Chapter - 1

Introduction to Financial Accounting

> ## Definition of Accounting

According to American institute of certifie[d] accountants "Accounting is the art of recording clas[sifying] & summarising in a significant manner in terms of money transactions & events where are in part at least of a financial character & interpreting the result there off".

> ## The process of Accounting is as follows

1 Recording transaction: Each an every business transac-tion is properly recorded on daily basis in the book of prime entry or journal entry

2 Classifying the transaction: It is a process of classifying or grouping the similar items under one head is known as posting or ledger entry

3 Summarising the transactions: It refers to present-ing the classified data in a readable & understandable form. It involes preparation of financial statements which includes income statement & balancesheet.

Interpreting the transactions: The financial debtor recorded is analysed & interpred in such a manner that and users can make a meaningfull judgement about the financial condition of the business.

→ Users of Accounting Information

1 Owners
The owners provide funds for the operation of a business and they want to know whether there funds are being properly utilised or not they are also interested in knowing profitability & financial position of there business.

2 Management
The information available in the books of accounts is much helpful to the management to plan the future activities of business.

3 Investors
The propective investors are in need of accounting information to judge the profitability & solvency of the business in which they are going to invest.

4 Creditors / Bankers
They want to know the financial position of a concern before giving loans or granting credit. The financial statement helps in judging the position.

5 Employees
Employee's are interested in knowing the earning capacity of the firm so that they

can claim for better salaries, bonus, working conditions etc...

6 Government

Government is also interested in the accoun of various business in order to impose income t. sales tax etc.

7 Researches

At present research schools also use the accounting information for the purpose of there research work.

8 Customers

Customers would like to have accounting informa-tion relating to profit made by the business.

9 Investment agencies

Investment institution uses the accounting information to serve they c to better regarding the safety of investment.

0 Stock Exchanges

Stock exchanges uses the accounting information for the purpose of listing the compaines in stock exchange

General Public

General public will get to know the contribu-tion of business to the society in the form of payment of tax, employment generation & contri-bution to society benefit...

→ Accounting Principles

There are two types of accounting principles

* Accounting Concepts
* Accounting Conventions

→ Accounting Concepts

1 Business Entity Concept

According to this concept business is kept separate from the proprietor so that the transaction of the business is recorded separately.

2 Money Measurement Concept

Under this concept only those transactions which can be expressed in terms of money are recorded in the books of accounts. Non-monetary transactions can not be recorded in the books of accounts.

3 Accounting Period Concept

This is also known as concept of definite accounting period. According to this concept, the life of the business is divided into suitable accounting period.

4 Going Concern Concept

This concept refers to the continuous existence of the business concern. The life of the business does not come to end within a year.

5 Dual Aspect Concept

papergrid Date: / /

According to this concept there must be a double entry to have a complete record of each business transaction. An entry being made for the receiving amount and a similar entry is made for the giving account. Therefore every debit must have a corresponding credit and vice versa.

6 Historical Record Concept

According to this concept only those transaction which have actually take place must be recorded.

7 Revenue Recognisetion Concept

This concept is mainly concern with the revenue being recognised in the income statement of an entry price revenue is the error inflow cash receivable or other consideration arising from sale of goods or services.

8 Matching Concept

According to this principle, the expenses incurred in an accounting period should be matched with the revenues in that period. It should be noted that appropriate cost have to be matched against the appropriate revenues for the accounting period.

9 Objective Evidence Concept

All the accounting transaction should be supported by document such as invoice, receipts cash memo, etc...

10 Cost Concept

papergrid

Date: / /

According to this concept, an asset is recorded in the books at the price paid to acquire and same should be recorded in books of accounts.

11 Accrual Concept

While preparing profit & loss account of a concern all revenues items relating to that period are taken into consideration irrespective of the fact that whether this items are paid or payable (outstanding).
Example: Outstanding salary, Prepaid insurance, etc...

12 Legal Aspect Concept

According to this concept records should reflect the legal validity of the transaction entered in the books of account whether it is not possible appropriate qualifying note should be given.

⇒ Accounting Conventions

1 Convention of Consistency

According to accounting rules, practices and conventions should be continuously observed and applied, therefore they should not change from one year to another. The result of different years ~~of different~~ will be comparable only when accounting rules & regulations are continuously observed from year to year.

2 Convention of Full disclosure

The financial statements must disclose all the

Date: / /

relevant and reliabe information, so that the users information may be useful to the users.

3 Convention of Conservatism

It is also known as anticipate no profit, provi- for all possible losses. This means an accountant should follow a cautious approach. He should recor- lowest possible value for assets and revenue, and the highest possible value for liabilities and expenses.

4 Convention of Materiality

The convention of materiality reveals that only important items should be recorded in the books. It is done to make a clear and understandable accounting statement rather than preparing accounting statement with unnecessary information which will confuse the reader.

⟹ Branches or Classification of Accounting

1 Financial Accounting

It is prepared to know financial position of the company by preparing income statement or profit and loss account and balancesheet.

2 Cost Accounting

This system deals with classification, recording, allocation and summarisation of the cost of products or operations. In this we prepare standard costing, cost forecasting will prepare cost sheet, cost control, etc..

