 7

A head office invoices goods to its branches at 20% less than the list price which is cost+100%. goods are sold to customers at list price .from the following particulars ascertain the profit made by the head office and branch.

	Head office	Branch
Stock in the beginning (at invoice price for branch)	30000	1600
Purchases during the year	256000	-----
Goods sent to branch	40000	-----
Sales	180000	36000
Expenses	32000	5000

Solution

Let cost price be	100
List price (retail price) 100+100%	200
Invoice price (200-20%)	160

Trading account

	Head Office(Rs)	Branch (Rs)		Head office(Rs)	Branch (Rs)
To stock	30000	1600	By sales	180000	36000
Purchases	256000	-----	Goods sent to branch	40000	-----
Goods from HO	-----	40000	Closing stock	171000	12800
Gross profit	105000	7200			
	391000	48800		391000	48800
Expenses	32000	5000	Gross profit	105000	7200
Stock reserve(closing)	3200	-----	Stock reserve (opening)		
12800x40/160	70200	2200	1600x40/160	400	-----
Net profit	105400	7200		105400	7200

Working note:

1. Calculation of closing stock at HO	Rs
Opening stock at cost	30000
Add purchases	256000
	286000
Less cost of goods sold (18000x100/200)	90000
	196000
Less cost of goods sent to branch (40000x100/160)	25000
	171000
Closing stock at HO	171000
	=====
2. Calculation of closing stock at branch	Rs
Opening stock at invoice price	1600
Add goods received from HO at invoice price	40000
	41600
Less goods sold at branch (36000x160/200)	28800
	12800
Closing stock at branch at invoice price	12800
	=====

INDEPENDENT BRANCHES

Independent branch means a branch which maintains its own set of books. In this system, branches are treated as separate independent units.

Features of such branches may be summarized as below

- 1) They keep a full system of accounting and trial balance can be extracted from the ledger
- 2) In the branch books, there will be a head of accounts and in the books of head office there will be a branch account
- 3) The branch does not confine its trading to the goods sent by the head office
- 4) There is no need for the branch to remit all cash. It can retain the cash out of which it can make the payment

Accounting entries are as follows:

Transaction	Head office books	Branch books
Goods supplied by head office	Branch a/c Dr: To goods sent to branch	Goods received from head office a/c Dr: To head office a/c
Cash remittance from head office to branch	Branch a/c Dr: To bank	Bank a/c Dr: To head office
Cash remittance from branch to head office	Bank a/c Dr: To branch a/c	Head office a/c Dr: To bank a/c
Remittance sent by branch but not received by head office	-----	Remittance in transit a/c Dr: To head office a/c
Asset purchased by the branch but asset a/c is to be kept in head office	Branch asset a/c Dr: To branch	Head office a/c Dr: To bank/liability
Depreciation with respect to the above asset	Branch a/c Dr: To branch asset	Depreciation a/c Dr: To head office
Head office expenses chargeable to branch	Branch a/c Dr: To P&L a/c	Head office expenses a/c Dr: To head office
Inter branch transactions	Receiving branch a/c Dr: To supplying branch	Receiving branch: Goods from head office a/c Dr: To head office Supplying branch: Head office a/c Dr: To goods sent to head office

Module 5

ACCOUNTING FOR HOTELS

Meaning and Definition of Hotels

A hotel simply refers to an establishment that provides rooms and meals. A hotel may be defined as a place that offers accommodation, food, and beverages at a cost that enables it to make a profit. Hotels provide accommodation, meals and refreshments, for irregular periods of time for those who may reserve their accommodation either in advance or on the premises. In broad terms, hotels provide facilities to meet the needs of the modern traveler.

In short, hotel is an establishment that provides lodging usually on a short term basis. Today hotels provide much more than just accommodation and meals. It often provides a number of services such as restaurant, swimming pool, or child care; some hotels have conference and meeting rooms. Services are provided to guests based on their needs. Now the hotel industry is referred to as 'hospitality industry'.

Features of Hotel Business

The chief features of hotel business are as follows:

1. Hotels provide accommodation and food items to guests.
2. Some hotels maintain bars. They offer drinks to customers.
3. Some hotels may have on their premises a beauty parlor, a hair dressing saloon, a jewelers shop, a book stall, a newspaper stand etc.
4. There are some hotels that provide various professional and technical services.
5. Most hotels provide credit facility to customers. No guest is required to pay room rent in advance or to pay for the other services and facilities at the time when the services are rendered to him. Sometimes an advance is required to be paid. At the time of departure the balance is paid
6. In hotels, there are large numbers of stereo type transactions.

Departments of a Hotel

All departments of a hotel may be classified into two-revenue departments and non-revenue departments.

Revenue Earning Departments

Revenue earning departments are operational departments that sell services or products to guests. A hotel has two major revenue earning departments. They are: (i) Accommodations, and (ii) food and beverage.

