Accounting For Not For Profit Organization Meaning, Features and Financial Statements of a Not-for-Profit Organization:

Meaning and Concept of Not-for-Profit Organisations:
i. These are the institutions/organisations that are set-up with general or specific objectives for rendering services and providing other social activities to enhance the welfare of general or a particular group of people.
ii. The aim of such institutions is not to earn profit, however, the organisations are capable of earning profit.
iii. A separate legal entity not owned by any individual or an enterprise.
iv. Examples of such organisations are schools, colleges, public hospitals, literacy societies for promoting sports, arts, culture, etc.

Characteristics or Features of Not-for-Profit Organisations
i. Formed by Promoters: These organisations are formed by the promoters who can be either individual or groups of individuals and enterprises.
ii. Separate Existence: These organisations have separate existence from its members, i.e. the life of an NPO is unaffected by the life of its members.
iii. Purpose: Its purpose is to further cultural, educational, religious, professional or public service objectives.
iv. Form: It is set-up as a charitable society or trust.
v. No Profit Motive: Its aim is not to earn profit, however, the organisation is capable of earning profit. Any surplus is used by the organisation for its prescribed objectives rather than distributing it among the members.
vi. Management: It is managed by a group of individuals known as Trustees or Managing Committee.
vii. Funding: The main source of their income is subscription, donations, government grants and other receipts
viii. Accounts: Unlike profit-seeking organisations, NPOs do not prepare Profit and Loss Account; rather they prepare Income and Expenditure Account to show a summary of revenue incomes and revenue expenses. The NPOs prepare final accounts every year which comprises of Receipt and Payment Account, Income and Expenditure Account and Balance Sheet

Financial Statements of a Not-for-Profit Organization:

i. It prepares annual or final accounts every year showing the financial transactions of the organisation.
ii. These annual or final accounts are prepared for its members and to comply with statutory requirements.
iii. Financial Statements of an NPO comprise of the following:
a. Receipts and Payments Account,
b. Income and Expenditure Account and
c. Balance Sheet.

Understanding Receipts and Payments Account
Meaning, Features, Format and Limitations of Receipts and Payments Account:
Meaning: It is an account that shows the summary of all cash and bank transactions occurred during an accounting period. It starts with the opening balances of cash and bank and ends with the closing balances of cash and bank. This account is a Real Account and lays the basis for the preparation of Income and Expenditure Account and the Balance Sheet.

Features: Following are the features of Receipts and Payments Account:

i. Nature: It is a summary of cash receipts and payments and hence, it an Asset Account/Real Account
ii. Recording: It provides the summary of all cash and bank transactions in a chronological order.
iii. Basis of Preparing: It is prepared on cash basis, i.e., it records only cash inflow and outflow. Accrued and outstanding transactions are not recorded in this account.
iv. Capital and Revenue: It records all the transactions whether capital or revenue.
v. Period: It records all the cash and bank transactions irrespective of whether they relate to current, previous or succeeding accounting periods.
vi. Opening and Closing Balances: Opening balance of this account is the cash in hand/ bank at the beginning of the accounting year and the closing balance shows cash in hand/bank at the end of the accounting period.
vii. Adjustment: Adjustments for accrued, outstanding items and depreciation is not required tobe made in this account.

viii. Purpose: The purpose of preparing this account is to show amount received and paid under various heads during the accounting year and also to know the cash position of the entity.

Format:

Receipts and Payments Account for the year ended 31, March ….. Year

Receipts	Amount	Payments	Amount
To Balance b/d(Opening Balance):	…	By Balance b/d (Opening Balance)(in	…
Cash in Hand Cash at Bank		case of Bank Overdraft)	…
To Subscriptions:For Previous Year …	….	By Salaries	…
For Current Year … For Next Year … To		By Rent	…
General DonationsTo		By Postage Expenses	…
Entrance/Admission Fees To General		By Newspapers and Magazines, etc.	…
Grants To Sale of Newspaper, Grass,	…	By Repairs	…
etc. To Sale of Old Used Sports	…	By Audit Fee	…
Materials To Interest on Investments	…	By Maintenance Expenses	…
To Income from Concerts/Lectures To	…	By Insurance	…
Dividends To Rent Received To	…	By Secretary’s Honorarium	…
Interest Received To Miscellaneous	…	By Honorarium	…
Receipts To Life Membership Fees To	…	By Municipal Tax	…
Subscriptions for Specific Purpose To	…	By Prize Distributed	…
Donation for Specific Purpose To	…	By Office Expenses	…
Legacies To Endowment Fund To Sale	…	By Expenses on Show	…
of Fixed Assets To Receipts on Account	…	By Miscellaneous Payments	…
of Special Fund, i.e., Match Fund, Prize	…	By Purchase of Fixed Assets (e.g.,	…

Fundetc. To Balance c/d (Bank Overdraft)*	… … … … … … … …	Furniture) By Sports Equipment By Investments By Books By Loan (Repayment) By Building By Balance c/d (Closing Balance): Cash in Hand Cash at Bank*	… … … … … … …
	…		…

*Either of the two will appear.

If the receipts side is more than the payments side then, Closing balance of cash and bank will appear on the credit side of this account.

If the payments side is more than the receipts side then, Closing balance of bank will appear (as Bank overdraft) on the debit side of this account.

Limitations of Receipts and Payments Account:

i. It follows cash basis of accounting and therefore, does not show incomes and expenses on accrual basis.

ii. It is not capable of showing whether the NPO is able to meet its day-to-day expenses out of its income or not as the credit transactions are ignored.

ACCOUNTANCY Accounting for Not-for-Profit Org

iii. It is not a perfect substitute of Trial Balance as this account fails to reveal the closing balances of all accounts.

Difference between Receipts and Payments Account and Cash Book:

S.L n.o	Basis	Receipts and payments account	Cash book
1	Statement Vs. account	It can be regarded as statement rather than an account. Unlike ordinary accounts, it does not show Date and Ledger Folio Columns	It can be regarded as an account as it works both as Journal as well as ledger and its balances are directly shown in the Balance Sheet.
2	Period	It is prepared at the end of the accounting period.	It is written on daily basis.
3	Date	It does not require the transactions to be written datewise. Even date column is not present in the R&P A/c	It requires the date-wise recording of the transactions.
4	Institutions	It is prepared by the Not-forProfit Organisation.	It is prepared by all types of organisation be it a commercial

			or Not-for-Profit organisation.
5	Side	It has receipts and payments side instead of debit and credit.	It is divided into debit and credit sides.
6	Ledger Folio	It does not have column for ledger folio.	It has a separate column for Ledger Folio

Meaning, Features, Format and Important Terms of Income and ExpenditureAccount:

Meaning:

i. It is like Profit and Loss Account of an enterprise or business firm.

ii. It shows all revenue income earned and revenue expenses incurred during an accounting period.

iii. It is prepared at the end of the accounting period on accrual basis of accounting.

iv. It determines the result of the organisation's operations, whether it has surplus or deficit.

v. It has 2 sides namely, debit and side. All the incomes and gains are recorded on the credit side and all the expenses and losses are recorded on the debit side.

vi. Excess of credit side over the debit side is termed as surplus, whereas, excess of debit side over the credit side is termed as deficit.

vii. Such surplus or deficit, as the case maybe, is either added to or deducted from the Capital Fund in the Balance Sheet.

ACCOUNTANCY Accounting for Not-for-Profit Organisation

Features:

i. Nature: It is a Nominal Account and therefore, all revenue expenses and losses incurred are recorded on the debit side and all revenue incomes and gains earned are recorded on the credit side of this account.

ii. Basis of Recording: It follows the accrual basis of accounting to ascertain Surplus or Deficit arising after meeting all revenue expenses against all revenue incomes at the end of an accounting period

iii. Period: It records only those expenses and incomes which relate to the current accountingperiod.
iv. Opening and Closing Balances: It has no opening balance, however, balance at the end is either surplus or deficit which is then transferred to Capital Fund in the Balance Sheet.

v. Adjustments: Since, it follows accrual basis of accounting, all the adjustments are to be given effect which are necessary to record the incomes, gains, expenses and losses relating to the current accounting period.

Formatof Income and Expenditure Account:

Dr. Income and Expenditure Account for the period ended… Cr

Expenditure	Amount	Income	Amount
To Salaries …		By Subscriptions …	
Add: Outstanding at the end…		Add: Outstanding at the end …	
…		Advance in the beginning…	
Less: Outstanding at the beginning …	…	…	
To Rent		Less: Outstanding at the beginning …	
To Insurance Premium …		…	
Less: Prepaid…	…	Less: Advance at the end …	…
To Audit Fees	…	By Entrance Fees	…
To Printing and Stationery	…	By Donations	…
To Honorarium	…	By Sale of Old Newspapers	…
To Telephone Expenses	…	By Hall Rent	…
To Repairs	…	By Sundry Receipts	…
To Depreciation	…	By Deficit	…
To Sports Material Used	…	(excess of expenditure over income)*	
To Surplus	…		
(excess of income over expenditure)*			
	…		…

Expenditure side to record: All revenue expenses for current period (after making adjustment for outstanding and prepaid expenses)

Income side to record: All revenue income for current period (after making adjustments for outstanding and advance income)

Some important terms:

Capital Expenditure:

i. It is an expenditure, which benefits the organisations for more than one accounting period.

ii. It results in the acquisition of assets which are used for the furtherance of activities carried on by the NPO.

iii. Examples include cost of land, building, furniture and any addition thereto.

Revenue Expenditure:

i. It is an expenditure, the benefits of which expire within the accounting period.

ii. In case of an NPO, such expenditure means expenditure incurred for social or charitable activities carried on by the NPO.iii. Examples include Materials used, rent, insurance, salaries, honorariumpaid etc.

Revenue Receipts:

i. Any income received from the activities carried out by organization is termed as revenue receipts.
ii. Examples include Subscription from members, General Donations, Rent Received, etc.