AS 11 The effects of changes in Foreign Exchange Rates

AS 12 Accounting for government grants

AS 13 Accounting for investments

AS 14 Accounting for amalgamations

AS 15 Employee Benefits

AS 16 Borrowing costs

AS 17 Segment reporting

AS 18 Related party disclosures

AS 19 Leases

AS 20 Earning per share

AS 21 Consolidated financial statement

AS 22 Accounting for taxes on income

AS 23 Accounting for investment in Associates in consolidated financial statements

AS 24 Discontinuing operations

AS 25 Interim financial reporting

AS 26 Intangible assets

AS 27 Financial reporting of interest in joint venture

AS 28 Impairment of assets

AS 29 Provisions, contingent liabilities & contingent assets

AS 30 Financial Instruments

AS 31 Recognition & Measurement

AS 32 Financial Instruments presentation, disclosu

⟹ Limitations of Accounting

1 In the balance sheet only monetary transactions are recorded & non-monetary transactions like skills, royalty, etc... will not considered.

Hire Purchase System

Meaning of Hire Purchase System

Hire purchase system refers to the system wherein the seller of goods delivers the goods to the buyer without transfering the ownership of goods. The payment for the goods made by the buyer in installments. If the buyer pays all the installments, the ownership of the goods will be transferred, on the payment of the last installmen

Features of Hire Purchase System

1. Hire purchase is an agreements between two parties called hire vendor & hire purchaser.

2. Payment for the goods will be made by the hire purchaser in installment.

3. If the hire purchaser pays all the installments, the ownership of goods will be transferred on payment of last installment.

4. If the hire purchaser stops paying the installments, the hire vendor repossesses the goods, resulting the transaction in 'hire'. In such case, each earlier installment paid will be treated as hire charges.

5 Each installment paid will be inclusive of payment towards price of the goods (principal amount) & payment of interest.

⟹ Meaning Installment Purchase System

Installment purchase system is a system where the buyer is given the ownership as well as the possession of the goods at the time of signing the contract. The buyer has the facility to pay the price in installments.

⟹ Differences between Hire Purchase System and Installment Purchase System

	Hire Purchase System	Installment Purchase System
1	It is a contract to hiring.	It is a contract of sale.
2	It is transferred by seller to buyer only after payment of all installments.	It is transferred by seller to buyer, immediately on signing the contract.
3	Risk of loss or damage of goods will be on the head of seller.	Risk of loss or damage of goods will be on the buyer.
4	On default of payment of any installment by the buyer, the seller can repossess the goods.	On default of payment of any installment by the buyer, the seller cannot repossess the goods but can file a case against the buyer.
5	The buyer can exercise the option of return of	The buyer cannot exercise the option of return of

	goods.	goods.
6	The buyer cannot dispose the goods to third party until the payment of last installment.	The buyer has the right to dispose the goods, even if all installments are not yet paid.

⇒ Important Terms & Provisions under Hire Purchase

1 Hire Purchaser

An hire purchaser is a buyer is a person who obtains the possession of goods for use with an option to either purchase it or return after use.

2 Hire Vendor

An hire vendor is a seller is a person who owns the goods, and who parts with the possession of these goods to the buyer with an option of 'purchase or hire'.

3 Cash Price

It refers to the price at which goods are sold under 'Contract of sale'.

4 Hire Purchase Price

It refers to price at which the goods are sold under hire purchase system. It includes cash price of goods & interest.

5 Installment Money

It refers to a part of hire purchase price purchaser, in periodic intervals.

6 **Deposit**

It means any sum payable by the hirer under the hire purchase agreement by way of deposit or other initial payment.

7 **Net Cash Price**

It refers to the difference between cash price of the goods & the deposit or downpayment. It is a amount on which, interest is calculated under hire purchase system.

8 **Net Hire Purchase Price**

It refers to the hire purchase price of the goods less delivery charges (if any, registration charges, insurance charges.

9 **Hire Purchase Charges**

It refers to the difference between net hire purchase price & net cash price of the goods. It is also referred to as interest.

⇒ **Hire Purchase Agreement**

According to section 2(c) of the Hire Purchase Act, 1972, an hire purchase agreement is one under which the goods are let in hire & under which the goods hirer has an option to purchase them in & the agreement should includes the following:

1 Possession of the goods is delivered by the owner there of to a person on condition that

On 1st Jan 1999 Amit purchase a furniture from Bangaloo Furniture Lmt on hire purchase system. The cash price of the furniture is ₹ 7450 the payment is to be made as follows:
₹2000 was downpayment
₹2000 annual for 3 years as installment

Calculation of Total Interest

Total Interest = Hire purchase price - Cash price

Hire purchase price = Total Installment + Downpayment
= [2000 x 3] + 2000
= 6000 + 2000
= 8000
Total Interest = 8000 - 7450
= 550

Calculation of Ratio

Amount due at 1st year beining = 8000 - 2000 = 6000
Amount due at 2nd year beining = 6000 - 2000 = 4000
Amount due at 3rd year beinging = 4000 - 2000 = 2000

= $\cancel{6000}^{3} : \cancel{4000}^{2} : \cancel{2000}^{1}$
= 3:2:1
= 6

Calculation of Interest per year

1st year = $550 \times 3/6$ = 275
2st year = $550 \times 2/6$ = 183

3rd year = 550 × 1/6 = 92

⇒ Case - 3

When cash price is not given.