Accommodations

Accommodation department is responsible for the sale of rooms.. These departments are responsible for maintaining and selling the rooms in a hotel. In most hotels, these are the departments that directly or indirectly generate more revenue than any other department. This is because the sale of rooms constitutes a minimum of 50 per cent of the total revenue of a hotel. The various departments that support the room divisions department are:

Front office department: It is an operational department. It is the office when the guest is received, provided information, his luggage is handled, his accounts are settled on departure, and his complaints, problems and suggestions are looked after. It is responsible for welcoming and registering guests, allotting those rooms, and helping guests checking out.

Housekeeping department: This department is responsible for the cleanliness, maintenance and the aesthetic standard of the hotel. Housekeeping includes the servicing of guest rooms. This includes cleaning bedrooms, staircases, public areas and floral arrangements, first aid to guests etc.

Maintenance department: This department is responsible for all kinds of maintenance, repair and engineering work on equipment, machines, fixtures and fittings. It undertakes the supply of air-conditioning, lighting, mechanical, electrical, carpentry and civil works of the hotel. Maintenance department is also known as engineering department.

Laundry: This is a critical department that launders the large volume of bed lines, restaurant lines, staff uniforms and guest garments. Large hotels may have an in-house laundry to control the movement of linen and uniform which are considered to be the precious assets of the hotel. Smaller hotels may outsource this activity to local laundries. The laundry is headed by laundry manager.

Food and Beverage (F & B) Department

The food and beverage department is another major revenue producing department. It is the key to the success of a hotel. The F & B department includes the restaurants, bars, coffee shops, banquets, room service, kitchen and bakery.. The various departments that come under the F & B may be discussed below in brief. :

Restaurant : A restaurant is a commercial establishment committed to the sale of food and beverage. A restaurant may be a licensed part of a hotel operation, whereby the sales of the restaurant contributes to the sales performance of the hotel, or a franchised operation, when the hotel leases space. In this case the hotel has no share in the profits of the restaurant operations. Restaurants are equipped with tables, chairs, crockery, cutlery, linen and decor. In addition to the basic purpose, restaurants may provide other facilities such as bar, entertainment, children party facilities, home delivery services, take-away services, outdoor catering etc.

Room Service: Room service is a food service operation. It provides food and beverage to guests staying in the hotel rooms. The room service is located in the kitchen and has an order-taker's desk. Guests may order their food and beverage directly from their rooms to the room service order-taker who will pass on the order to the service team. The service team co-ordinates with the kitchen or bar for the preparation of the item.

Bars : The bar dispenses wines, liquor, spirits, juices, cigars and cigarettes. Restaurant food service professionals will co-ordinate with the bar for a guest's beverage orders.

Banquets : The banquets department is a major revenue area within food and beverage department. It is headed by a banquet manager. He organizes and looks after large parties like dinners for hundreds of guests, conventions, marriage receptions and other functions.

Kitchens : A kitchen is the place where food is prepared. Large hotels have independent sections to deal with various aspects of food preparation due to the large volume of activity. Kitchen personnel co-ordinate closely with restaurants, room service, bars and banquets for the supply of food orders. Chef-de-cuisine is the head of the kitchen. He is responsible for planning, organizing and controlling the kitchen operations.

Kitchen stewarding : This department is primarily concerned with the storage, maintenance, cleanliness, and issue of cutlery, crockery, hollowware, chinaware and glassware to the restaurants and kitchens. It is responsible for the cleanliness of kitchens and the washing of pots and pans.

Minor Revenue Earning Departments

There are certain departments which earn smaller revenue. Such departments are as follows:

Health club and recreation: People are getting increasingly health and physical fitness conscious. Hence some hotels maintain gymnasiums for men and women and swimming pool. Similarly, some hotels provide tennis courts, squash courts, and many other recreation facilities.

Delicatessen : This department sells in-house butchery products.

Patisseries. : It sells bakery products.

Beauty Salon : This provides hair dressing service and beauty care.

Flower Shop : This is the retail outlet of the flowers and ferns from the gardens of the hotel.

Health food counter : This is usually found at the health club. The counter provides health foods and diet foods that support a health regimen created by a dietician.

Non-Revenue Departments (Staff Departments)

Non-revenue departments or staff departments are those that support the revenue departments in their efforts. In fact, non-revenue departments are supporting departments. They help to generate revenue indirectly by playing a supporting role to revenue earning departments. These departments may be discussed as below :

Finance and accounts department : This department comprises of two sections - finance and accounts. The finance section is responsible for raising funds and generating profits through innovative investments and funding. This is headed by financial controller. He is assisted by financial analysts. The accounts section monitors the revenues and expenditures of the hotel. The functions of accounting section include hotel, etc.

This department is headed by the human resource manager.

Sales and marketing department : This department is concerned with finding customers. It advertises in various media such as television, newspapers, trade magazines. etc. It organizes promotions to attract guests in different seasons and festivals. A team of sales personnel go out into the market and sell the property to corporate houses, travel agent, tour operators and airlines for more business. This department is headed by the sales and marketing manager.