Capital Receipts:

i. Receipts other than revenue receipts are termed as Capital Receipts.
ii. Receipts from donor for the specified purpose are also termed as Capital Receipts.
iii. Examples include Life Membership Fee, Corpus Donations, Furniture Fund, etc.

Difference between Income and Expenditure Account and Profit and Loss Account:

Basis of distinction	Income and expenditure Account	Receipts and payments Account
Nature	It is like as profit and loss account.	It is the summary of the cash book.
Nature of Items	It records income and expenditure of revenue nature only.	It records receipts and payments of revenue as well as capital nature.
Period	Income and expenditure items relate only to the current period.	Receipts and payments may also relate to preceding and succeeding periods.
Debit side	Debit side of this account records expenses and losses.	Debit side of this account records the receipts.
Credit side	Credit side of this account records income and gains.	Credit side of this account records the payments.
Depreciation	Includes depreciation.	Does not includes depreciation.
Opening Balance	There is no opening balance.	Balance in the beginning represents cash in hand /cash at bank or overdraft at the beginning.
Closing Balance	Balance at the end represents excess of income over expenditure or vice-versa.	Balance at the end represents cash in hand at the end and bank balance (or bank overdraft).
Cash basis/Accrual basis	Follows Accrual basis	Follows Cash basis.
Nature of Account	Nominal account	Real account.

Understanding Balance Sheet

Meaning, Format and Important Points to prepare Balance Sheet:

Meaning:

i. It is a statement that reveals the financial position of an organisation at a particular date.

ii. It shows assets, liabilities and Capital Fund.

iii. It is prepared in the same manner as that for a business firm.

iv. It is prepared after the Income and Expenditure Account.

v. Any surplus or deficit in the Income and Expenditure Account is transferred to Capital Fund, where, Capital Fund = Total Assets – Total Liabilities.

Opening Balance Sheet:

It shows the balances of all the assets, liabilities, funds and reserves in the beginning of an accounting period. It is usually prepared to ascertain the capital fund in the beginning or any other missing item.

Need for Preparing Opening Balance Sheet

In case, the Capital Fund is not mentioned in the question, then in order to ascertain the Capital Fund we need to prepare the Opening Balance Sheet. All the opening balances of assets such as, building, furniture, outstanding subscription (at the beginning), etc. and all the opening balances of liabilities such as, creditors, advance subscription (at the beginning), outstanding expenses etc. are recorded in this balance sheet. The excess of the total of the Assets over the total of the Liabilities is regarded as Capital Fund.

Closing Balance Sheet:

It is prepared to assess the true and fair financial position of an organisation at the end of an accounting period.

Following points should be kept in mind while preparing the Balance Sheet:

i. Expenses and Incomes: Expenses that are outstanding or prepaid and Incomes that are receivable or received in advance will appear in the Balance Sheet as Assets or Liabilities based on the nature of the respective items.

ii. Special Receipts: Special items like specific donations for building, sports, etc. will not appear in the Income and Expenditure Account. Instead they are shown as liabilities in the Balance Sheet.

iii. Surplus and deficit: Balancing of Income and Expenditure Account will either give a surplus or a deficit. This surplus/deficit is then added to or reduced from the Capital Fund Balance and only the net amount is shown in Balance Sheet.

iv. Assets: Amounts of assets that are shown in the opening Balance Sheet are to be adjusted for all current year transactions related to the respective assets which includes purchase of asset, sale of asset and depreciation. Such adjusted amount will then appear in the closing Balance Sheet.

v. Liabilities: Amounts of liabilities that are shown in the opening Balance Sheet are to be adjusted for all current year transactions related to the respective liability which shall include payments made against them or additional liability being created. Such adjusted amount will then appear in the closing Balance Sheet.

vi. Loans and Advances: Opening amount of loan taken should be adjusted for all repayments made during the year against it and only the net amount should be shown as a liability. In case of advances, opening balance should be adjusted for all the amounts recovered during the year and only the net amount should be shown as an asset.

Format of Opening Balance Sheet of a Not-for-Profit Organisation.

Liabilities	Amount	Assets	Amount
Bank Overdraft, if any Outstanding Expenses Advance Subscription Capital Fund*(balancing figure)	… … … …	Cash in Hand Cash at Bank Fixed Assets, if any Investments, if any Outstanding Subscriptions Prepaid Expenses	… … … … … …
	…		…

Format of Closing Balance Sheet of a Not-for-Profit Organisation.

Liabilities	Amount		Assets	Amount
Capital fund: Opening Balance Add: Surplus OR Less: Deficit Add: Capitalised Income of			Cash in hand and /or Cash at Bank Outstanding Incomes Prepaid Expenses Stock of Consumable	....

the Current Year on account of: Legacies Entrance Fees Life Membership Fees Closing Balance Special Fund/Donations: Previous Balance (If any) Add: Receipts for the item during the period Add: Income earned on fund/Donations’ Investments Less: Expenses paid out of fund/Donations Net Balance Creditors for Purchases and/or supplies Bank Overdraft Outstanding Expenses: Income received in Advance			Items: Previous Balance Add: Purchases in the current Period Less: Value consumed during the period Previous Balance Add: Purchases in the current Period Less: Book Value of the Asset sold/disposed off Closing Balance	 ....
	......			......

ACCOUNTING TREATMENT OF SOME IMPORTANT ITEMS:

1. ENTRANCE FEES: It is the amount paid by a person at the time of becoming a member of a nonprofit organisation. It is treated as a revenue receipt and is credited to Income and Expenditure account. If it is specified as to be capitalized then it should be entered in Liabilities side of Balance Sheet.

2. LIFE MEMBERSHIP FEES OR LIFE SUBSCRIPTION: It is the amount received from a member in lump sum and he is given the membership of the organisation for the whole life. It is treated as a capital receipt and added to the capital fund on the liabilities side of the Balance sheet.

3. DONATIONS: Donation is the amount received form a person, firm, company by way of gift. Donation received may be a general donation or specific donation.

a. General donation: It is treated as an income and is credited to the Income and Expenditure account

b. Specific donation: It will be capitalized and is shown on the liabilities side of Balance sheet.

Note:. In the absence of any information about the nature of donation it should be treated as general Donation.

4. LEGACY: It is the amount received by the non-profit organisation as per the will of a deceased person. The donor may or may not specify the purpose for which the donated amount can be used. it should be treated as capital receipt and be shown in the liabilities side of Balance sheet .

5. SUBSCRIPTION: It is the major source of income of a not-for –profit organisation. Subscriptions are the amount paid by the members of such organisations to maintain their membership.

a. Subscription income for the current year is shown in the Income and Expenditure account. It is calculated as follows:

Particulars	Amount	Amount
Total subscription received during the year	xxx	Xxx
Add: subscription o/s at the end of the current year	xxx	
Subscription received in advance in the beginning	xxx	Xxx
	xxx	Xxx
Less: subscription o/s at the beginning of the year		
Subscription received in advance at the end of the year		xxx
Subscription to be shown in Income and Expenditure account		xxx

b. Subscription o/s at the end of the year is an asset and the subscription received in advanceis a liability

6. GOVERNMENT GRANT: Not-for-organisations may receive grants from government, corporates, national and international agencies. If the grant is received for any specific purpose then the grant is capitalized and shown on the liability side of balance sheet. If the grant is not marked for any specific purpose such as maintenance grant, then it is treated as income and is credited to income and expenditure account.

7. INTEREST ON GENERAL FUND INVESTMENTS: it is treated as revenue receipt and hence credited to Income and Expenditure account.

8. a. FUND BASED ACCOUNTING: It refers to an accounting system in which receipts and incomes relating to a particular fund are credited to that particular fund and expenses related to that fund are credited to that particular fund are debited to it. (Prize Fund, Tournament Fund, Building Fund etc.)

b. INTEREST ON SPECIFIC FUND INVESTMENT: It is added to the respective fund (e.g. Interest on building fund investment is added to Building Fund)

9. ENDOWMENT FUND: It a fund that arises from a gift and its income is devoted for a specific purpose. It is considered as a capital receipt and is shown in the liabilities side of Balance sheet.

10. SALE OF OLD SPORTS MATERIALS: The amount so received is treated as revenue income assuming that its book value is zero. It is shown on the credit side of Income and Expenditure account.

11. SALE OF OLD NEWSPAPERS AND MAGAZINES: The amount realized from the sale is accounted as an income and credited to Income and Expenditure account.

12. SALE OF OLD ASSET: Any gain or loss on sale of old assets is transferred to income and expenditure account.(Loss on expenditure side and Profit on income side)

13. HONORARIUM: This is the amount paid to those persons who are not regular employees of the organisation, but render some useful services to the organisation. It a token payment given in honour of the services rendered. It is shown on the debit side of the Income and Expenditure account.

14. STOCK OF STATIONERY/MEDICINES/BATS AND BALLS:
Opening stock+ purchases – closing stock = Stock consumed during the year. It will appear in the expenditure side of income and expenditure account.

PROBLEMS ON SUBSCRIPTION:

As per the receipts and payments account for the year ended 31st march 2019 the subscription received were Rs.3, 00,000.

Additional information is given below:

Subscription o/s on 1.4.2018 30,000

Subscription o/s on 31.03.2019	40,000
Subscription received in advance as on 1.4.2018	10, 000
Subscription received in advance as on 31.03.2019	20, 000

Ascertain the amount of Income from subscription for the year 2018-19 and also show relevant items of subscription appear in opening and closing balance sheet,

SOLUTION:

Particulars Amount

Sub received as per receipts and payments a/c		300000
Add: sub o/s 31.3.2019		40000
Add :sub Received in advance 1.4.201810000		
Less: sub o/s 1.4.2018	30000	350000
Less: Sub received in advance 31.3.201920000 50000		
Income from sub for the year 2018-19		300000

Balance Sheet as at 31.03.2018

Liabilities	Amount	Assets	Amount
Sub received in advance	10000	Sub o/s	30000

Balance Sheet as at 31.03.2019

Liabilities	Amount	Assets	Amount
Sub received in advance	20000	Sub o/s	40000

PROBLEM ON SPECIFIC FUNDS:

Show how you will deal with the following in the financial statements of a club:

Details	debit	Credit
Prize fund		80000
Prize Fund investment	80000	
Income from prize fund investment		8000
Prizes awarded	6000	

Solution

Balance Sheet as at ……..