1 Calculate the cash price of an asset from the following:
₹3000 paid at the time of agreement
₹21600 paid at the time of 1st year
₹20700 paid at the time of 2nd year
₹19800 paid at the time of 3rd year
₹18900 paid at the time of 4th year
Rate of interest 5% per annum

Solution

Calculation of Cash Price

No. of Installment	Closing Balance (a)	Installment Amount (b)	Total (a+b) = c	Interest 5/105 d	Opening Balance c-d
4		18900	18900	900	18000
3	18000	19800	37800	1800	36000
2	36000	20700	56700	2700	54000
1	54000	21600	75600	3600	72000

Cash Price = Principal + Downpayment
= 72000 + 3000 = 75000

2 Calculate the cash price of an asset from the following
₹10000 Downpayment
1st year installment ₹14000
2nd year installment ₹13000
3rd year installment ₹12000
4th year installment ₹11000
Rate of Interest 10% per annum

Calculation of Cash Price

No. of Installment	Closing Balance (a)	Installment Amount (b)	Total (a+b) = c	Interest 10/110 d	Opening Balance c-d
4	-	11000	11000	1000	10000
3	10000	12000	22000	2000	20000
2	20000	13000	33000	3000	30000
1	30000	14000	44000	4000	40000

Cash Price = Principal + Downpayment
= 40000 + 10000
= 50000

3 Calculate the cash price of an asset from sold under installment from following details
₹6000 downpayment
1st half yearly installment ₹14400

papergrid

Date: / /

2nd half yearly installment ₹ 13300
3rd half yearly installment ₹ 12200
4th half yearly installment ₹ 12100
Rate of Interest 20% per annum

Solution

Calculation of Cash Price

No. of Installment	Closing Balance (a)	Installment Amount (b)	Total (a+b) = c	Interest 10/110 d	Opening Balance c-d
4	-	12100	12100	1100	11000
3	11000	12200	23200	2109	21091
2	21091	13300	34391	3126	31265
1	31265	14400	45665	4151	41514

Cash Price = Principal + Downpayment
= 41514 + 6000
= 47514

⟹ Case - 4

When installement plus interest is given or hire purchase price exclusive of interest or when hire purchase price is equal to cash price.

4 Calculate the value of each installment

Cash Price ₹ 12000

Downpayment 20% on cash price

Balance of cash price is payable in 3 equal installment together with interest at 10% per annum.

Solution Calculation of Interest

Cash Price	12000
Less: Downpayment [12000 x 20%]	2400
	9600
Add: 1st year interest at 10% [9600 x 10%]	960
	10560
Less: 1st year installment + interest [3200 + 960]	4160
	6400
Add: 2nd year interest at 10% [6400 x 10%]	640
	7040
Less: 2nd year installment + interest [3200 + 640]	3840
	3200
Add: 3rd year interest at 10% [3200 x 10%]	320
	3520
Less: 3rd year installment + interest [3200 + 320]	3520
	xxx

papergrid

Date: / /

5 Mr. Gupta purchased a machine on 1st Jan 1998 under hire purchase system from Mr. Pankaj. The cash price was ₹ 15500 the payment for the purchase is to be made as under.

On signing of agreement ₹ 3000

1st year end ₹ 5000

2nd year end ₹ 5000

3rd year end ₹ 5000

Make necessary journal entries in the books of Mr. Gupta under asset accrual method. Charge depreciation at 10% on diminishing value method.

tion Calculation of Total Interest

Total Interest = Hire purchase price − Cash Price

Hire purchase price = Total installment + Downpayment

= (5000x3) + 3000

= 15000 + 3000

= 18000

Total Interest = 18000 − 15500

= 2500

Calculation of Ratio's

Amount due at begining of 1st year = 18000 − 3000 = 15000

Amount due at begining of 2nd year = 15000 − 5000 = 10000

Amount due at begining of 3rd year = 10000 − 5000 = 5000

$\frac{3}{\cancel{15000}} : \frac{2}{\cancel{10000}} : \frac{1}{\cancel{5000}}$

papergrid
Date: / /

= 3:2:1
= 6

Calculation of Interest per year

1st year = 2500 x 3/6 = 1250
2nd year = 2500x 2/6 = 833
3rd year = 2500 x 1/6 = 417

Calculation of Depreciation

Cash Price	15500
Less: 1st year depreciation	1550
	13950
Less: 2nd year depreciation	1395
	12555
Less: 3rd year depreciation	1256
	112999

Calculation of Cash Price in each installment

Installment - Interest

1st year = 5000 - 1250
= 3750

2nd year = 5000 - 833
= 14167

3rd year = 5000 - 417
= 4583

Journal Entries

In the Books of Mr. Gupta

Date	Particulars	LF	Debit	Credit
1/1/1998	Machinery A/c Dr.		3000	
	To Bank A/c			3000
	[Being downpayment paid]			
31/12/1998	Machinery A/c Dr.		3750	
	Interest A/c Dr.		1250	
	To Pankaj A/c			5000
	[Being 1st year installment due]			
31/12/1998	Pankaj A/c Dr.		5000	
	To Bank A/c			5000
	[Being 1st year installment paid]			
31/12/1998	Depreciation A/c Dr.		1550	
	To Machinery A/c			1550
	[Being depreciation charged]			
31/12/1998	P/L A/c Dr.		2800	
	To Interest A/c			1250
	To ~~Installment~~ Depreciation A/c			1550
	[Being interest & depreciation transfered to P/L A/c]			

papergrid

Date: /

31/12/1999	Machinery A/c Dr.		4167	
	Interest A/c Dr.		833	
	To Pankaj A/c			5000
	[Being 2nd year Installment due]			
31/12/1999	Pankaj A/c Dr.		5000	
	To Bank A/c			5000
	[Being 2nd year installment paid]			
31/12/1999	Depreciation A/c Dr.		1395	
	To Machinery A/c			1395
	[Being depreciation charged]			
31/12/1999	P/L A/c Dr.		2228	
	To Interest A/c			833
	To Depreciation A/c			1395
	[Being interest & depreciation to transfered to P/L A/c]			
31/12/2000	Machinery A/c Dr.		4583	
	Interest A/c Dr.		417	
	To Pankaj A/c			5000
	[Being 3rd year installment due]			
31/12/2000	Pankaj A/c Dr.		5000	
	To Bank A/c			5000
	[Being 3rd year installment paid]			

papergrid

Date: / /

31/12/2000	Depreciation A/C Dr.		1256	
	To Machinery A/C			1256
	[Being depreciation charged]			
31/12/2000	P/L A/C Dr		1673	
	To Interest A/C			417
	To Depreciation A/C			1256
	[Being interest & depreciation transfered to P/L A/C]			

Machinery A/C

Dr. Cr.