Purchase department : This department is led by the purchase manager. The main responsibilities of the purchase department is to procure all the departmental inventories. In most hotels, the central stores is part of the purchase department.

Security department : The security department is responsible for safeguarding the assets and employees of the hotel. It is also responsible for establishing a safe environment for guests. It is concerned with implementing safety programmers.

Revenues and Expenditures of a Hotel

Now let us examine the major heads of revenues and expenses of a hotel.

Revenues of a Hotel : The major heads of revenue (primary or principal sources of revenue) of a hotel may be outlined as below:

1. Revenue earned from selling rooms (i-e room rent). The income head is “Accommodation” or “Rentals”.
2. Revenue earned from selling foods and beverages including wines, liquors etc. The income head is “Income from meals and Refreshments”.
3. Income from letting out banquet hall for marriage parties etc. , and conference rooms for holding meetings, seminars, conferences etc.
4. Income from other sources (minor sources) such as laundry, telephone services, health club facilities, swimming pool, variety shows etc.

A big hotel may grant licenses to outsiders in consideration of license fees to run various shops in the shopping centre on the premises of the hotel itself. In the shopping centre there may be shops selling jewellery, handicrafts, fancy garments, medicines, book etc. Usually in such a hotel, there is a beauty parlor as well as a hair dressing saloon run by outsiders under license from the hotel. In such cases, the hotel earns an additional revenue in the form of license free.

Some hotels levy service charges at specified rates on room rent and price charged for food items, beverages etc. served to the guests. Thus service charge is a source of revenue for the hotel.

Expenditures of a Hotel: A hotel incurs the following expenditures (major heads of expenditures):

1. Purchase of provisions, stores and wine.
2. Kitchen and bar expenses.
3. Remunerations to staff (or employee remuneration and welfare expense)
4. Electricity, fuel and water.
4. Entertainment expenses.
5. Advertisement and publicity expenses.
6. Repairs, renewals and replacements.
7. Administrative and general expenses.
8. Room occupying expenses, etc.

Working Papers

Working papers consists of collections of data, computations, memoranda, preliminary drafts of financial statements and other useful papers used by accountants. With the help of the data collected from the various departments of a hotel, computations, memoranda, preliminary drafts of financial statements etc., the final financial statements can be easily prepared. In short, working papers are sheets of paper containing accounting data, calculations etc. which assist the accountants in the preparation of financial statements.

Working papers are not part of the formal accounting records. The accountant prepares them for his use. He keeps them with himself. These are not meant for use by the owners or managers. A type of working paper commonly used by accountants is the work sheet. A worksheet is a columnar sheet of paper used to summaries information needed to prepare financial statements and to record adjusting and closing entries. It is also an informal device for assembling the required information in one place.

Advantages of Working Papers

1. Working papers assist accountants in organizing the information required for the formal financial statements, so that no important information is omitted.
2. Working papers provide evidence of supporting computation and are useful in explaining to auditors the basis of the figures appearing in the financial statements.
3. Working paper is an information device for assembling the required information at one place. This helps to prepare financial statements somewhat easily.
4. Working papers help to assure the accountant that potential errors will be discovered.
5. Working papers are particularly useful in hotels and restaurants where there are numerous accounts and adjusting entries.

Preparation of Final Accounts

After transactions are recorded in the subsidiary books, entries are posted in the appropriate ledger accounts. After extracting the balances in the ledger accounts a trial balance is prepared at the end of the accounting year to check the arithmetical accuracy. From the trial balance final accounts are prepared in the usual manner. The final accounts consist of Profit and Loss Account and Balance Sheet.

Illustration 1

The following is the trial balance of Ashoka Hotel on 31st March 2009. You are required to prepare the hotel's trading and profit and loss accounting for the year ending 31st March 2009 and a balance sheet as on that date.

<i>Debits</i>	<i>Rs.</i>	<i>Credits</i>	<i>Rs.</i>
Cash at bank	40,000	Capital	2,00,000
Provisions and other purchases	1,10,000	Apartments and attendance	1,25,000
Stocks	10,000	Meals and refreshments	1,45,000
Kitchen equipment	40,000		
Printing and stationery	5,000	Bank interest	5,000
Postage and telephone	4,500	Sundry revenue receipts	15,000
Wages and salaries	50,000	Discounts received	3,000
Fuel and light	9,500	Sundry creditors	12,000
Repairs and renewals	2,500		
Restaurant furniture	22,500		
Advertising	5,000		
China and utensils	15,000		
Sundry debtors	20,000		
Drawings	15,000		
Bad debts	4,500		
Rates	1,500		
Building	<u>1,50,000</u>		
	<u>5,05,000</u>		<u>5,05,000</u>

Prepare final accounts after making the following adjustments:

- (1) A sum of Rs. 6,000 representing accommodation Rs. 2800 and meals Rs. 3,200 to be charged to proprietor.
- (2) A sum of Rs. 12,000 representing accommodation Rs. 3,000 and meals Rs. 9,000 to be charged to staff who are provided with free boarding and lodging.
- (3) Accrued wages and salaries amount to Rs. 4,000.
- (4) Provide depreciation as follows:
 - (a) Buildings 5%.
 - (b) Kitchen equipment 10%.
 - (c) Restaurant furniture Rs. 1,500.
 - (d) China and utensils were revalued at Rs. 12,500.