Liabilities	Amount	Assets	Amount
Prize fund	80,000	Sports fund investment	80,000
Add: income from investment	8,000		
Less: prizes awarded	(6,000)82,000		

PROBLEMS ON STOCK OF STATIONERY/MEDICINIES:

Calculate the amount to be posted to Income and Expenditure Account for the year ended 2018-19:

Particulars	Rs
Stock of Medicine on 1st April 2018	5,000
Creditors for medicine on 1st April 2018	9,000
Advance paid for medicine carried forward from 2017-18	12,000
Stock of Medicine on 31st March 2019	8,000
Advance paid for medicine on 31st March 2019	16,000
Amount paid for medicine during the year 2018-19	2, 20,000

Creditors for medicine on 31st March 2019 15,000

Solution:

Amount paid for medicine during the year 2018-19	2, 20,000
Add: Advance paid for medicine carried forward from 2017-18	12,000
Less: Advance paid for medicine on 31st March 2019	(16,000)
Add: Creditors for medicine on 31st March 2019	15,000
Less: Creditors for medicine on 1st April 2018	(9,000)
Add: Stock of Medicine on 1st April 2018	5,000
Less: Stock of Medicine on 31st March 2019	(8,000)
Cost of Medicine consumed 2018-19	2, 19,000

PROBLEMS ON INCOME AND EXPENDITURE ACCOUNT: (MISSING FIGURES)

In the following Income and Expenditure Account for the year ended 31st March 2019 and Balance Sheet as on that, determine the missing information. Assume there is no sale/purchase of any fixed asset during the year.

Income and Expenditure account For the year ended 31st March 2019

Expenditure Rs Income Rs

To Rent 10,000
Add: O/s at the End …….. ----------- By Subscription …….
Add: Subscription due
To Salary …… Attheend …….
Add: O/S at the end8,000 25,000 Less: Subscription due
To Printing and Stationery 15,000 In the beginning (5,000)
To General Expenses ………… Less: Subscription received in
To Depreciation: advance for next year(15,000)………..
Clubs building @5 % 15,000
Furniture @10 % 1,800 16,800 By Entrance fee 12,000
To Surplus (Excess of Income 57,800 By Sale of old sports Material 800
over Expenditure)
1,32,800 1,32,800

Balance SheetAs at 31sty March 2019

Liabilities Rs Assets Rs

Capital Fund ………. Club Building …………………
Add: Surplus………… 2, 18,000 Furniture …………………
Books5,800
Outstanding subscription 40,000
Sports Material 6,000
Cash at Bank ……………..
Match Fund 1,50,000
Outstanding Rent 2.000
Outstanding Salary ………..
Subscription in Advance ……….

Solution:

Income and Expenditure accountFor the year ended 31st March 2019

ExpenditureRs Income Rs

To Rent 10,000
Add: O/s at the End 2,000 12,000 BySubscription 1,00,000
Add: Subscription due
At the end40,000
To Salary 17,000Less: Subscription due
Add: O/S attheend 8,000 25,000 In the beginning(5,000)
To Printing and Stationery 15,000 Less: Subscription received
To General Expenses 6,200 advance (15,000)1,20,000
To Depreciation:

Clubs building @ 5 % 15,000 ByEntrance fee 12,000
Furniture @10 % 1,80016,800 BY Sale of old sports Material 800
To Surplus 57,800
1,32,800 1,32,800

Balance Sheet As at 31st March 2019

Liabilities Rs Assets Rs
Capital Fund 1,60,200 Club Building 2,85,000
Add: Surplus 57,8002,18,000 Furniture 16,200
Books 5,800
Match Fund 1,50,000Outstanding subscription 40,000
Outstanding Rent 2,000 Sports Material 6,000
Outstanding Salary 8,000 Cash at Bank 40,000
Subscription in Advance 15,000
3,93,000 3,93,000

PROBLEM ON INCOME AND EXPENDITURE ACCOUNT ONLY:

Receipts and payments account of a sports club for the year ended 31,March, 2019

Receipts	Amount	Payments	Amount
Balance b/d	10,000	Salaries	15,000
Subscriptions	52,000	Billiards table	20,000
Entrance fee	5,000	Office expenses	6,000
Tournament fund	26,000	Tournament expenses	31,000
Sale of old newspapers	1,000	Sports equipment	40,000
Legacy	37,000	Balance c/d	19,000
Total	1,31,000	Total	131,000

Additional information: On 31/03/2019. Subscription outstanding was <2000 and on 31/03/2018 subscription outstanding was <3000. Salary outstanding on 31/03/2019 was <1500. On 01/04/2018 the club had building <75000 furniture <18000, 12% investment 30,000 and sports equipment 30,000. Depreciation charged on building, furniture and sports equipment @10% p.a. including
purchases.
Prepare income and expenditure account for the year ended 31/03/2019.

Solution:

Income and Expenditure account for the year ended 31/3/2019

Expenditure	Amount	Income	Amount
Salaries	16 500	Subscription	51,000
Office expenses	6 000	Entrance fee	5,000
Tournament expenses	5 000 1	Sale of old newspaper	1,000
newspaper	000	Accrued interest on investment	3,600
Depreciation:			
Furniture	1 800		
Billiard table	2 000		
Building	7 500		
Sports equipment	7 000		
Surplus	14 800		
	60,600		60,600

PROBLEMS FOR PRACTICE: (6 marks)

(1) Prepare Income and Expenditure Account and Balance Sheet for the year ended March 31, 2015 from the following information.

Receipt and Payment Account for the year ending March 31, 2015

Receipts	Amount	Payments	Amount
Balance b/d	41,000	Salaries and Wages:	88,000
Subscriptions:		2013-14 4,800	37,000
2013-14 7,200		2014-15 83,200	60,000
2014-15 3,37,600		Sundry expenses	16,000
2015-16 12,000	3,56,800	Freehold land	24,000
Entrance fees	16,000	Stationery	37,500
Locker rent	58,000	Rates	4,000
Revenue from refreshment	48,000	Refreshment expenses	2,50,000
Income from investments	56,000	Telephone charges	6,000
		Investments	53,300
		Audit fee	
		Balance c/d	
	5,75,800		

The following additional information is provided to you:

1. There are 1800 members each paying an annual subscription of Rs. 200, Rs. 8,000 were in arrears for 2013-14 as on April 1, 2014.
2. On March 31, 2015 the rates were prepaid to June 2015; the charge paid every year being Rs. 24,000.
3. There was an outstanding telephone bill for Rs. 1,400 on March 31, 2015.
4. Outstanding sundry expenses as on March 31, 2014 totaled Rs. 2,800.
5. Stock of stationery as on March 31, 2014 was Rs. 2000; on March 31, 2015, it was Rs. 3,600.
6. On March 31, 2014 Building stood at Rs. 4,00,000 and it was subject to depreciation @ 2.5% p. a.
7. Investment on March 31, 2014 stood at Rs. 8,00,000.
8. On March 31, 2015, income accrued on investments purchased during the year amounted to Rs. 1,500.

Solution:

Income and Expenditure Accountfor the year ending on March 31, 2015

Expenditure	Amount	Income	Amount
Salaries and Wages Sundry	83,200	Subscriptions	3,60,000
Expenses 37,000 Less:	34,200	Entrance fees Locker rent	16,000
Outstanding on31.3.2014 2,800			58,000
Stationery : (consumed) Opening stock			
2,000	14,400	Income from refreshment:	
Add: Purchases 16,000		Revenue from 48,000	10,500
Less: Closing stock 3,600		refreshment Less:	
Rates 24,000	24,000	Refreshment 37,500	
Less: Paid for 2015-166,000		expenses	
Add: Prepaid in 2014-15 6,000	5,400		57,500
Telephone charges 4,000	6,000	Income from 56,000	
Add: Outstanding 1,400	10,000	investments	

Audit fee Depreciation on building Surplus (excess of Income over expenditure)	3,24,800	Add: Accrued income 1,500 on current year investment	
	5,02,000		5,02,000

Balance Sheet as on March 31, 2014

Liabilities	Amount	Assets	Amount
Outstanding Sundry Expenses Outstanding Salary and Wages General Fund (Balancing figure)	2,800 4,800 12,49,400	Cash and Bank balance Subscription in arrears Stock of stationery Rates prepaid Investments Building	41,000 8,000 2,000 6,000 8,00,000 4,00,000

Balance Sheet as on March 31, 2015

Liabilities	Amount	Assets	Amount
Outstanding Telephone Expenses Subscription received in Advance General Fund 12,49,400 Add: Surplus 3,24,800	1,400 12,000 15,74,200	Cash and Bank Balance Subscription in Arrears Stock of Stationery Rates Prepaid Accrued Interest on investment Investments 8,00,000 Additions 2,50,000 Building 4,00,000 Less: Depreciation 10,000 Land	53,300 23,200 3,600 6,000 1,500 10,50,000 3,90,000 60,000
	15,87,600		15,87,600

Question Bank with Answers: (3 marks)

a)From the following information, calculate the amount of subscriptions to be credited to Income and Expenditure account for the year 2018-19.