Date	Particulars	Amount	Date	Particulars	Amount
1/1/98	To Bank A/c	3000	31/12/98	By Depreciation A/c	1550
31/12/98	To Pankaj A/c	3750			
			31/12/98	By Bal C/d	5200
		6750			6750
1/1/99	To Bal b/d	5200	31/12/99	By Depreciation A/c	1395
31/12/99	To Pankaj A/c	4167			
			31/12/99	By Bal C/d	7972
		9367			9367
1/1/20	To Bal b/d	7972	31/12/20	By Depreciation A/c	1256
31/12/20	To Pankaj A/c	4583			
			31/12/20	By Bal C/d	11299
		12565			12555

papergrid
Date: / /

Pankaj A/C

Dr. Cr.

Date	Particulars	Amount	Date	Particulars	Amount
31/12/98	To Bank A/c	5000	31/12/98	By Machinery A/c	3745
			31/12/98	By Interest A/c	1250
		5000			5000
31/12/99	To Bank A/C	5000	31/12/99	By Machinery A/c	4167
			31/12/99	By Interest A/c	833
		5000			5000
31/12/20	To Bank A/C	5000	31/12/20	By Machinery A/C	4583
			31/12/20	By Interest A/C	417
		5000			5000

Interest A/C

Dr. Cr.

Date	Particulars	Amount	Date	Particulars	Amount
31/12/98	To Pankaj A/c	1250	31/12/98	By P/L A/C	1250
		1250			1250
31/12/99	To Pankaj A/C	833	31/12/99	By P/L A/C	833
		833			833
31/12/20	To Pankaj A/c	417	31/12/20	By P/L A/c	417
		417			417

papergrid

Date: / /

9 On 1st Jan 1996 B purchased a machine from XY Company on hire purchase basis the particulars are as follows:

Cash price ₹ 100000

₹40000 to be paid on signing the contract.

₹ 20000 plus interest paid for 3 years.

Interest charged on outstanding balance 5% per annum

Depreciation at 10% on diminishing balance method.

Pass necessary journal & ledger entries.

Solution Calculation of Interest

Cash Price	10000
Less: Downpayment	40000
	60000
Add: 1st year interest at 5%	3000
	63000
Less: 1st year installment & interest [20000 + 3000]	23000
	40000
Add: 2nd year interest at 5%	2000
	42000
Less: 2nd year installment & interest [20000 + 2000]	22000
	20000
Add: 3rd year interest at 5%	1000
	21000
Less: 3rd year installment + interest [20000 + 1000]	21000
	xxx

Calculation of Depreciation

Cash Price	100000
Less: 1st year depreciation	10000
	90000
Less: 2nd year depreciation	9000
	81000
Less: 3rd year depreciation	8100
	72900

Journal Entries
In the Books of Mr. B

Date	Particulars	LF	Debit	Credit
1/01/1996	Machinery A/c Dr.		40000	
	To Bank A/c			40000
	[Being downpayment paid]			
31/12/1996	Machinery A/c Dr.		20000	
	Interest A/c Dr.		3000	
	To XYZ A/c			23000
	[Being 1st year installment due]			
31/12/1996	XYZ A/c Dr.		23000	
	To Bank A/c			23000
	[Being 1st year installment paid]			
31/12/1996	Depreciation A/c Dr.		10000	
	To Machinery A/c			10000

papergrid
Date: / /

Date	Particulars		L.F.	Debit	Credit
	[Being depreciation charged]				
31/12/1996	P/L A/c	Dr		13000	
	To Interest A/c				3000
	To Depreciation A/c				10000
	[Being interest & depreciation transfered to P/L A/c]				
31/12/1997	Machinery A/c	Dr.		20000	
	Interest A/c	Dr.		2000	
	To XYZ A/c				22000
	[Being 2nd year installment due]				
31/12/1997	XYZ A/c	Dr.		22000	
	To Bank A/c				22000
	[Being 2nd year installment paid]				
31/12/1997	Depreciation A/c	Dr.		9000	
	To Machinery A/c				9000
	[Being depreciation charged]				
31/12/1997	P/L A/c	Dr.		11000	
	To Interest A/c				2000
	To Depreciation A/c				9000
	[Being interest & depreciation transfered to P/L A/c]				
31/12/1998	Machinery A/c	Dr.		20000	
	~~To~~ Interest A/c	Dr.		1000	
	To XYZ A/c				21000

	[Being 3rd year installment due]			
31/12/1998	XYZ A/c Dr.		21000	
	To Bank A/c			21000
	[Being 3rd year installment paid]			
31/12/1998	Depreciation A/c Dr.		8100	
	To Machinery A/c			8100
	[Being depreciation charged]			
31/12/1998	P/L A/c Dr.		9100	
	To Interest A/c			1000
	To Depreciation A/c			8100
	[Being interest & depreciation transfered to P/L A/C]			

Machinery A/c

Dr.

