Indira Gandhi
National Open University
School of Management Studies

BCOC-131
Financial Accounting

Block

4

HIRE PURCHASE AND INLAND BRANCHES

COURSE PREPARATION TEAM

Accountancy-II: ECO-14
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BLOCK 4 HIRE PURCHASE AND INLAND BRANCHES

Now a days it is quite common to sell goods on the basis of payment in instalments. This may take the form of hire purchase or instalment payment system. In both cases, the price charged by the vendor is higher than the cash price because it would include the amount of interest for deferment of payment. Hence, while recording such transactions in books of account, one has to keep this aspect in view. The accountants have developed suitable methods for recording all transactions relating to such purchases and sales. In this block, you will study the methods of recording these transactions in the books of the seller as well as the buyer in Unit 11 and Unit 12.

Large business houses usually operate through a network of branches spread over a wide area. To ensure operational efficiency, each branch is treated as a separate profit centre. Hence, there is need for devising suitable system of branch accounting.

In this block, Unit 13 and Unit 14 deal with the systems of accounting for branches.

Unit 11 deals with the hire purchase system and its accounting treatment in the books of the vendor and the buyer, where goods sold on hire purchase basis are of substantial sales value.

Unit 12 describes the accounting treatment in case of default and repossession of goods by the vendor under the hire purchase agreement. It also discusses the accounting treatment when goods are sold under the instalment payment system. It also explains the method of maintaining basic record for transactions relating to goods of small value sold on hire purchase, and discusses the systems of ascertaining profit or loss on such business during an accounting period.

Unit 13 deals with the accounting system for dependent branches which do not keep full accounting records.

Unit 14 explains the accounting system of independent branches (excluding foreign branches) which keep full accounting records.

UNIT 11 HIRE PURCHASE ACCOUNTS-I

Structure

11.0 OBJECTIVES

After studying this unit, you should be able to:

- explain what a hire purchase agreement is;
- describe the legal position to a hire purchase agreement;
- calculate interest and cash price in relation to a hire purchase agreement; and
- pass the basic accounting entries in the books of both purchaser and vendor.

11.1 INTRODUCTION

When the goods are sold, the purchaser may either make the full payment at one time or may defer the payment. When the payment is deferred, the amount may be paid in monthly, quarterly or yearly instalments. When the price of an article is paid by instalments, the total amount paid is higher than the actual cash price of the article. The excess price is the charge for interest and the risk involved. This arrangement of making the payment in instalments is beneficial to both the seller and the buyer. The seller is able to sell more goods and the buyer can buy expensive items with his limited resources. There are two systems of deferred payments, namely, (i) Hire Purchase System, and

(ii) Instalment Payment System. In this unit, we will learn in detail about the Hire Purchase System.

11.2 NATURE OF HIRE PURCHASE AGREEMENT

A hire purchase agreement is one under which the buyer takes delivery of goods, promising to pay the price in certain number of instalments and until full payment is made, to treat the payment as hire charges for using the said goods. In fact, a hire purchase agreement stipulates that (i) the delivery of goods will be given by the owner of goods to the hire purchaser, (ii) payment will be made in instalments, (iii) each instalment will be treated as hire charge so that if default in respect of payment of even the last instalment is made, the seller will be entitled to take away the goods without compensating the hire purchaser in any form, and (iv) if all instalments are paid and the other conditions are fulfilled, the ownership of the goods will pass to the buyer.

Therefore in case of hire purchase, the seller i.e., the vendor gives only the possession of the goods and retains the ownership with him until the last instalment is paid. In other words, the hire purchaser is only the user of the goods and not the owner. In case, he fails to pay the instalments, the vendor will take his goods back. Apart from that, the vendor will not pay back the amount received from the purchaser. Such an amount will be treated as hire charge for the goods. Therefore, till the last instalment is paid, the hire purchaser has got an option, whether to purchase that particular article or not.

As mentioned earlier, the payment made by the hire purchaser under this system is always more than what he pay if he decide to go for cash purchase. The reason is that, apart from the cash price, the hire purchase price includes:

i) interest for payment being made over a period of time,

ii) the payment for the risk taken by the seller,

iii) expenditure on the registration, insurance and delivery of goods, etc.

11.3 LEGAL POSITION

11.3.1 Definition

According to Section 2(c) of the Hire Purchase Act. 1972, the hire purchase agreement is an agreement under which the goods are let on hire and the hirer has an option to purchase them in accordance with the terms of the agreement under which:

i) possession of goods is delivered by the owner thereof to a person on condition that such person pays the agreed amount in periodical instalments,

ii) the property in the goods is to pass to such person on the payment of the last such instalments, and

iii) such person has a right to terminate the agreement at any time before the property so passes.