Subscription received during the year	50,000.
Subscription outstanding on 31st March 2018	18,000
Subscription outstanding on 31st March 2019	9,000
Subscription received in advance on 31st March 2018	10,000
Subscription received in advance on 31st March2019	12,000

b)A club has 500 members. Each member has to pay subscription @<200. Total Subscription received during the year ending 31.3.2019 was <1, 20,000 including <12,000 for the year 2017-18 and <18,000 for the year 2020-21. Twenty members have paid their subscription for 2018-19 in the year 2017-18. Subscription outstanding as on 31.3.2018 was <15,000. Compute the amount of subscription to be shown in the Balance Sheet as at 31st March2019.
(Outstanding sub. For 2018-19 is <9000 (including <3000 (15000-12000) for 2017-18) and sub received in income and expenditure account is <1, 00,000.)

c)From the following information, calculate the amount of sports material to be debited to Income and Expenditure account for the year ended 31st March 2019.

Particulars	Amount
Balance of sports materials on 1.4.2018	20,000
Balance of sports materials on 31.3.2019	15,000
Creditors for sports materials on 1.4.2018	40,000
Creditors for sports materials on 31.3.2019	45,000
Payment made to creditors for sports materials during the year ended 31stMarch 2019.	2,00,000

(Credit purchase of sport materials <2, 05,000; material used during the year <2, 10,000.)

Show how will you deal with the following items while preparing the Final Accounts of a club for the year ending 31st march, 2019 in each of the alternative cases:

(a) Tournament Expenses 15,000

(b) Tournament Receipts <25,000 and Tournament Expenses <19,000

(c) Tournament Fund <75,000; Tournament Expenses < 25,000

(d) Tournament fund <75,000; Tournament Receipts <25,000 and Tournament expenses <55,000

(e) Tournament Fund <55,000; Tournament Expenses <67,000. Tournament receipts<5,000.

(a& b income and expenditure account) (c,d Balance sheet liability side) (e income and expenditure a/c expenditure side)

OBJECTIVE /MCQ ON NOT-FOR –PROFIT ORGAISATIONS:

1. Income and Expenditure account shows transactions of Capital nature for the accounting year. (TRUE/FALSE)
2. Surplus or Deficit of a non-profit organisation is added to or subtracted from accumulated fund (TRUE/FALSE)
3. A NPO has a Match Fund of <1,00,000 and Match Expenses of <40,000 Match fund and Match expenses will be shown in the liabilities side of the Balance Sheet , expenses being deducted from fund.(TRUE/FALSE)
4. An advance receipt of subscription from members of Not-for –profit organisation is an Asset. (TRUE/ FALSE)
5. Under NPO, sale of old newspaper is shown as an income
(TRUE/FALSE)
6. Excess of Income over Expenditure in Income and Expenditure account prepared by a NPO is termed as Deficit.(TRUE/FALSE)
7.Building Fund, Library Fund etc. is based on Accounting
8. Amount paid by the members to keep their membership alive is termed as
9. Amount received as donation by NPO under will of a deceased person is termed as______
10. Life membership fees received by a NPO is a_
11. Token payment made to a person, who voluntarily undertakes a service which would normally command a fee is .
12. Receipts and Payments Account is based on_ Basis of accounting.
13. Which of the following is an example of not-profit-organisation:
a. public hospitals b. corporations c. Audit firm d. Insurance companies.
14. <100000 received as annual subscription. Out of this <20000 is of pervious year whereas <10000 is receivable at the end of the current year. Amount of subscription that will be show in income and expenditure account willbe
a. <1, 00,000 b. <90, 000 c. <1, 20,000 d. <80, 000
15. surplus of Not-for –Profit organisations
a. distributed among the members
b. is not distributed among the members
c. May be or May not be distributed among the members
d. is debited to General fund.
16. if Life Membership fees of <5000 wrongly treated as revenue receipt then effect of this error on surplus and closing balance of capital fund will be
a. Capital fund increased and surplus increased by<5000
b. Capita fund decreased and surplus increased by<5000
c. No effect on capital fund but surplus increased by<5000
d. Capital fund decreased by <5000 but no effect on surplus.
17. Income and Expenditure Account is based on
(a) Cash Basis of Accounting.
(b) Accrual Basis of Accounting.
(c) Mixed Basis of Accounting.
(d) Management Accounting.
18. Delhi cricket club gives the following information. Opening Stadium Fund is <10, 00,000. Donation for Stadium fund received during the year Rs.500000. Income from Stadium Fund Investment Rs.100000. Amount spent during the year on construction of stadium is Rs.600000. Identify which of the following statement is correct in respect to preparation of Balance sheet.
a. Rs.600000 shown on the asset side of the Balance sheet.
b. Rs.600000 shown on the asset side of the Balance sheet Also Rs.600000 is transferred to the credit of Income and Expenditure account,
c. Rs.600000 shown on the asset side of the Balance sheet Also Rs.600000 is transferred from

Stadium fund to General fund in the Balance sheet.
D.Rs.600000 is shown as an expense in the Income and Expenditure account and Rs.600000 is transferred to the credit pf Income and Expenditure account from Stadium fund.
19. Subscriptions received during the year Rs.5,000,amount received in advance for the next year is Rs.300. Amount outstanding for current year was Rs.400. The amount to be credited to the Income and Expenditure account is
a. 4,000 b. 5100 c. 4200 d.4600
20. Subscription received during the year Rs.50, 000. ;Subscriptions Outstanding at the end of the year` 8,000; Subscription outstanding at the beginning of the year ` 6,000. Net Income from subscription will be—
(A)48,000 (B)64,000 (C)52,000 (D)36,000
21. When the Tournament Expenses incurred are more than the Tournament Fund, then the excess amount is
a. Debited to Income and Expenditure account
b. Credited to Tournament Fund
c. Shown on the Asset side of Balance sheet
d. Credited to Income and Expenditure Account
22. Which of the following is prepared to find out the income of a trading concern?
A. Receipts and Payments a/c
B. Income and Expenditure a/c
C. Profit and Loss a/c
D. Balance Sheet.
23. If Income is Rs.16,000 and deficit debited to Capital Fund is Rs.4,300 then Expenditure is: A. 16,000 B. 4,300 C.20,300 D. None of these
24. The Main purpose of Not-for- Profit organisation is :
A. To earn profit B. to serve the society C. To improve the economy D. None of the above.
25. If 10% Interest on Investment appearing in the Receipts side is Rs.7000, then the value of investment will be:
A. Rs.1,00,000 B. 70,000 C.56,000 D.49,000
26. Entrance fees received amounted to Rs.50,000. In this 25% is to be capitalized. Mention the amount to be shown in income side of Income and Expenditure account:
A.12,500 B.13,200 C.50,000 D. 37,500
27. Subscription outstanding for the year 2018-19 is Rs.2500. Subscription outstanding for the year 2017-18 was Rs.5000 out of which Rs.3000 were received during the year 2018-19. The outstanding subscription to be shown in the Income and expenditure for current year 2018-19 is :
A.Rs. 500 B. Rs.1000 C. Rs.2500 D. Rs.3000
28. Furniture (Book value) Rs.5,000 were sold for Rs. 4,500. New Furniture worth Rs.10,000 were purchased during the year. The amount which is to be debited to Income and Expenditure account is :
A. Profit on sale Rs.500 B. Loss on sale Rs.500 C. Sale of furniture Rs.4500 D. Purchase of Rs.10000
29. Stock of medicines on 1.4.18 were Rs.5000. Medicines purchased during the year is Rs.5000. Medicines sold during the year is Rs.2500. Closing stock of medicines are Rs.3000. Stock of medicines used during the year 2019 is:
A.Rs.7000 B Rs.2500 C. Rs.5000 D. Rs.10000
30. Receipts and payments account makes no difference between:
A. capital Receipts and Capital payments B. Revenue receipts and revenue payments
C. Current year and previous year D. All the above.
Answers:
1 FALSE 6 FALSE 11 HONORORIUM 16 C 21 A 26 D
2 TRUE 7 FUND BASED 12 CASH BASIS 17 B 22 C 27 A
3 TRUE 8 SUBSCRIPTION 13 A 18 C 23 C 28 B
4 FALSE 9 LEGACY 14 B 19 B 24 B 29 A
5 TRUE 10 CAPITAL
RECEIPT 15 B 20 C 25 B 30

Accounting for Partnership Firms:

Basic Concepts:

Meaning and Definition

According to Section 4 of the Partnership Act 1932 "Partnership is the relation between persons who have agreed to share the profits of a business carried on by all or any of them acting for all"

Features of partnership Firm

1) Association of two or more persons: There must be at least two persons and maximum of 50 persons to form a partnership and they must be competent to contract.

2) Partnership Agreement or Deed: There must be an agreement among partners to form a partnership. It can be written or oral.

3) Legal Business: The business of the partnership firm must be a legally allowed business.

4) Sharing of Profits or Losses: The partners must share profits or losses in a certain ratio.

5) Mutual Agency: The partners mutually take part in daily routine work or the work may be carried on by one or more partners on behalf of the other partners. Every partner is legally liable for the acts of all other partners, whether he is taking part in the activities of the firm or not.

6) Unlimited Liability: Partners' liability to the third parties is unlimited. If there are losses, and the firm is not able to pay its debts fully, then all the partners shall be jointly and severally liable to pay the debts of the firm to an unlimited extent.

Partnership Deed: The document, which contains terms of the agreement, is called' Partnership Deed'. It generally contains the details about all the aspects affecting the relationship between the partners including the objective of business, contribution of capital by each partner, ratio in which the profits and the losses will be shared by the partners and entitlement of partners to interest on capital, interest on loan, etc.

Provisions of Partnership Act, 1932 in the absence of Partnership Deed:

(a) Profit Sharing Ratio: If the partnership deed is silent about the profit sharing ratio, the profits and losses of the firm are to be shared equally by partners.

(b) Interest on Capital: No interest on capital is payable if the partnership deed is silent on the issue.

(c) Interest on Drawings: No interest is to be charged on the drawings made by the partners, if there is no mention in the Deed.