Date	Particulars	Amount	Date	Particulars	Amount
1/1/1996	To Bank A/c	40000	31/12/96	By Depreciation A/c	10000
31/12/96	To XYZ A/c	20000	31/12/96	By Bal c/d	50000
		60000			60000
1/1/97	To Bal b/d	50000	31/12/97	By Depreciation A/c	9000
31/12/97	To XYZ A/c	20000	31/12/97	By Bal c/d	61000
		70000			70000
1/1/98	To Bal b/d	61000	31/12/98	By Depreciation A/c	8100
31/12/98	To XYZ A/c	20000	31/12/98	By Bal c/d	72900
		81000			81000

XYZ A/C

Dr. Cr.

Date	Particulars	Amount	Date	Particulars	Amount
31/12/96	To Bank A/C	23000	31/12/96	By Machinery A/C	20000
			31/12/96	By Interest A/C	3000
		23000			23000
31/12/97	To Bank A/C	22000	31/12/97	By Machinery A/C	20000
			31/12/97	By Interest A/C	2000
		22000			22000
31/12/98	To Bank A/C	21000	31/12/98	By Machinery A/C	20000
			31/12/98	By Interest A/C	1000
		21000			21000

Interest A/C

Dr. Cr.

Date	Particulars	Amount	Date	Particulars	Amount
31/12/96	To XYZ A/C	3000	31/12/96	By P/L A/C	3000
		3000			3000
31/12/97	To XYZ A/C	2000	31/12/97	By P/L A/C	2000
		2000			2000
31/12/98	To XYZ A/C	1000	31/12/98	By P/L A/C	1000
		1000			1000

Royalty Accounts

=> Meaning of Royalty

Royalty is a periodical sum based on output or sales payable by the lessee to the lessor for having utilizing the rights of the lessor.

* The person who makes payment is called lessee
* The owner of asset to whom the payment is made is called lessor.

=> Minimum Rent Or Dead

The Royalty agreement are usally with a co cost that the lessee must pay a minimum amount irrespective of volume of output or s in a particular period. Such amount is called a minimum rent or dead rent or fixed ren

* Minimum rent becomes payable only when the royalty is less then minimum rent.

=> Short Working

The excess of minimum rent over actuall royalty is called short workings.

=> R... of Short Working

papergrid
Date: / /

It refers to recovering short working of any year from the surplus royalty of the succeeding years.

⇒ Types of Recovery of Short Working

1 Fixed Recovery

When the recovery is permitted only over a fixed or stipulated period is called fixed recovery

2 Floating Recovery

When the recovery is permitted over a subsequen period following the year of short working It is also called subsequent recovery.

3 Recovery within lifetime of the lease

When the recovery is permitted over the life time of the lease therefore no restriction of time for recovery of short working.

⇒ Fixed Recovery

1 Prepare an analysis table from the followi details
Royalty payable ₹ 50 paise per ton of output.
Minimum rent ₹ 7500 per annum.
Right of recovery of short working upto 3 years.

Output during the first 3 years ₹ 10000, ₹14000 & ₹ 18000 respectively

Solution

Year	Output	Royalty	Minimum Rent	Short Working	Short Working Recovery	Short Working Irrecovery	Amt paid to Landlord
1	10000	5000	7500	2500	-	-	7500
2	14000	7000	7500	500	-	-	7500
3	18000	9000	7500	-	1500	1500	7500

2 ABC Company acquired a lease from Landlord. It was agreed that the company should pay ₹ 12 per ton of coal raised subjected to minimum rent ₹ 36000 & the short workings to be recovered in first 3 years. The output raised for the first 4 years was
1998 production ₹ 1750
1999 production ₹ 2750
2000 production ₹ 3750
2001 production ₹ 4750
Prepare analysis table

Solution

Year	Output	Royalty	Minimum Rent	Short Working	Short Working Recovery	Short Working Irrecovery	Amount paid to Landlord
1	1750	21000	36000	15000	-	-	36000

1 Jyothi mining company is engaged in wooking a coal mine on 1st Jan 1998. It is entered into an agreement with the owner of the landlord which provides royalty of ₹ 20 per ton minimum rent ₹ 50000 per annum. The short workings can be recovered within a period of first 3 years. The output during the first 5 years was
1998 production ₹ 2000
1999 production ₹ 2250
2000 production ₹ 3000
2001 production ₹ 3800
2002 production ₹ 5000
The amount due to landlord is respect of each year were paid at the end of each year. Prepare necessary journal entries.

Year	Output	Royalty	Minimum Rent	Short Working	Short Working Recovery	Short Working lapsed	Amount paid to Landlord
1998	2000	40000	50000	10000	-	-	50000
1999	2250	45000	50000	5000	-	-	50000
2000	3000	60000	50000	-	10000	5000	50000
2001	3800	76000	50000	-	-	-	76000
2002	5000	100000	50000	-	-	-	100000

I Six Marks:

1 Prepare Analysis table from the following de[tails]
Minimum rent ₹20000
Royalty payable ₹5 per ton
Short workings can be recovered during the first 3 year only.
Production of 1st 4 years
2000 units 2012
3000 units 2013
4000 units 2014
4500 units 2015

[Solu]tion

Analysis Table

Year	Output	Royalty	Minimum Rent	Short Working	Short Working Recovery	Short Working recoup	Amount paid to landlord
2012	2000	10000	20000	10000	-	-	20000
2013	3000	15000	20000	5000	-	-	20000
2014	4000	20000	20000	-	-	15000	20000
2015	4500	22500	20000	-	-	-	22500

II Fourteen marks.

papergrid

Date: / /

1. X Company Limited took a lease from a landlord for a period of 25 years from 1st Jan 2010 on a royalty of ₹ 2 per ton of coal raised with a minimum rent of ₹ 20000 and power to recover shortworking during the 1st 4 years of lease