11.3.2 Characteristics of Hire Purchase Agreement

Following are the characteristics of the hire purchase agreement.

i) It must be in writing and must he signed by all the parties thereto (Section 3)

ii) According to Section 4 of Hire Purchases Act, 1972, the agreement must state

  a) the hire purchase price of the goods to which the agreement relates;

  b) the cash price of the goods, that is to say, the price at which the goods may be purchased by the hirer for cash;

  c) the date on which the agreement shall be deemed to have commenced;

  d) the number of instalments by which the hire purchase price is to be paid, the amount of each of those instalments and the date (the mode of determining the date upon which it is payable) and the person to whom and the place where it is payable; and

  e) the goods to which the agreement relates, in a manner sufficient to identify them.

Apart from the above mentioned conditions, a full description of the amount to be paid in cash or by cheque, if any, should be given in the agreement.

11.3.3 Rights of Hirers

As per the Hire Purchase Agreement, the hirer has got the right to return the goods to the vendor. Apart from this, the Hire Purchase Act gives the following rights to the hirer.

1) The owner (or the vendor) cannot terminate the hire purchase agreement for default in payment of hire or due to an unauthorised act or breach of expressed conditions unless a notice in this regard in writing is given to the hirer. The notice period is (i) one week where the hire is payable at weekly or less than that interval, and (ii) two weeks in other cases.

2) In the following cases, the right to repossess the goods will not exist unless it is sanctioned by the court.

  i) Where the hire-purchase price is less than Rs. 15, 000 and one half of the hire purchase price has been paid.

  ii) Where the hire purchase price is higher, three-quarters of the hire purchase price has been paid. However, the right of repossession will lapse in case of motor vehicles where the hire purchase price is less than Rs. 5,000 and one-half of the amount has been paid. In other cases (where H.P. price is Rs. 5,000 or more), it happens if three-quarters of the hire purchase price has been paid. The Central Government has the power of raising the limit to nine-tenths where the hire purchase price is Rs. 15,000 or more.

3) The hirer has the right of receiving from the owner, on payment of Re. 1 for expenses, a statement showing the amount paid by or on behalf of the hirer, the amount which has become due under the agreement which remains unpaid together with the dates concerned and the amount which has not yet become payable under the agreement and the dates and the modes concerned.

4) If the amount paid by the hirer till the date of the repossession of the goods and the value of the goods on the date of the repossession taken together exceeds the hire purchase price, the excess is payable to the hirer. For ascertaining the value of the goods, the owner or the vendor has the right of deducting reasonable expenses for repossessing the goods for storing the goods or repairing them, for selling them, and for payment of arrears of taxes.

Cheek Your Progress A

1. Fill in the blanks

   i) A contract for sale of goods may be either a sale or an ……….. to sell.

   ii) A hire purchase sale is an agreement to ………..

   iii) The ownership of goods under a hire purchase agreement is to ……….. upon fulfilment of certain…………..

   iv) Under a hire purchase agreement payments are made in ………..

   v) Each instalment payment is treated as ………..

   vi) If the purchaser fails to pay even the last instalment, the seller will be entitled ……….. to the goods.

   vii) From the legal point of view, a hire purchase agreement should be made in ………..

   viii) A hirer has the right to ……….. the agreement before payment of the last instalment by paying the seller the agreed amount.

   ix) A hirer may assign his ……….,………. and interest under a hire purchase agreement.

2. State whether the following statements are **True** or **False**.

   i) A hire purchase agreement is an 'outright' sale transaction.

   ii) If the hirer fails to pay the last instalment, the amounts paid earlier are considered as hire charges.

   iii) A hire purchase agreement is an 'executed contract' and an instalment sale is an 'executory contract'.

   iv) If the hirer opts for full payments before the due dates, a rebate should be available to him.

   v) A seller cannot repossess the goods if the purchaser fails to pay the last instalment only.

   vi) The Hire Purchase Act, 1972 is in operation now.

11.4 ASCERTAINING THE INTEREST AND CASH PRICE

As mentioned earlier, when the goods are sold on hire purchase, the price so charged by the vendor is always higher than the cash price. The excess price i.e., the difference between the hire purchase price and the cash price, includes the interest charges and the compensation for risk. However, for accounting purposes, the difference between the two prices is treated as the payment for interest. Thus, the hire purchase price includes:

i) the cash price, which is a capital expenditure for purchase of an asset, and

ii) the interest, which is an item of revenue nature. Since the cash price is of capital nature and the interest payment is of revenue nature, both will be treated in a different manner in the books of account. It is, therefore, necessary to separate the hire purchase price into cash price and interest. However, it may be noted that the Cash Down Payment made immediately after signing the agreement will not include the element of interest. Another point to be kept in mind is that the interest element in each instalment is not same. It keeps on reducing with every instalment. This is so because the interest is charged on the balance of the principal amount due and not on the full amount. For proper allocation, therefore, we must know the cash price, the hire purchase price and the amount of interest.