(d) Interest on Advances: If any partner has advanced some money to the firm beyond the amount of his capital for the purpose of business, he shall been titled to get an interest on the amount at the rate of 6 percent perannum.

(e) Remuneration for Firm's Work: No partner is entitled to get salary or other remuneration for taking part in the conduct of the business of the firm.

Fixed and Fluctuating Capital Accounts of Partners

There are two methods by which the capital accounts of partners can be maintained. These are:

(i) Fixed capital method and

(ii) fluctuating capital method.

<u>Fixed Capital Method:</u> Under the fixed capital method, the capitals of the partners shall remain

fixed unless additional capital is introduced or a part of the capital is withdrawn as per the agreement among the partners. All items like share of profit or loss, interest on capital, drawing interest on drawings, etc. are recorded in separate accounts, called Partner's Current Account.
* The partners' capital accounts will always show a credit balance, which shall remain the same (fixed) year after year unless there is any addition or withdrawal of capital.
* The partners' current account on the other hand, may show a debit or a credit balance. Thus under this method, two accounts are maintained for each partner viz., capital account and current account, While the partners' capital accounts shall always appear on the liabilities side in the balance sheet, the partners' current account's balance sall be shown on the liabilities side, if they have credit balance and on the assets side, if they have debit balance.
The partner's capital account and the current account under the fixed capital method would appear as shown below:

Partner’s capital account

Date	Particulars	Jf	Amount	Date	Particulars	Jf	Amount
	To Bank A/c(permanent withdrawal of capital) To Balance c/d (closing balance)		…… ……		By Balance b/d By Cash/Bank A/c (Additional Capital)		…… …….
			…..				……

Partner’s current account

Date	Particulars	Jf	Amount	Date	Particulars	Jf	Amount
	To Balance b/d (Incase of debit opening balance) To Drawings A/c (Drawings against Profit) To Interest on Drawings A/c To Profit and Loss A/c (Loss) To Balance c/d*		…… ……… …….. …….. ……….		By Balance b/d (In case of credit opening balance) By Interest on Capital A/c By CommissionA/c By Partners ‘Salary A/c By Profit andLoss App. A/c(Profit)		……… ……… ……… ……… ……….
			………..				……….

Fluctuating Capital Method: Under the fluctuating capital method, only one account, i.e. capital account is maintained for each partner. All the adjustments such as share of profit and loss, interest on capital, drawings, interest on drawings, salary or commission to partners, etc. are recorded directly in the capital accounts of the partners. This makes the balance in the capital account to fluctuate from time to time. That's the reason why this method is called fluctuating capital method. In the absence of any instruction, the capital account should be prepared by this method. The proforma of capital accounts prepared under the fluctuating capital method is given below:-

Partner’s capital account

Date	Particulars	Jf	Amount	Date	Particulars	Jf	Amount
	To DrawingsTo Bank (permanent withdrawal of capital) To Interest on Drawings A/c To Profit and LossAppropriationA/c (Loss) To Balance c/d*		…….. ……... ………. …….. ………		By Balance b/d By Cash/BankA/c (Additional Capital) By Interest on Capital A/c By Commission A/c By Partners ‘Salary A/c By Profit and Loss Appropriation		……. …….. ……… …….. ……… ………

					.A/c(Profit)		
			………..				………

Difference between Fixed capital method and Fluctuating capital method

Basis	Fixed capital method	Fluctuating capital method
Meaning	Capitals of the partner's remains fixed unless additional capital is introduced. or a part of the capital is withdrawn.	Capitals of partners fluctuates.
No. of Accounts	Two separate accounts are maintained for each partner: 1. Capital account 2. Current account	Only one account called capital accountmaintained i.e
Adjustments	All adjustments like share of profit or loss, interest on capital, drawings, etc. are recorded in a separate account which is called partner's current account	All adjustments are like share of profit or loss, interest on capital, drawings, etc. are recorded in capital account of the partner.
Debit/Credit balance	Capital account will always show credit balance	It can show either debit or credit balance

Distribution of Profit among Partners

The profits and losses of the firm are distributed among the partners in an agreed ratio. However, if the partnership deed is silent, the firm's profits and losses are to be shared equally by all the partners.
You know that in the case of sole partnership the profit or loss, ascertained by the profit and loss account is transferred to the capital account of the proprietor. In case of partnership, however, certain adjustments such as interest on drawings, interest on capital, salary to partners, and commission to partners are required to be made. For this purpose, it is customary to prepare a Profit and Loss Appropriation Account of the firm and as certain the final figure of profit and loss to be distributed among the partners, in their profit sharing ratio.
The Proforma of Profit and Loss Appropriation Account is given as follows:

Dr. Profit and Loss Appropriation Account Cr.

Particulars	Amount	Particulars	Amount
To Profit and Loss A/c (Net loss transferred from Profit and Loss Account) To Interest on Capitals: A … B … To Partners' Salaries To Partners' Commissions To Reserve To Profit transferred to: *A's Capital A/c … *B's Capital A/c …	……. …… …… …… …… ……	By Profit and Loss A/c (Net Profit transferred from Profit and Loss Account) By Interest on Drawings: A ….. B…..	…… ……
	……..		……..

*Note: Interest on partner's loan is to be treated as a charge against profits.

Journal Entries for preparation of partner's capital/current account and Profit and Loss Appropriation Account:
1. Transfer of the balance of Profit and Loss Account to Profit and Loss Appropriation Account:
(a) If Profit and Loss Account shows a credit balance (net profit):
Profit and Loss A/c Dr.
To Profit and Loss Appropriation A/c
(b) If Profit and Loss Account shows a debit balance (net loss)
Profit and Loss Appropriation A/c Dr.

To Profit and Loss A/c
2. Interest on Capital:
(a) For Allowing interest on capital:
Interest on Capital A/c Dr.
To Partner's Capital/Current A/cs (individually)
(b) For transferring interest on capital to Profit and Loss Appropriation Account:
Profit and Loss Appropriation A/c Dr.
To Interest on Capital A/c
3. Interest on Drawings:
(a) For charging interest on drawings to partners' capital/current accounts:
Partners Capital/Current A/c's (individually) Dr.
To Interest on Drawings A/c
(b) For transferring interest on drawings to Profit and Loss Appropriation Account:
Interest on Drawings A/c Dr.
To Profit and Loss Appropriation A/c

4. Partner's Salary:
(a) For Allowing partner's salary to partner's capital/current account:
Salary to Partner A/c Dr.
To Partner's Capital/Current A/c's (individually)
(b) For transferring partner's salary to Profit and Loss Appropriation Account:
Profit and Loss Appropriation A/c Dr.
To Salary to Partner's A/c
5. Partner's Commission:
(a) For crediting commission allowed to a partner, to partner's capita/currentl account:
Commission to Partner A/c Dr.
To Partner's Capital/Current A/c's (individually)
(b) For transferring commission allowed to partners to Profit and Loss Appropriation Account.
Profit and Loss Appropriation A/c Dr.
To Commission to Partners Capital/Current A/c
6. Share of Profit or Loss after appropriations:
(a) If Profit:
Profit and Loss Appropriation A/c Dr.
To Partner's Capital/Current A/c's (individually)
(b) If Loss:
Partner's Capital/Current A/c (individually)
To Profit and Loss Appropriation A/c
Note: In case firm suffers a loss, no interest on capital, salary, remuneration is to be allowed to partners.

Interest on Capital
No interest is allowed on partners' capitals unless it is expressly agreed among the partners. When the Deed specifically provides for it, interest on capital is credited to the partners at the agreed rate with reference to the time period for which the capital remained in business during a financial year. Interest on capital is generally provided for in two situations: (i) when the partners contribute unequal amounts of capitals but share profits equally, and (ii) where the capital contribution is same but profit sharing is unequal.
Interest on capital is calculated with due allowance for any addition or withdrawal of capital during the accounting period. For example, Mohini, Rashmiand Navin entered into partnership, bringing in Rs. 3,00,000, Rs. 2,00,000 and Rs. 1,00,000 respectively into the business. They decided to share profits and losses equally and agreed that interest on capital will be provided to the partners @10 per cent per annum. There was no addition or withdrawal of capital by any partner during the year. The interest on capital works out to Rs. 30,000 (10% on 30,000) for Mohini, Rs. 20,000 (10% on 2,00,000) for Rashmi, and Rs. 10,000 (10% on 1,00,000) for Navin.
Take another case of Mansoor and Reshma who are partners in a firm and their capital accounts showed the balance of Rs. 2,00,000 and Rs. 1,50,000 respectively on April 1, 2016. Mansoor introduced additional capital of Rs. 1,00,000 on August 1, 2016 and Reshma brought in further capital of Rs. 1,50,000 on October 1, 2016. Interest is to be allowed @ 6% p.a. on the capitals. It shall be worked as follows:
For Mansoor

(2,00,000*6/100)+(1,00,000*6/100*8/12= Rs. 12,000 + Rs. 4,000 = Rs. 16,000
For Reshma
(1,50,000*6/100)+(1,50,000*6/100*6/12)= Rs. 9,000+Rs. 4,500= Rs. 13,500
When there are both addition and withdrawal of capital by the partners during a financial year, the interest on capital is calculated as follows:
(i) On the opening balance of the capital accounts of partners, interest is calculated for the whole year;
(ii) On the additional capital brought in by any partner during the year, interest is calculated from the date of introduction of additional capital to the last day of the financial year.
(iii) In case of withdrawal of capital, interest on capital will be calculated as:
On opening capital from the beginning of the year till date of capital withdrawn and then on the reduced capital for the remaining time period. Alternatively, it can be calculated with respect of amount remained in business for the relevantperiod.
Illustration 5
Saloni and Srishti are partners in a firm. Their capital accounts as on April 01. 2016 showed a balance of Rs. 2,00,000 and Rs. 3,00,000 respectively. On July 01, 2016, Saloni introduced additional capital of Rs. 50,000 and Srishti, Rs. 60,000. On October 01 Saloni withdrew Rs. 30,000, and on January 01, 2016 Srishti withdraw, Rs. 15,000 from their capitals. Interest is allowed @ 8% p.a. Calculate interest payable on capital to both the partners during the financial year 2016–2017.
Solution
Statement Showing Calculation of Interest on Capital :
For Saloni