2010 5000

2011 8000

2012 10000

2013 15000

2014 20000

Pass necessary journal entries & ledger accounts under minimum rent method.

ution

Analysis Table

Year	Output	Royalty	Minimum Rent	Short Working	Short Working Recover	Short Working Irrecovery	Amount paid to Landlord
2010	5000	10000	20000	10000	-	-	20000
2011	8000	16000	20000	4000	-	-	20000
2012	10000	20000	20000	-	-	-	20000
2013	15000	30000	20000	-	10000	4000	20000
2014	20000	40000	20000	-	-	-	40000

Journal Entries
In the Books of X Company Limited
Under Minimum Rent

Date: / /

Date	Particulars		LF	Debit	Credit
2010	Minimum Rent A/c	Dr.		20000	
	To landload A/c				20000
	[Being minimum rent due]				
2010	Royalty A/c	Dr.		10000	
	shortworking A/c	Dr.		10000	
	To Minimum Rent A/c				20000
	[Being minimum rent splitted into royalty & shortworking]				
2010	Landload A/c	Dr.		20000	
	To Bank A/c				20000
	[Being minimum rent paid]				
2010	Production A/c	Dr.		10000	
	To Royalty A/c				10000
	[Being royalty transfered to production A/c]				
2011	Minimum Rent A/c	Dr.		20000	
	To landload A/c				20000
	[Being minimum rent due]				
2011	Royalty A/c	Dr.		16000	
	Shortworking A/c	Dr.	—	4000	
	To Minimum rent A/c				20000
	[Being minimum rent splitted into royalty & shortworking]				
2011	Landload A/c	Dr.		20000	
	To Bank A/c				20000

	[Being minimum rent paid]			
2011	Production A/c Dr.		16000	
	To Royalty A/c			16000
	[Being royalty transfered to production A/c]			
2012	Minimum Rent A/c Dr.		20000	
	To Landlord A/c			20000
	[Being minimum rent due]			
2012	Royalty A/c Dr.		20000	
	To Minimum rent A/c			20000
	[Being minimum rent splitted into royalty]			
2012	Landlord A/c Dr.		20000	
	To Bank A/c			20000
	[Being minimum rent paid]			
2012	Production A/c Dr.		20000	
	To Royalty A/c			20000
	[Being royalty transfered to production A/c]			
2013	Royalty A/c Dr.		30000	
	To Shortworking A/c			10000
	To Landlord A/c			20000
	[Being royalty amount due]			
2013	Landlord A/c Dr		20000	
	To Bank A/c			20000

papergrid

Date: / /

Minimum Rent A/c

Dr. | | | | | Cr.

Date	Particulars	Amount	Date	Particulars	Amount
2010	To Landlord A/c	20000	2010	By Royalty A/c	10000
			2010	By Shortworking A/c	10000
		20000			20000
2011	To Landlord A/c	20000	2011	By Royalty A/c	16000
			2011	By Shortworking A/c	4000
		20000			20000
2012	To Landlord A/c	20000	2012	By Royalty A/c	20000
		20000			20000

Royalty A/c

Dr.

Date	Particulars	Amount	Date	Particulars	Amount
2010	To Minimum Rent	10000	2010	By Production	10000
		10000			10000
2011	To Minimum Rent	16000	2011	By Production	16000
		16000			16000
2012	To Minimum Rent	20000	2012	By Production	20000
		20000			20000
2013	To Landlord	20000	2013	By Production	30000
2013	To Shortworking	20000			
		30000			30000

papergrid

Date: / /

2014	To Landload	40000	2014	By Production	4000
		40000			4000

Landload A/C

Dr.

Date	Particulars	Amount	Date	Particulars	Amo
2010	To Bank	20000	2010	By Minimum Rent	2000
		20000			2000
2011	To Bank	20000	2011	By Minimum Rent	2000
		20000			2000
2012	To Bank	20000	2012	By Minimum Rent	20000
		20000			20000
2013	To Bank	20000	2013	By Royalty	20000
		20000			20000
2014	To Bank	40000	2014	By Royalty	40000
		40000			40000

Short Working A/C

Dr.

Date	Particulars	Amount	Date	Particulars	Amount
2010	To Minimum Rent	10000	2010	By Bal c/d	10000
		10000			10000
2011	To Bal b/d	10000	2011	By Bal c/d	14000
2011	To Minimum Rent	4000			

		14000			
					14000
2013	To Bal b/d	14000	2013	By Royalty	10000
			2013	By Pl A/c	4000
		14000			
					14000

2 ABC leased a oil well on 1st Jan 2010. The minimum rent was ₹ 200000 & Royalty was ₹ 20 per ton of curde oil. The short working were recoverable in the ~~sobsi~~ suceeding 2 years of such shall working. The output working during the 1st 4 years were as follows:

5500

8000

11250

12500

Prepare minimum rent A/c, short working A/c, Royalty A/c, Landlord A/c.

Solution

Analysis Table

Year	Output	Royalty	Minimum Rent	Short Working	Short Working Recovery	Short Working lapse	Amount paid to Landlord
2010	5500	110000	200000	90000	-	-	200000
2011	8000	160000	200000	40000	-	-	200000
2012	11250	225000	200000	-	25000	65000	200000
2013	12500	250000	200000	-	40000	-	210000

Date: / /

Minimom Rent A/c

Dr. Cr.

Date	Particolars	Amount	Date	Particolars	Amount
2010	To Landload A/c	200000	2010	By Royalty A/c	110000
			2010	By Shoatwoaking A/c	90000
		200000			200000
2011	To Landload A/c	200000	2011	By Royalty A/c	160000
			2011	By Shoatwoaking A/c	40000
		200000			200000

Royalty A/c

Dr.