Solution

PROFIT AND LOSS ACCOUNT for the year ended 31-03-2009

	Rs.		Rs.
To Provisions etc.	1,10,000	By Apartments etc.(see note)	1,30,800
“ Wages and salaries	50,000	“ Meals (see note)	1,57,200
Add : Free food	12,000	“ Bank interest	5,000
Add : Outstanding	4,000	“ Sundry revenue receipts	15,000
“ Fuel and light	9,500	“ Discounts received	3,000
“ Advertising	5,000		
“ Bad debts	4,500		
“ Rates	1,500		
“ Repairs and renewals	2,500		
“ Printing and stationary	5,000		
“ Postage and telephone	4,500		
“ Depreciation :			
Buildings	7,500		
Kitchen equipment	4,000		
Restaurant furniture	1,500		
China etc	2,500		
	15,500		
“ Net profit transferred to capital A/c.	<u>87,000</u>		
	<u>3,11,000</u>		<u>3,11,000</u>

Balance Sheet As at 31-03-2009

	Rs.		Rs.
Wages and Salaries		Cash at Bank	40,000
-accrued	4,000	Sundry debtors	20,000
Sundry creditors	12,000	Stocks	10,000
Capital	2,00,000	China and utensils	12,500
Less : Drawings		Kitchen equipments	40,000
Cash	15,000	Less : Depreciation	4,000
Food	6,000	Restaurant furniture	22,500
	21,000	Less : Depreciation	1,500
	1,79,000	Building	1,50,000
Add : Profits	87,000	Less : Depreciation	7,500
	2,66,000		1,42,500
	<u>2,82,000</u>		<u>2,82,000</u>

Working Note :

- (1) Drawings should be debited with Rs. 6,000. Accommodation should be credit with Rs. 2,800 and Meals should be credited with Rs. 3,200.
- (2) Rs. 12,000 should be debited to wages and salaries. Rs. 3,000 should be credited to accommodation and Rs. 9,000 should be credited to meals.
- (3) The amount to be shown in the P/L A/c. under the head accommodation is calculated as follows :

Amount as T/B =	Rs. 1,25,000
Charged to proprietor	Rs. 2,800
Charged to staff	Rs. 3,000
Total	1,30,800

- (4) The amount to be shown in the P/L A/c. under the head meals is calculated as below :

Amount as per T/B	Rs. 1,45,000
Charged to proprietor	Rs. 3,200
Charged to staff	Rs. 9,000
Total	1,57,200

Room Rate

Room rate simply refers to room rent. It is the charge fixed by the hotel for accommodation provided to the guests. It is the rate at which the guests are charged for the rooms let out to them.

A hotel earns maximum amount of revenue from the room rent. Hence, the room rate must be fixed judiciously. While determining the room rate, certain factors need to be considered. Some of them are: (a) availability of rooms in the hotel, (b) location of the hotel, (c) location of the particular room, (d) availability of various facilities, (e) occupancy rate, (f) type of building (g) estimated cost of operation, (h) expected rate of return on investment, etc.

Calculation of Room Rate

The average room rate is calculated by applying the following formula:

$$\text{Average Room Rate} = \frac{\text{Estimated cost of operation} + \text{Expected rate of return on investment}}{\text{Total number of available rooms that can be let out}}$$

The above formula gives the average room rate. But the same rate is not charged for all the rooms in a hotel.

Bases of Charging Room Rates

There are different bases of charging room rates. There are three main methods of charging room rates. They are: (a) 24 hours stay system, (b) night stay system and (c) check-out system.

- (a) **24 hours stay system:** Under this system, a guest is charged a fixed amount for a stay of every 24 hours or part thereof from the time of his occupying the room in the hotel. This means he has to pay this fixed amount even if he stays only for a few hours.

Illustration 2

Mr. Lal occupied a room in the Sagar Hotel, Trissur on 15 th January 2010. He came at 8 a.m. for accommodation only at a Rent of Rs. 800 per day for every 24 hours or part thereof.