	(Rs.)
Interest on Rs. 2,00,000 for 3 months.2, 00, 000 *8/100* 3/12	= 4000
Add : Interest on Rs. 2,50,000 for 3 months .2,50,000* 8/100* 3/12	= 5,000
Add : Interest on Rs. 2,20,000 for 6 months .2, 20,000* 6/12* 8/100	= 8,800
	17,800

For Srishti

	(Rs.)
Interest on Rs. 3,00,000 for 3 months .3,00,000* 8/100* 3/12	=24,000
Add : Interest on Rs,60,000 for 6 months 60,000* 8/100* 9/12	= 3, 600
	27,600
Less: Interest on Rs. 15,000 for 3 months . 15,000*8/100*3/12	= 300
	27,300

Sometimes opening capitals of partners may not be given. In such a situation before calculation of interest on capital the opening capitals will have to be worked out with the help of partners' closing capitals by marking necessary adjustments for the additions and withdrawal of capital, drawings, share of profit or loss, if already shown in the capital accounts the partners.
Illustration 6
Josh and Krish are partners sharing profits and losses in the ratio of 3:1. Their capitals at the end of the financial year 2015-2016 were Rs. 1,50,000 and Rs. 75,000. During the year 2015-2016, Josh's drawings were Rs. 20,000 and the drawings of Krish were Rs. 5,000, which had been duly debited to partner's capital accounts. Profit before charging interest on capital for the year was Rs. 16,000. The same had also been debited in their profit sharing ratio. Krish had brought additional capital of Rs. 16,000 on October 1, 2015. Calculate interest on capital @ 12% p.a. for the year 2015-2016.

Solution
Statement Showing Calculation of Capital at the Beginning

Particulars	Josh Rs.	Krish Rs.
Capital at the end	1, 50,000	75,000
Add: Drawings during the year	20,000	5,000
	1, 70,000	80,000
Less: Share of profit (credited)	12,000	4,000
	1, 58,000	76,000
Less: Additional capital	—	16,000
Capital in the beginning	1,58,000	60,000

Interest on capital will be as 18,960 (12% of Rs. 1,58,000) for Josh and Rs. 960 for krish calculated as follows:

(60,000*12/100) (16,000*12/100*6/12)
= Rs. 7,200 + Rs. 960
= Rs. 8,160.

As clarified earlier, the interest on capital is allowed only when the firm has earned profit during the accounting year. Hence, no interest will be allowed during the year the firm has incurred net loss and if in a year, the profit of the firm is less than the amount due to the partners as interest on capital, the payment of interest will be restricted to the amount of profits. In that case, the profit will be effectively distributed in the ratio of interest on capital of each partner.

Illustration 7

Anupam and Abhishek are partners sharing profits and losses in the ratio of 3 : 2. Their capital accounts showed balances of Rs. 1,50,000 and Rs. 2,00,000 respectively on Jan 01, 2017. Show the calculation of interest on capital for the year ending December 31, 2017 in each of the following alternatives:

(a) If the partnership deed is silent as to the payment of interest on capital and the profit for the year is Rs. 50,000;
(b) If partnership deed provides for interest on capital @ 8% p.a. and the firm incurred a loss of Rs. 10,000 during the year;
(c) If partnership deed provides for interest on capital @ 8% p.a. and the firm earned a profit of Rs. 50,000 during the year;
(d) If the partnership deed provides for interest on capital @ 8% p.a. and the firm earned a profit of Rs. 14,000 during the year.

Solution

(a) In the absence of a specific provision in the Deed, no interest will be paid on the capital to the partners. The whole amount of profit will however be distributed among the partners in their profit sharing ratio.
(b) As the firm has incurred losses during the accounting year, no interest on capital will be allowed to any partner. The firm's loss will however be shared by the partners in their profit sharing ratio.

Rs. .
(c) Interest to Anupam @ 8% on Rs. 1,50,000 = 12,000
Interest to Abhishek @ 8% on Rs. 2,00,000 = <u>16,000</u>
<u>28,000</u>

As the profit is sufficient to pay interest at agreed rate, the whole amount of interest on capital shall be allowed and the remaining profit amounting to Rs. 22,000 (Rs. 50,000 – Rs. 28,000) shall be shared by the partners in their profit sharing ratio.
(d) As the profit for the year is Rs. 14,000, which is less than the amount of interest on capital due to partners, i.e. Rs. 28,000 (Rs. 12,000 for Anupam and Rs. 16,000 for Abhishek), interest will be paid to the extent of available profit i.e., Rs. 14,000. Anupam and Abhishek will be credited with Rs. 6,000 and Rs. 8,000, respectively. Effectively this amounts to sharing the firm's profit in the ratio of interest on capital, i.e., 3:4.

Interest on Drawings

The partnership agreement may also provide for charging of interest on money withdrawn out of the firm by the partners for their personal use. As stated earlier, no interest is charged on the drawings if there is no express agreement among the partners about it. However if the partnership deed so provides for it, the interest is charged at an agreed rate, for the period for which drawings have been made. Remained outstanding from the partners during an accounting year. Charging interest on drawings discourages excessive amounts of drawings by the partners. The calculation of interest on drawings under different situations is shown as here under.

When Fixed Amounts was Withdrawn Every Month

Many a time, a fixed amount of money is withdrawn by the partners, at equal time interval, say each month or each quarter. While calculating the time period, attention must be paid to whether the fixed amount was withdrawn at the beginning (first day) of the month, middle of the month or at the end (last day) of the month. If withdrawn on the first day of every month, interest on total amount will be calculated for 6½ months; if withdrawn at the end at every month, it will be calculated for 5½ months, and if withdrawn during the middle of the month, it will be calculated for 6 months using the following formula:

Interest on drawings = Total amount withdrawn x Rate of interest/100 x average period x 1/12

Suppose, Aashish withdrew Rs. 10,000 per month from the firm for his personal use during the year ending March 31, 2017. The calculation of average period and the interest on drawings, in different situations would be as follows:

(a) When the amount is withdrawn at the beginning of each month:

Average Period = No. of months of 1 drawings + No. of month of last drawings

2

12+1

2

6.5 months.

2020-21

Interest on Drawings = 1, 20,000 x 8 x13 x1

100x2x12

= Rs. 5,200.

(b) When the amount is withdrawn at the end of each month

Average Period = No. of months of 1 drawings + No. of months of last drawings

2

=11+ 0

2

= 5.5 months

Interest on Drawings = 1 20 000x 8x 11x 1

100x 2 x12

= Rs. 4,400.

(c) When money is withdrawn in the middle of the month

When money is withdrawn in the middle of the month, nothing is added or deduced from the total period.

Average Period = No. of months of 1 drawings + No. of month of last drawings

2

=11.5+0.5

2

= 6 months

Interest on Drawings =1 20 000x 8x 6x 1

100x 12

= Rs. 4,800.

When Fixed Amount is withdrawn Quarterly

When fixed amount of money is withdrawn quarterly by partners, in such a situation, for the purpose of calculation of interest, the total period of time is ascertained depending on whether the money was withdrawn at the beginning or at the end of each quarter. If the amount is withdrawn at the beginning of each quarter, the interest is calculated on the total money withdrawn during the year, for a period of seven and half months i.e.,

12+ 3

2

= 7.5 months

and if withdrawn at the

and of each quarter it will be calculated for a period of 4½ months, i.e.,

9+0

2

Suppose Satish and Tilak are partners in a firm, sharing profits and losses equally. During financial year 2016–2017, Satish withdrew Rs. 30,000 quarterly. If interest is to be charged on drawings @ 8% per annum, the calculation of average period and interest on drawings will be as follows:

(a) If the amount is withdrawn at the beginning of each quarter

Statement Showing Calculation of Interest on Drawings

the interest can be calculated on the total amount withdrawn

during the accounting year, i.e. Rs. 1,20,000 for a period of 7½ months

(12+9+6+3)/4. as follows:

= 1,20,000 × 8 ×15x1

100x2x12

= 6,000.

(b) If the amount is withdrawn at the end of each quarter

Statement Showing Calculation of Interest on Drawings

Alternatively, the interest can be calculated on the total amount withdrawn

during the accounting year, i.e., Rs. 1,20,000 for a period of 4½ months
(9 + 6 + 3 + 0)/4 months as follows:
= Rs. 1,20,000 × 8x9x1
100x2x12
= Rs. 3,600

When Varying Amounts are Withdrawn at Different Intervals
When the partners withdraw different amounts of money at different time intervals, the interest is calculated using the product method. Under the product method, for each withdrawal, the money withdrawn is multiplied by the period (usually expressed in months) for which it remained withdrawn during the financial year. The period is calculated from the date of the withdrawal to the last day of the accounting year. The products so calculated are totaled and on the total of the products interest at the specified rate is calculated as under:
Total of products × Rate/100 ×1/12
For example,
Shahnaz withdrew the following amounts from her firm, for personal use during the year ending March 31, 2017. Calculate interest on drawings by product method, if the rate of interest to be charged is 7 per cent per annum.