Date	Particolars	Amount	Date	Particolars	Amount
2010	To Minimom Rent	200000	2010	By Production	200000
		200000			200000
2011	To Minimom Rent	260000	2011	By Production	160000
		160000			160000
2012	To Land load	200000	2012	By Production	225000
	To Shoatwoaking	25000			
		225000			225000
2013	To Landload	200000	2013	By Production	250000
	To Short woak-ing	40000			
		250000			250000

Date: / /

Landlord A/c

Dr. Cr.

Date	Particulars	Amount	Date	Particulars	Amount
2010	To Bank	200000	2010	By Minimum Rent	200000
		200000			200000
2011	To Bank	200000	2011	By Minimum Rent	200000
		200000			200000
2012	To Bank	200000	2012	By Royalty	200000
		200000			200000
2013	To Bank	210000	2013	By Royalty	210000
		210000			210000

Short Workings A/c

Dr. Cr.

Date	Particulars	Amount	Date	Particulars	Amount
2010	To Minimum Rent	90000	2010	By Bal c/d	90000
		90000			90000
2011	To Bal b/d	90000	2011	By Bal c/d	130000
	To Minimum Rent	40000			
		130000			130000
2012	To Bal b/d	130000	2012	By Royalty	25000
				By P/L A/c	65000
				By Bal c/d	40000
		130000			130000
2013	To Bal b/d	40000	2013	By Royalty	40000
		40000			40000

Conversion of Partnership Firm into Limited Company

Sale of firm to a company refers to sale of a partnership firm to a company or purchasing of partnership by a company.

A partnership firm may convert itself into a joint stock company however for accounting purpose it shall be treated as a company taken over partnership firm.

A company which is being sold to a company is called vendor firm. A company which is going to purchase a firm is called purchasing company.

=> **Objectives of Conversion of Partnership into Joint Stock Company.**

* To take the advantage of limited liability.
* To increase the capital.
* To increase the managerial skill.
* To expand the scale of operation.

=> **Accounting for Sale of Firm to a company**

Step1: Calculation of purchase consideration
Step2: Ascertaining the firm of discharge of purchase consideration.
Step3: Closing the books of vendor firm by

Date: / /

passing ledger accounts.
Step 4: Passing incorporation entries in the books of purchasing company.

⇒ Calculation of Purchase Consideration

The price or consideration payable by the purchasing company for taking over assets & liabilities of the vendor firm is called purchase consideration.

⇒ Methods of Calculating of Purchase

1. Lumpsum method

A fixed amount or a lumpsum is paid by the purchasing company for the assets & liabilities taken over from vendor firm.

2. Net Asset method

Total assets taken over at an agreed value by purchasing company.

Less total liabilities taken over at an agreed value by purchasing company.

3. Net Payment method

Under this method actual payment made by purchasing company against each item of liability would be specified the payment may be in cash or shares or in debentures or in combination

⇒ Assertining the Fiom of Discharge of Purchase Consideration

The purchase consideration may be discharged by the purchase company in any of the form.

* Completely in Cash
* Completely in Shares
* Completely in Debentures
* Partly in cash, shares & debentures

⇒ Closing the books of Vendor fiom

When the fiom is sold to a company or converete into a company the books of accounts have to be closed. The following are the ledger accounts.

* Realisation A/c
* Purchasing Company A/c
* Shares in purchase company A/c
* Partners Loan A/c
* Partners Capital A/c
* Cash or Bank A/c

1 Realisation A/c

This account is debited with all assets at book value & credited with all liabilities at book value except partners loan.

2 Purchasing Company A/c

Total PC ~~1032000~~ 1032000

1 Pass incorporation entries in the books of company from the following details.
Purchase Consideration is ₹ 250000
Value of Sundry assets taken over ₹ 300000
Current liabilities taken over ₹ 30000
Settlement of purchase consideration 60% in equity shares of ₹ 10 each at par & balance in 6% debentures of ₹ 100 each at par

Solution Calculation of Purchase Consideration

Equity shares of ₹ 10 each [250000 x 60%]	150000
6% Debentures of ₹ 100 each [250000 x 40%]	100000
Total PC.	250000

Calculation of Goodwill or Capital Reserves

Dr. Cr.

Particulars	Amount	Particulars	Amount
Sundry Assets	300000	Current Liabilities	30000
		Purchase Consideration	250000
		Capital Reserves	20000
	300000		300000

Date:

Incorporation Entries
In the books of Purchase Consideration

Date	Particulars	LF	Debit	Credit
1	Business Purchase A/C Dr.		250000	
	To Vendor Firm A/C			2500
	[Being purchase consideration due]			
2	Sundry A/c assets A/C. Dr.		300000	
	To Current liabilities A/C			30000
	To Purchase Consideration A/C			250000
	To Capital Reserves A/C			20000
	[Being assets & liabilities taken over]			
3	Vendor Firm A/C Dr.		250000	
	To Equity Shares A/C			150000
	To Debentures A/C			100000
	[Being purchase consideration paid]			

2 Pass incorporation entries in the books of purchasing company. Purchase consideration ₹600000. Value of assets taken over ₹700000 current liabilities taken over ₹50000. Settlement of purchase consideration 80% in equity shares of ₹10 each & balance in 8% debentures of ₹100 each.

papergrid

Date: / /

7 Ram, Ravi & Robert are in partnership sharing profit & losses in the ratio of 4:3:1. On 31st March 2012. They agreed to sell their business to a limited Company. The position on the date was as follows.