Compute the amount payable by Mr. Lal under each of the following conditions assuming that service charge levied by the hotel @ 10%

- (a) If he checks out at 4.00 p.m. on 15-01-2010
 (b) If he checks out at 7.00 a.m. on 16-01-2010
 (c) If he checks out at 1.00 p.m. on 16-01-2010
 (d) If he checks out at 8.00 p.m. on 17-01-2010

Solution

(a) Amount payable by Mr. Lal	Rs.
Room Rent for one day @ Rs. 800 per day	800
Add : Service Charge @ 10%	80
	880
(b) Amount Payable by Mr. Lal	
Room Rent for one day only @ Rs. 800 per day	800
(He stayed for 23 hours, he had to pay one day's minimum rent)	
Add: Service Charges @ Rs. 10%	80
	880
(c) Amount Payable by Mr. Lal	
Room Rent for 2 days @ Rs. 800 per day	1,600
(He stayed for 29 hours, i.e., one day full and 5 hours part thereof. So he had to pay 2 days' rent)	
Add : Service Charges @ 10%	160
	1,760

(d) Amount Payable by Mr. Lal

Room Rent for 3 days @ Rs. 800 per day	2400
(He stayed for 2 days and 12 hours i.e., 2 days' charge and 12 hours part thereof, so he had to pay 3 days' rent)	
Add : Service Charges @ 10%	240
	2640

- (b) Night stay system :** Under this system, the guest has to pay the room rent for every night spent in the hotel. Normally he should vacate the room before dinner of the next day. In case he fails, he has to pay charges for another night. Similarly, the guest has to pay room rent for one night even if he does not stay even a single night.

Illustration 3

Mr. Raju occupied a hotel, Hotel Samudra, at Kovalam. He came to the hotel at 10 p.m. on 22nd March 2010 and the charge was @ Rs. 1000 per night stay.

Compute the amount payable by Mr. Raju under each of the following conditions assuming that the service charges were @ 10% levied by the hotel :

- If he checks out at 11.00 a.m. on 23rd March 2010
- If he checks out at 8.00 p.m. on 23rd March 2010
- If he checks out at 4.00 p.m. on 24th March 2010
- If he checks out at 9.00 p.m. on 25th March 2010

Solution**(a) Amount Payable by Mr. Raju**

Room Rent for one night only @ Rs. 1000 per night	1,000
(He spend just one night only and vacated at 11a.m. So, charges for one night to be leveied)	
Add : Service Charges @ 10%	100
	1100

(b) Amount Payable by Mr. Raju

Room Rent for 1 night only @ Rs. 1000 per night	1000
(He spent 1 night and he vacated the hotel before dinner)	
Add : Service Charges @ 10%	100
	1100

(c) Amount Payable by Mr. Raju

Room Rent for 2 nights @ Rs. 1000 per night	2000
(He spent 2 nights i.e., 23rd and 24th night)	
Add : Service Charges @ 10%	200
	2200

(d) Amount Payable by Mr. Raju

Room Rent for 3 nights @ Rs. 1000 per night	3,000
(He spent 3 nights i.e., 23rd , 24th & 25th, before dinner of 26th he left the hotel)	
Add : Service Charges @ 10%	300
	3300

(c) Check-out System: Under this system, a check-out time is fixed by the hotel authorities by taking into consideration the timings of buses, trains or flights. Generally, 12 noon is taken as check-out time. One full days charge is levied from one check-in time to the following check-out time. Naturally, if any guest occupies more than the check-out time, he has to pay another day's room rent. Generally, the check-in time and check-out time are the same. This system is widely adopted by hotels in India.

Note : Check-out is an American term adopted by hotels in India. It means departure of a guest from a hotel. Thus, check-in means the arrival of a guest in a hotel.

Illustration 4

Mr. A arrives in Mumbai and checks into a room in a five-star hotel at 4 p.m. on 1st June 2009 at Rs. 500 per day plus 10% for service charges on European Plan. Check out time in the hotel is 12 noon.

Calculate the amount payable by Mr. A in each of the following circumstances :

- (i) If Mr. A checks out at 10 p.m. on the same day
- (ii) If Mr. A checks out at 9 a.m. on 2nd June 2009
- (iii) If Mr. A checks out at 6 p.m. on 2nd June 2009
- (iv) If Mr. A checks out at 4 a.m. on 3rd June 2009

Show also the amount payable by Mr. A if the charges were leviable @ Rs. 500 for a stay of every 24 hours or part thereof plus service charges at 10%

Solution**Based on 12 Noon Check-out Time**

Particulars	No. of days	Rate	Amount	Service Charges @ 10%	Total Amount payable	
		Rs.	Rs.	Rs.	Rs.	
Check out at 10 p.m. on the same day	1	500	500	50	550	550
" " " 9a.m. on 2nd June	1	500	500	50	550	
" " " 6p.m. " " "	2	500	1,000	100	1,100	
" " " 4 a.m. " " "	3	500	1,500	150	1,650	

Based on 24 hour Check-out Time

Check out at 10 p.m. on the same day	1	500	500	50	550
" " " 9 a.m. " " "	1	500	500	50	550
" " " 6 p.m. on 2nd June	2	500	1,000	100	1,100
" " " 4a.m. " " "	2	500	1,000	100	1,100

Operating Ratios

Generally hotels compute some operating ratios for measuring the efficiency in operation. These are physical ratios and not monetary ratios. Some of the important ratios may be discussed below :

1. Room occupancy rate : It is the ratio of the number of rooms occupied by the guests to the total number of lettable rooms available. It is usually expressed as a percentage. It is calculated as below :

$$\text{Room occupancy rate} = \frac{\text{No. of rooms occupied}}{\text{No. of lettable rooms available}} \times 100$$

Thus, the room occupancy rate shows the percentage of lettable rooms which are generating revenue for the hotel. The higher the rate, the better it is for the hotel and vice versa.