Date	Amount (Rs.)
April 1, 2016	16,000
June 30, 2016	15,000
October 31, 2016	10,000
December 31, 2016	14,000
March 1, 2017	11,000

Calculation of interest on drawings will be as follows:
Statement Showing Calculation of Interest on Drawings

Date	Amount (Rs.)	Time in monthsPeriod	Product (Rs.)
April 1, 2016	16,000	12 months	1, 92,000
June 30, 2016	15,000	9 months	1, 35,000
Oct. 31, 2016	10,000	5 months	50,000
Dec. 31, 2016	14,000	3 months	42,000
Mar. 1, 2017	11,000	1 month	11,000
Total			4,30,000

Interest = Sum of Products × Rate × 1/
12
= Rs. 4,30,000 ×7/100 ×1/12
=30100/12
= Rs. 2,508 (approx.).
Illustration 8
John Ibrahm, a partner in Modern Tours and Travels withdrew money during the year ending March 31, 2017 from his capital account, for his personal use. Calculate interest in drawings in each of the following alternative situations, if rate of interest is 9 per cent per annum.
(a) If he withdrew Rs. 3,000 per month at the beginning of the month.
(b) If an amount of Rs. 3,000 per month was withdrawn by him at the end of each month.
(c) If the amounts withdrawn were : Rs. 12,000 on June 01, 2016, Rs. 8,000; on August 31, 2016, Rs. 3,000; on September 30, 2016, Rs. 7,000, on November 30, 2016, and Rs. 6,000 on January 31, 2017.
Solution
(a) As a fixed amount of Rs. 3,000 per month is withdrawn at the beginning of the month, interest on drawings will be calculated for an average period of 61/2 months.
Interest on drawings = Rs. 36,000x 9x 13x 1
100x 2x 12
= Rs. 1,755
(b) As the fixed amount of Rs. 3,000 per month is withdrawn at the end of each month, interest on drawings will be calculated for an average period of 51/2 months.
=36,000x 9x 11x 1
100x 2x 12
= Rs. 1,485
(C) Statements showing Calculation of Interest on Drawings

Date	Amount Withdrawn(Rs.)	Period (in months)	Product (Rs.)
Jun. 1, 2016	12,000	10	1, 20, 000
Aug. 31, 2016	8,000	7	56,000
Sept. 30, 2016	3,000	6	18,000
Nov. 30, 2016	7,000	4	28,000
Jan. 31, 2017	6,000	2	12,000
			2 , 34,000

Total Interest = 2, 34,000*9/100*1/12

= 1,755

Illustration 9

Manu, Harry and Ali are partners in a firm sharing profits and losses equally. Harry and Ali withdrew the following amounts from the firm, for their personal use during 2019-2020.

Date	Harry (Rs.)	Ali (Rs.)
2019		
April, 01	5,000	7,000
July, 01	8,000	4,000
December, 01	5,000	5,000
March, 01, 2020	4,000	10,000

Calculate interest on drawings if the rate of interest to be charged is 10 per cent, and the books are closed on December 31 every year.

Statement Showing Calculation of Interest on Drawings

Harry			Ali		
Amount (Rs.)	Period (in months)	Product (Rs.)	Amount (Rs.)	Period (in months)	Product (Rs.)
5000	12	60,000	7,000	12	84,000
8000	9	72,000	4,000	9	36,000
5000	4	20,000	5,000	4	20,000
4000	1	4,000	10,000	1	10,000
		1, 56,000			1, 50,000

Amount of Interest

Harry = $\frac{1,56,000 \times 10 \times 1}{100 \times 12}$

= Rs. 1,300

Ali = $\frac{1,50,000 \times 10 \times 1}{100 \times 12}$

= Rs. 1,250

Problems for practice:

1. Govind is a partner in a firm. He withdrew the following amounts during the year 2015-16:

	(Rs.)
April 30, 2019	6,000
June 30, 2019	4,000
Sept. 30, 2019	8,000
Dec. 31, 2019	3,000
Jan. 31, 2020	5,000

The interest on drawings is to be charged @ 6% p.a. The books are closed on March 31, every year. Calculate interest on drawing :

2. Ram and Syam are partners sharing profits/losses equally. Ram withdrew Rs. 1,000 p.m. regularly on the first day of every month during the year 2018-19 for personal expenses. If interest on drawings is charged @ 5% p.a. Calculate interest on the drawings of Ram.

3. Verma and Kaul are partners in a firm. The partnership agreement provides that interest on drawings should be charged @ 6% p.a. Verma withdraws Rs. 2,000 per month starting from April 01, 2019 to March 31, 2020. Kaul withdrew Rs, 3,000 per quarter, starting from April 01, 2019. Calculate interest on partner's drawings.

When Dates of Withdrawal are not specified

When the total amount withdrawn is given but the dates of withdrawals are not specified, it is assumed that the amount was withdrawn evenly throughout the year.

For example;
Shakila withdrew Rs. 60,000 from partnership firm during the year ending March 31, 2020 and the interest on drawings is to be charged at the rate of 8 per cent per annum. For calculation of interest, the period would be taken as six months, which is the average period assuming, that amount is withdrawn evenly in the middle of the month, throughout the year. The amount of interest on drawings works out to be Rs. 2,400 as follows:

$$\frac{8 \times 6 \times 60{,}000}{100 \times 12}$$

= Rs. 2,400

Past Adjustments

If after closing the accounts for the year it is the discovered that some errors have been committed, then these errors have to be rectified. Some adjustment entries have to be passed to rectify the error. The entries are made through Profit & Adjustment A/c. These entries are to rectify the errors committed in past, therefore, they are known as 'Past Adjustments'. Generally the following types of errors are committed:

(i) Interest on Capital and on Drawings have been omitted.
(ii) Interest on Capital and on Drawings have been provided at higher or lower rates than the rates agreed in the Deed.
(iii) Salary or commission to partners either not given or a higher or lower amount has been given.
(iv) Profit shared in a wrong ratio.

Adjustment Chart

Particulars	A	B	C	Firm
Interest on capital	+	+	+	-
Partner's salary/commission	+	+	+	-
Interest on drawings	-	-	-	+
	+	+	+	
For taking back wrong profit	-	-	-	+
Profit after all adjustments	+	-	+	0

* Assumed that there are three partners A, B and C.
* Assumed that all errors are related to omission
* + means Cr the partner's capital A/c
* - means Dr the partner's capital A/c
* In last+ amount should be equal to- amount

Note: Similarly following errors can be rectified accordingly:
(i) Interest on Capital and on Drawings have been provided at higher or lower rates than the Rates agreed in the Deed
(ii) Salary or commission to partners either a higher or lower amount has been given.

Guarantee of Profit to a Partner

Guarantee of profit means a minimum amount of profit to be paid to a partner. This amount shall be given to him if his share of profit is lower than the guaranteed amount. The deficit shall be borne either by one of the old partners or by all the old partners in a particular agreed ratio. If there is no agreement, then in their old profit sharing ratio, if his actual share of profit is more than the guaranteed amount, then, he will be given his actual share of profit. He gets the guaranteed amount or the actual share of profit, whichever is higher.

(a) Guarantee given by all partners
(i) Compare the amount of guarantee and his actual share of profit. If guaranteed amount is more than his actual share of profit, then the guaranteed amount will be debited to profit and loss Appropriation Account and the partner's account will be credited with the guaranteed amount.
(ii) The deficiency shall be shared by other partners in their profit sharing ratio.
(b) Guarantee given by One Partner only
First calculate his share of profit. Compare it with the guaranteed amount. The amount of deficiency is to be charged from the partner who gave guarantee.
(c) Guarantee given to a partner by other partners in a ratio different from their profit sharing ratio

Distribute profit among all the partners in the profit sharing ratio. Work out the amount of deficiency by comparing it with the guaranteed amount and his actual share of profit. The other partners will bear the deficiency in an agreed new ratio.

Goodwill

Meaning of Goodwill

Over a period of time, a well - established business develops an advantage of good name, reputation and wide business connections. This helps the business to earn more profits as compared to a newly setup business. In accounting, the monetary value of such advantage is known as "goodwill".
Factors Affecting the Value of Goodwill
The main factors affecting the value of goodwill are as follows:
1. Nature of business: A firm that produces high value added products or having as table demand disable to earn more profits and therefore has more goodwill.
2. Location: If the business is centrally located or is at a place having heavy customer traffic, the goodwill tends to be high.
3. Efficiency of management: A well-managed concern usually enjoys the advantage of high productivity and cost efficiency. This leads to higher profits and so the value of good will also be high.
4. Market situation: The monopoly condition or limited competition enables the concerned to earn high profits which leads to higher value of goodwill.
5. Special advantages: The firm that enjoys special advantages like import licenses, low rate and assured supply of electricity, long-term contracts for supply of materials, well-known collaborators, patents, trademarks etc. enjoy higher value of goodwill.
Need for Valuation of Goodwill
In a partnership firm, goodwill needs to be valued in the following circumstances:
1. Change in the profit sharing ratio amongst the existing partners;
2. Admission of new partner;
3. Retirement of a partner;
4. Death of a partner; and
5. Dissolution of a firm involving sale of business as a going concern.
6. Amalgamation of partnership firm
Methods of Valuation of Goodwill
1. Average Profits Method
(a) Simple Average
Stepwise procedure to calculate Goodwill under this method:
Step1: Work out profits or losses given for each of the past year after taking into account abnormalities, if any.
Step2: Calculate average by dividing the total profit of all the years by the number of years.
Step3: Goodwill= Average Profit x Number of year's purchase.
(b) Weighted Average
This is a better method than the simple average method. It takes into account the importance of each year. Under this method, earlier years are less important than the recent years. Thus, each year's profit is multiplied by its respective number (weight) in chronological order. The latest year will be given the highest weight and the earliest year will be given lowest weight. Each profit figure will be multiplied by its weight and then the total of these products will be calculated. This total will be divided by the total of weights.
Then Goodwill = Weighted average x number of years' purchase
2. Super Profit Method
Stepwise procedure to calculate Goodwill under this method:
Calculate the average profit,
1. Calculate the normal profit on the capital employed on the basis of the normal rate of return, Formula = Normal Profit = Capital Employed x NRR /100
2. Calculate the super profits by deducting normal profit from the average profits, Formula- Super Profit = Average Profit - Normal Profit
3. Goodwill = Super profits x number of years 'purchase.
3. Capitalisation Method
Under this method the goodwill can be calculated in two ways: (a) by capitalizing the average profits, or (b) by capitalizing the super profits.
(a) Capitalisation of Average Profits: This involves the following steps:
(i) As certain the average profits based on the past few years' performance.