Liabilities	Amount	Assets	Amount
Capital		Free hold property	36000
Ram	40000	Machinery	24000
Ravi	30000	Debtors	30000
Robert	26000	Stock	26000
Loan from Bank	8000	Cash	4000
Creditors	16000		
	120000		120000

The company took over the following assets expect cash at the valuation shown below

Free hold property ₹ 44000

Machinery ₹ 22000

Debtors ₹ 28000

Stock ₹ 24000

Goodwill ₹ 8000

The company also agreed to pay the creditors which was agreed at ₹ 15400. The company paid 3300 shares of ₹ 10 each fully paid & in the balance in cash. The expenses amounted to ₹1000.

Prepare necessary ledger accounts in the books of the firm.

Date:

Solution Calculation of Purchase Consideration

Free hold property	44000
Machinery	22000
Debtors	28000
Stock	24000
Goodwill	8000
	126000
Less: Liabilities taken over:	
Creditors	15400
Total PC	110600

Discharge of Purchase Consideration

3300 Shares at ₹ 10 [3300x10]	33000
Cash [110600 - 33000]	77600
Total PC	110600

Realisation A/c

Dr. Cr.

Particulars	Amount	Particulars	Amount
To Free hold property	36000	By Creditors	16000
To Machinery	24000	By Bank loan	8000
To Debtors	30000	By Purchase Consideration	110600
To Stock	26000		
To Cash [Bank loan]	8000		
To Cash [Expenses]	1000		
To Realisation A/c [P]	9600		
To Ram: 9600x4/8 = 4800			
To Ravi: 9600x3/8 = 3600			
To Robert: 9600x1/8 = 1200			
	134600		134600

Purchasing Company A/c

Dr.

Particulars	Amount	Particulars	Amount
To Purchase Consider-ation	110600	By Shares	33000
		By Cash	77600
	110600		110600

Shares in Purchasing Company A/c

Dr. Cr.

Particulars	Amount	Particulars	Amount
To Shares	33000	By Ram	14000
		By Ravi	10500
		By Robert	8500
	33000		33000

Partner's Capital A/c

Dr. Cr.

Particulars	Ram	Ravi	Robert	Particulars	Ram	Ravi	Robert
To Shares	14000	10500	8500	By Bal c/d	40000	30000	26000
				By Realisat-ion A/C [P]	4800	3600	1200
To Cash	30800	23100	18700				
	44800	33600	27200		44800	33600	27200

Date: / /

Woaking Note

Calculation of final Claim Ratio

44800 : 33600 : 27200

224 : 168 : 136

112 : 84 : 68 = 264

Ram. $33000 \times 112/264 = 14000$

Ravi : $33000 \times 84/264 = 10500$

Robert : $33000 \times 68/264 = 8500$

Cash A/C

Dr. Cr.

Particulars	Amount	Particulars	Amount
To Bal b/d	4000	By ~~Purchasing~~ Realisation	8000
To Purchasing Company	77600	By Realisation (Expe)	1000
		By Ram	30800
		By Ravi	23100
		By Robert	18700
	81600		81600

R, M & A carrying on business in partnership sharing profit & loss in the ratio of 4:3:1 on 31st March 2016. They agreed to sell there business to a limited company. There position on that date was as follows

Liabilities	Amount	Assets	Amount
Creditors	40000	Free hold property	90000
Loan	20000	Machinery	60000
Capital		Debtors	75000
R	100000	Stock	65000
M	75000	Cash	10000
A	65000		
	300000		300000

The company took over the following assets except cash

Free hold property ₹ 110000

Machinery ₹ 55000

Debtors ₹ 70000

Stock ₹ 60000

Goodwill ₹ 20000

The company also agreed to pay the creditor which was agreed at ₹ 38500. The company also paid 168000 in fully paid shares of ₹ 10 each and balance in cash.

The expenses amounted to ₹ 2500

Prepare necessary ledger A/c in the books of the Firm.

Solution Calculation Of Purchase Consideration

~~Shares~~

Free hold property	110000
Machinery	55000
Debtors	70000

Date: / /

Stock	60000
Goodwill	20000
	315000
Less: liabilities takenover	
Creditors	38500
Total PC	276500

Discharge of Purchase Consideration

168000 shares at ₹ 10 [168000 x 10]	168000
Cash [276500 - 168000]	108500
Total PC	276500

Realisation A/c

Dr. Cr.

Particulars	Amount	Particulars	Amount
To Freehold property	90000	By Creditors	40000
To Machinery	80000	By Loan	20000
To Debtors	75000	By Purchase Consideration	276500
To Stock	65000		
To Cash [loan]	20000		
To Cash [Expenses]	2500		
To Realisation A/c [P]	24000		
R = 24000x4/8 = 12000			
M = 24000x3/8 = 9000			
A = 24000x1/8 = 3000			
	336500		336500

Purchasing Company A/C

Dr. Cr.

Particulars	Amount	Particulars	Amount
To Purchase Consider-ation	276500	By Shares	168000
		By Cash	108500
	276500		276500

Shares in Purchasing Company A/C

Dr. Cr.

Particulars	Amount	Particulars	Amount
By Shares	168000	By R	71273
		By M	53455
		By A	43272
	168000		168000

Partner's Capital A/C

Dr. Cr.

Particulars	R ₹	M ₹	A ₹	Particulars	R ₹	M ₹	A ₹
To Shares	71273	53455	43272	By Bal b/d	100000	75000	65000
				By Realisa-tion A/c [P]	12000	9000	3000
To Cash A/C	40727	30545	24728				
	112000	84000	68000		112000	84000	68000