The Federation of Hotels and Restaurants Association of India requires monthly occupancy rate from its member hotels. However, a hotel may calculate its room occupancy rate daily, weekly, and bimonthly, quarterly, or yearly etc. as well

Illustration 5

A five-star hotel has 660 rooms in all, out of which 52 rooms are used for operational purposes and 8 rooms are used by the departmental managers.

If 480 rooms are occupied by the guests on any day, calculate the room occupancy rate.

Solution

$$\text{Room Occupancy Rate} = \frac{\text{No. of Rooms occupied}}{\text{No. of Rooms available for letting-out}} \times 100$$

No. of rooms available for letting-out is calculated as below :

$$660 - 52 - 8 = 600$$

$$\frac{480}{600} \times 100 = 80\%$$

$$600$$

If we are asked to calculate the room occupancy rate for a particular day, first the number of rooms occupied by the guests brought forward from the previous day is taken up. Then the number of rooms in which the guests check-in during the day is added to this figure. From this figure (total) the number of rooms from which the guests check-out during the day is deducted. The resultant figure is the occupancy of rooms for the day.

Illustration 6

The check out time of the Imperial Hotel is 11 a.m. On 4th July, 2009 the Visitors Ledger of the hotel shows that immediately after 11 a.m. there are 93 rooms in which guests are staying . Till 11 a.m. on 5th July, 2009 guests from 23 rooms check out while in 27 rooms new guests check in. Calculate the room occupancy of rooms for 4 th July, 2009

Solution

Calculation of Occupancy of Rooms on 4th July 2009

Number of rooms occupied, brought forward	=	93
Add : Number of rooms in which new guests checked in during the day	=	27
		120
Less : Number of rooms from which guests checked out during the day	=	23
Occupancy of rooms as on 4th July, 2009		97

2. Bed occupancy rate : In most of the hotels, there are single-bedded rooms, double bedded rooms and family rooms. Hence, total number of beds are more than the total number of lettable rooms. In this case, bed occupancy rate is more important than room occupancy rate. The bed occupancy rate refers to the ratio of beds occupied by the guests in a hotel to the total number of beds available in the hotel. It is expressed as a percentage. It is calculated as below :

$$\text{Bed occupancy rate} = \frac{\text{No. of beds occupied}}{\text{No. of total beds available}} \times 100$$

Illustration 7

A five star hotel in Mumbai has 350 rooms out of which 250 rooms are single-bed rooms and 100 rooms are double-bed rooms. On 15th October 2009, 180 single-bed rooms and 60 double-bed rooms are occupied by the guests. Calculate the bed occupancy rate for the day.

Solution

No. of beds in the single room = 250 x 1	=	250
No. of beds in the double room = 100 x 2	=	200
Total number of rooms in the hotel		450
Total No. of beds occupied by the guests = 180 + (60 x 2) = 300		
		$300 \times 100 = 66\frac{2}{3} \%$

$$\text{Bed occupancy rate} = \frac{300}{450} \times 100 = 66\frac{2}{3} \%$$

3. Double occupancy rate : This is the ratio of double rooms occupied by the guests to the total rooms occupied by the guests. It is calculated by using the following formula :

$$\text{Double occupancy rate} = \frac{\text{Total No. of guests} - \text{No. of rooms occupied}}{\text{No. of rooms occupied}} \times 100$$

When we deduct number of rooms occupied from the total number of guests, we get the number of double rooms occupied. Thus this ratio shows the proportion of double rooms occupied by the guests out of the total rooms occupied.

Illustration 8

In Pamila Hotel, there are in all 170 lettable rooms. The hotel has single bed rooms as well as double bed rooms. On 17th June, 2009, 160 rooms were occupied by 210 guests. Calculate the double occupancy rate for the day

Solution

$$\begin{aligned} \text{Double Occupancy Rate} &= \frac{\text{Total no. of guests} - \text{No. of rooms occupied} \times 100}{\text{No. of rooms occupied}} \\ &= \frac{210 - 160 \times 100}{160} = 31.25\% \end{aligned}$$

Note : This may verified on the assumption that 50 double rooms were occupied by the guests (100 guests) and 110 single rooms were occupied by the guests (110 guests). Thus out of total number of rooms occupied (160), the proportion of double rooms occupied is 31.25% (i.e., $50/160 \times 100$). Total number of double rooms occupied is equal to total number guests minus no. of guests. It is in this way we get the no. of double rooms occupied.