(ii) Capitalize the average profits on the basis of the normal rate of return to ascertain the capitalised value of average profits as follows:
Average Profits x 100/Normal rate of Return
(iii) As certain the actual capital employed (net assets) by deducting outside liabilities from the total assets (excluding goodwill).
Capital Employed/Net Assets = Total Assets (excluding goodwill) – Outside Liabilities
(iv) Compute the value of goodwill by deducting net assets from the capitalised value of average profits, i.e.(ii)–(iii).
Capitalisation of Super Profits: It involves the following steps.
(i) Calculate capital employed of the firm, which is equal to total assets minus outside liabilities.(i) Calculate capital employed of the firm, which is equal to total assets minus outside liabilities.
(ii) Calculate normal profit = Capital Employed X Normal Rate of Return/100
(iii) Calculate average profit for past years, as specified.
(iv) Super profits = average profits/Actual profit - normal profits
(v) Goodwill = Super Profits × 100/ Normal Rate of Return
Note: In other words, goodwill is the capitalised value of super profits. The amount of goodwill worked out by this method will be exactly the same as calculated by capitalising the average profits.

Question
X,Y and Z share profit in the ratio of 2:3:5.They earned a profit of Rs. 1,50,000 for the year ended 31-12-2015. The profit was by mistake distributed among X, Y and Z in the ratio of 3:2:1, respectively. This error was noted in the beginning of the new year. They have set up an old age Home for the old and poor in the city.Identify the business values and give the missing figures in the following solution

Particulars	X	Y	Z	Firm
1. Profit distributed in wrong ratio taken backDr.	(75000)	(50000)	(25000)	150000
2. The profit now distributed in correct ratio Cr.	30000	45000	75000	(150000)
3. Adjusted profit	(45000)	(5000)	50000	0

Note: The amount put in the brackets means negative value.

And give adjustment entry.
X's Capital A/c Dr.45000
Y's Capital A/c Dr. 5000
To Z's Capital A/c 50000
(Being Adjustment entry made)
Value: Sensitivity towards poor. Fulfilling social responsibility

Question Bank
Partnership Deed
1. Mohan and Shyam are partners in a firm. State whether the claim is valid if the partnership agreement is silent in the following matters:
(i) Mohan is an active partner. He wants a salary of Rs.10,000 per year
(ii) Shyam had advanced a loan to the firm. He claims interest@10% per annum
(iii) Mohan has contributed Rs.20,000 and Shyam Rs.50,000 as capital. Mohan wants equal share in profits.
(iv) Shyam wants interest on capital to be credited @ 6% per annum.
2. State whether the following statements are true or false:
(i) Valid partnership can be formulated even without a written agreement between the partners
(ii) Each partner carrying on the business is the principal as well as the agent for all the other partners
(iii) Methods of settlement of dispute among the partners can't be part of the partnership deed
(iv) If the deed is silent, interest at the rate of 6% p.a. would be charged on the drawings made by the partner
Division of Profit
3. X and Y are partners with capitals of Rs.15,00,000 and Rs.10,00,000 respectively. They agree to share profits in the ratio of 3:2. Show how the following transactions will be recorded in the P & L Appropriation and capital accounts of the partners in case:
(i) The capitals are fixed, and
(ii) The capitals are fluctuating. The books are closed on March 31, every year.
Particulars X (Rs.) Y (Rs.)
Additional capital contributed on July1,2015 3,00,000 2.00,000
Interest on capital 5% 5%
Drawings (during 2015-16) 30,000 20,000

Interest on drawings 12% 12%
Salary 20.000 –
Commission 10,000 7,000
The profits for the year ending 31st March, 2016 were Rs 71,500.
Hint: If the capitals are fixed: X's capital A/c-Rs 18,00,000; Y's capital A/c-Rs 12,00,000
X's current A/c-Rs 20,700; Y's current A/c-Rs 80.
If the capitals are fluctuating: X's capital A/c-Rs 18,20,700; Y's capital A/c-Rs 12,00,800
Interest on Capital & Interest on Drawings
A and B are partners sharing profits and losses in the ratio of 3:2. Their capital accounts showed balances of Rs.1,50,000 and Rs. 2,00,000 respectively on Jan 01, 2003. Show the treatment of interest on capital for the year ending December 31, 2006 in each of the following alternatives:
If the partnership deed is silent as to the payment of interest on capital and the profit for the year is Rs.50,000;
If partnership deed provides for interest on capital @8% p.a. and the firm incurred a loss of Rs.10,000 during the year;
(a) If partnership deed provides for interest on capital @8% p.a. and the firm earned a profit of Rs.50,000 during the year;
(b) If the partnership deed provides for interest on capital @8% p.a. and the firm earned a profit of Rs.14,000 during the year.
Hint: In the absence of any information interest on capitals will be appropriation of profit

Guarantee of Profit
1. Ram, Mohan and Sohan are partners with capitals of Rs.5,00,000, Rs.2,50,000 and 2,00,000 respectively. After providing interest on capital @10% p.a. the profits are divisible as follows:
Ram ½, Mohan 1/3 and Sohan 1/6. Ram and Mohan have guaranteed that Sohan's share in the profit shall not be less than Rs.25,000, in any year. The net profit for the year ended March 31, 2016 is Rs.2,00,000, before charging interest on capital.
You are required to show distribution of profit.
(Ans: Profit to Ram, Rs.48,000, Mohan, Rs.32,000 and Sohan, Rs.25,000)
Past Adjustment
2. The net profit of X, Y and Z for the year ended March 31, 2006 was Rs.60,000 and the same was distributed among them in their agreed ratio of 3:1:1. It was subsequently discovered that the under mentioned transactions were not recorded in the books:
(i) Interest on Capital @5% p.a.
(ii) Interest on drawings amounting to X Rs.700, Y Rs.500 andZRs.300.
(iii) Partner's Salary: X Rs.1000, YRs.1500p.a.
The capital accounts of partners were fixed as: X Rs.1,00,000, Y Rs.80,000 and Z Rs.60,000. Record the adjustment entry.
(Ans: X Dr. Rs.2,700, Y credit Rs.2,600 and Z credit Rs.100]

Valuation of Goodwill
3. Compute the value of goodwill on the basis of four years' purchase of the average profits based on the last five years? The profits/losses for the last five years were as follows:
2012 – Rs 25,000; 2013 - Rs40,000; 2014 - (Rs15,000) loss; 2015 - Rs80,000; 2016 - Rs1,00,000
Ans: Rs 1,84,000
4. Capital employed in a business is Rs.2,00,000. The normal rate of return on capital employed is 15%. During the year 2002 the firm earned a profit of Rs.48,000. Calculate good will on the basis of 3 years purchase of super profit?
(Ans: Rs.54,000)
5. A business has earned average profits of Rs.1,00,000 during the last few years. Find out the value of goodwill by capitalisation method, given that the assets of the business are Rs.10,00,000 and its external liabilities are Rs.1,80,000. The normal rate of return is 10%?
(Ans: Rs.1,80,000)

ACCOUNTING TREATMENT OF GOODWILL
GOODWIL TO BE ADJUSTED THROUGH PARTNERS' CAPITAL/CURRENT ACCOUNTS OR BY RAISING AND WRITING OFF GOODWILL
CHANGE IN PROFIT-SHARING RATIO AMONG EXISTING PARTNERS

Treatment of existing Goodwill appearing in the Balance Sheet:
Journal entry:
Old Partners' Capital/Current a/c………………Dr. (In Old profit sharing ratio)
To Goodwill a/c
(Being the existing goodwill is written off)
Method1: When goodwill is adjusted through partners' capital /current accounts
Journal Entry:
Gaining partners Capital/ Current a/c………Dr. (In Gaining Ratio)
To Sacrificing Partners 'Capital /Current a/c (In Sacrificing Ratio)
(Being the compensation of gaining partners to Sacrificing partners)
Method2: When Goodwill is raised and Written off
Goodwill a/c……………………………Dr. (Full revised value of Goodwill)
To Old Partners' Capital/ Current a/c (In old Profit sharing ratio)
(Being the goodwill raised and credited to Partners Capital accounts in old profit sharing ratio)
All Partners Capital/ Current a/c .... Dr. (In new profit sharing ratio)
(Including Incoming or new partner)
To Goodwill a/c (With value of Goodwill)
(Being the goodwill debited to Partners Capital accounts in New profit sharing ratio)
EXAMPLE
1. A,B,C are partners in a firm sharing profits in the ratio 3:2:1. From 1st April2019, A' sacrifices 1/6th share in favour of C'. Goodwill of the firm is valued atRs1,20,000.
Pass the Journal entry for Goodwill.
First Method:

Date	Particulars	L.F	Debit(Rs.)	Credit (Rs)
01-04-2019	C's capital A/c…………………………………Dr To A's capital A/c (Being goodwill adjusted through capital accounts)		20,000	 20,000

Second Method

Date	Particulars	L.F	Debit	Credit
01-04-2019	Goodwill A/c…………………………………Dr To A's capital A/c (1,20,000*3/6) To B's capital A/c (1,20,000*2/6) To C's capital A/c (1,20,000*1/6) (Being goodwill raised in old profit sharing ratio)		1,20,000	 60,000 40,000 20,000
,,	A's capital A/c (1,20,000*2/6) B's capital A/c (1,20,000*2/6) C's capital A/c (1,20,000*2/6) Goodwill A/c (Being goodwill written off in new profit sharing ratio)		40,000 40,000 40,000	 1,20,000

The End