Illustration 9

On 31st March, 2010 the following balances appeared in the books of the Alfa Hotels Ltd.

	Rs.		Rs.
Interest on debentures	60,000	12% Mortgage debentures	5,00,000
Rates and Taxes	18,000	Share capital	40,00,000
Stock of provisions on 1.04.09	2,50,000	General reserve	5,00,000
Purchase of provisions	25,00,000	Unclaimed dividends	15,000
Salaries and Wages	7,50,000	Provision of bad debts	50,000
Provident and Contribution	30,000	Trade creditors	2,50,000
Miscellaneous expenses	50,000	Expenses owing	80,000
Directors fees	24,000	Visitor's credit balances	10,000
Managing director's salary	2,15,000	Staff provident fund	7,50,000
Land	15,00,000	Income from boarding and	
Buildings	50,00,000	lodging	51,00,000
Furniture and fittings	15,00,000	Miscellaneous receipts	65,000
Linen, crockery, glass-ware,		Depreciation amount :	
cutlery and utensils	3,20,000	Buildings	20,00,000
Sundry debtors	3,50,000	Furniture etc	10,00,000
Prepaid expenses	25,000	Linen, crockery etc	1,80,000
Advance against purchase		P/L Account	81,000
of buildings	15,00,000		
Cash in hand	15,000		
Balance at bank	4,74,000		
	1,45,81,000		1,45,81,000

After taking the following information also into account, prepare the company's balance sheet as on 31st March, 2010 and its profit and loss amount for the year ended :

- (i) Stock of provisions on 31st March, 2010 was valued at Rs. 3,00,000.
- (ii) Provide Rs. 1,00,000 for depreciation of furniture and fittings; Rs. 20,000 for depreciation of linen, crockery, glassware, etc.
- (iii) Make a provision for taxation @ 35%
- (iv) The directors decide to recommend a dividend @ 10% on the paid up capital of the company. Make a provision for dividend tax @ 10% of the proposed dividend and transfer the remaining balance in profit and loss account to general reserve.
- (vi) The entire paid up share capital of the company consists of fully paid equity shares of Rs. 10 each.

Solution

Alfa Hotels Ltd.
Profit and Loss Account
for the year ended 31st March, 2010

	Rs.		Rs.
To Stock of Provisions on 1st April, 2009	2,50,000	By Income from Boarding and Lodging	51,00,000
To Purchases of Provisions	25,00,000	By Miscellaneous Receipts	65,000
To Salaries and wages	7,50,000	By Stocks of Provisions on 31st March, 2010	3,00,000
To Provident Fund Contribution	30,000		
To Rates and Taxes	18,000		
To Miscellaneous Expenses	50,000		
To Interest on Debentures	60,000		
To Directors' Fees	24,000		
To Managing Director's Salary	2,15,000		
To Depreciation on :			
Furniture and Fittings	1,00,000		
Linen, Crockery etc	20,000		
To Provision for Taxation @35%	5,06,800		
To Net Profit for the year c/d	9,41,200		
	54,65,000		54,65,000
To Proposed Dividend	4,00,000	By Balance b/f	81,000
To Provision for Dividend Tax @ 10%	40,000	By Net Profit for the year b/d	9,41,200
To General Reserve - Transfer	5,82,200		
	10,22,200		10,22,200

Balance Sheet of Alfa Hotels Ltd. as on 31st March, 2010

<i>Liabilities</i>	Rs.	Rs.	<i>Assets</i>	Rs.
Share Capital			Fixed Assets	
Authorized			? Land, cost	15,00,000
Issued and subscribed :			Buildings, cost	50,00,000
4,00,000 Equity Shares of			Less: Depreciation	20,00,000
Rs. 10 each, fully paid up			40,00,000 Furniture and	30,00,000
Reserves and Surplus			Fittings, cost	15,00,000
General Reserve :			Less: Depreciation	11,00,000
Balance as per last			Linen, Crocker	4,00,000
balance sheet	5,00,000		Glassware etc. cost	3,20,000
Add : Amount			Less Depreciation	2,00,000
added this year	5,82,200	10,82,200	Current Assets,	
			Loans and Advances	
Secured Loans			(A) Current Assets	
12 % Mortgage Debentures	5,00,000		Stocks	3,00,000
Current Liabilities & Prov.			Debtors	3,50,000
(A) Current Liabilities			Less : Provision for	
Trade Creditors	2,50,000		Bad Debts	50,000
Visitors' Credit Balances	10,000		Cash in hand	15,000
Expenses owing	80,000		Balance at Bank	4,74,000
Unclaimed Dividends	15,000		(B) Loans and Advances	
(B) Provisions			Prepaid Expenses	25,000
Provision for Taxation	5,06,800		Advances against	
Proposed Dividend	4,00,000		purchase of buildings	15,00,000
Dividend Tax	40,000			
Staff Provident Fund	7,50,000			
	76,34,000			76,34,000

Note: Since the hotel is a company, Balance Sheet has been prepared in the prescribed format given in the Companies Act, 1956.

Illustration 10

Mr. A occupies a room in a hotel at 10 a.m. on 1st September 2009 on European Plan @ Rs. 1500 for a stay of every 24 hours or a part thereof. Calculate the amount payable by Mr. A in each one of the following circumstances assuming that service charge is also payable @ 10%.

- (a) If Mr. P checks out at 8 p.m. on 1st September 2009
- (b) If Mr. P checks out at 8 a.m. on 2nd September 2009

- (c) If Mr. P checks out at 2 p.m. on 2nd September 2009
 (d) If Mr. P checks out at 11 p.m. on 3rd September 2009

Solution

(a) Amount payable by Mr. A	Rs.	
Room rent for one day @ Rs. 1500 per day (Minimum guaranteed)		1500
Add: Service charges @ 10%		150
		1650
(b) Amount payable by Mr. A		
Room rent for one day @ Rs. 1500 per day (Because his stay has not exceeded 24 hours)		1500
Add: Service charge @ 10%		150
		1650
(c) Amount payable by Mr. A		
Room rent for 2 days @ Rs. 1500 per day (Because his stay has exceeded 24 hours)		3000
Add: Service charge @ 10%		300
		3300
(d) Amount payable by Mr., A		
Room rent for 3 days @ Rs. 1500 per day (Stay has exceeded 48 hours but has not exceeded 72 hours)		4500
Add: Service charge @ 10%		450
		4950

Illustration 11

Shri Prabhu arrives at a way-side hotel at 2 p.m. on 15th February 2010, and a room is let out to him on European Plan @ Rs. 400 for every night spent plus 10% service charge. Calculate the amount payable by him in each of the following circumstances:

- (a) If he checks out at 7 p.m. on 15th February 2010
 (b) If he checks out at 8 a.m. on 16th February 2010
 (c) If he checks out at 6 p.m. on 16th February 2010, and
 (d) If he checks out at 10 a.m. on 17th February 2010

Solution

Amount payable by Mr. Prabhu	Rs.
(a) Room rent for one night @ Rs. 400 per night (He has to pay charge for one night even though he has not Spent a single night)	400
Add: Service charge @ 10%	40
	440
(b) Room rent for one night @ Rs. 400 per night	400

(he has spent one night in the hotel)	
<i>Add: Service charge @10%</i>	40
	440
(c) Room rent for one night @ Rs. 400 per night	400
(He has spent only one night because he checks out Before dinner the next day)	
<i>Add: Service charge @ 10%</i>	40
	440
(d) Room rent for 2 nights @ Rs. 400 per night	800
(He has spent 2 nights)	
<i>Add: Service charge @ 10%</i>	80
	880

Illustration 12

The check out time of a hotel is 11 a.m. In that hotel, a guest checks in at 2 p.m. on 23rd November 2009 hiring a room on European Plan @ Rs. 2000 per day plus service charge @ 10%. You are required to calculate the amount payable by him in each one of the following cases.

- The guest checks out at 8 a.m. on 24th November 2009
- The guest checks out at 11 a.m. on 24th November 2009
- The guest checks out at 2 p.m. on 24th November 2009
- The guest checks out at 10 a.m. on 25th November 2009

Solution

Fixed check-out time is 11 a.m. and checks in time is 2 p.m. on 23rd November 09

(a) Check-out at 8 a.m. on the next day	
The guest will be charged for one day	Rs.
(Because he has not stayed beyond the check out time Following the check in time)	2000
<i>Add: Service charge @ 10%</i>	200
	2200
(b) Check-out at 11 a.m. on the next day	
The guest will be charged for one day	
(Because he leaves the hotel at the check-out time following the check-in time)	2000
<i>Add: Service charge @ 10%</i>	200
	2200
(c) Check-out at 2 p.m. on the next day	
The guest will be charged for two days	4000
(because he has stayed for one full day and a part)	
<i>Add : Service charges @ 10%</i>	400

	4400
(d) Check-out at 10 a.m. on 25th Nov. 2009	
The guest will be charged for 2 days	
(he has not stayed beyond the fixed check out time)	4000
Add : Service charges @ 10%	400
	4400

Illustration 13

The Cochin Hotel has 179 rooms in all, out of which 15 rooms are used for operational purposes and 4 rooms are occupied by the general manager and the departmental managers. If 136 rooms are occupied by the guests on 27 March 2010, calculate the room occupancy rate for the day.

Solution

Total number of rooms in the hotel = 179

Number of lettable rooms in the hotel = Total number of rooms - number of rooms used for operational purposes - number of rooms occupied by the managers of the hotel
= 179 - 15 - 4 = 160

Number of rooms occupied by the guests = 136

Room Occupancy Rate = $\frac{\text{Number of rooms occupied by the guests}}{\text{Number of lettable rooms in the hotel}} \times 100$
= $\frac{136}{160} \times 100 = 85\%$