11.4.1 Ascertainment of Interest

While calculating interest, we may be faced with any of the following two situations:

a) When rate of interest, total cash price and instalments are given

b) When total cash price and instalments are given but the rate of interest is not given.

In both the above mentioned cases, the interest has to be calculated. Let us now take them one by one.

a) When Rate of Interest, Total Cash Price and Instalments are given

In this situation, before calculating the element of interest included in each instalment, it will be helpful to ascertain the total amount of interest involved. This will be ascertained by subtracting the Total Cash Price from the hire purchase price. Then the following steps should be followed for calculating the amount of interest on each instalment.

i) Calculate the outstanding cash price at the time of first instalment by subtracting down payment from the total cash price.

ii) Calculate interest on the first instalment. This is to be calculated on the outstanding cash price at the time of first instalment by applying the given rate of interest. In this connection, you should keep in view the mode of instalments i.e., whether the instalment is annual, half-yearly or quarterly. Usually, in case of purchases for heavy equipment, the instalment is annual.

iii) Calculate the amount of cash price included in the first instalment by subtracting the amount of interest as calculated in step (ii) from the amount of the first instalment.

iv) Calculate the outstanding cash price at the time of second instalment by subtracting the amount of cash price of the first instalment from the outstanding cash price at the time of first instalment i.e., (i) —

(iii).

v) Calculate, interest on the second instalment by applying the rate of interest to the outstanding cash price at the time of second instalment.

The amount of the subsequent instalments can be worked out in the same manner i.e., by first calculating the outstanding cash price at the time of the instalment due and then applying the rate of interest to this amount. However, the amount of interest on the last instalment is worked out differently. This can be done by simply subtracting the outstanding cash price at the time of last instalment from the amount of the last instalment. Alternatively, you can work it out by subtracting the sum of interests of all previous instalments from the total amount of interest included in the hire purchase price. The amount of interest so calculated can also be verified by applying the rate of interest to the outstanding cash price at the time of last instalment. Of course, there may be a small difference due to the fact that the hire purchase price is not fixed by inclusion of the exact amount of interest. It is usually fixed as a round figure. However, if the difference happens to be a large amount, you should check all calculations of interest and outstanding cash price at the time of each instalment.

illustration 1 will help you to calculate the interest with the help of the above mentioned procedure.

Illustration 1

A Ltd. purchased a Machine on hire purchase from Z Ltd. on January 1, 2016, paying Rs. 8,000 immediately and agreeing to pay three annual instalments of Rs. 8,000 each on December 31, every year. The cash price of the machine is Rs. 29,800 and the vendors charge interest @ 5% per annum. Calculate the amount of interest paid by the buyer to the seller every year.

Solution :

The total interest = Hire Purchase Price – Cash Price

Hire Purchase Pric = Cash Down Payment + Instalments

= 8,000 + 3(8,000)

= 8,000 + 24,000

= Rs. 32,000

Cash Price = Rs. 29,800

So Total Interest = 32,000 — 29,800 = Rs. 2,200

Now, we can calculate the interest on each instalment as follows.

i) **Outstanding Cash Price at the time of first instalment**
Total Cash Price – Down Payment
= 29,800 – 8,000
= Rs. 21,800

ii) **Interest on first instalment**

$$\text{Outstanding Cash Price} \times \frac{\text{Rate of Interest}}{100}$$

$= 21{,}800 \times \frac{5}{100}$

= Rs. 1,090

iii) **Cash Price of first instalment**

Instalment – Interest on first instalment

= 8,000 – 1,090

= Rs. 6,910

iv) **Outstanding Cash Price at the time of second instalment**

Outstanding Cash Price atthe time of 1st instalment – Cash Price of the first Instalment

= 21,800 – 6,910

= **Rs.** 14,890

v) **Interest on second instalment**

$= \frac{14{,}890 \times 5}{100} = \text{Rs. } 745$

vi) **Cash Price of second instalment**

= 8,000 – 745 = Rs. 7,255

vii) **Outstanding Cash Price at the time of last instalment**

= 14,890 – 7,255 = Rs. 7,635

viii) **Interest on the last instalment**

= Instalment – Outstanding Cash Price at the time of last instalment

= Rs. 8,000 – 7,635

= Rs.365

Alternatively, Total Interest – Sum of Interest of all previous years.

= 2,200 – (1,090 + 745)

= 2,200 – 1,835

= Rs. 365

Verification

$\text{Outstanding Cash Price at the time of last instalment} \times \frac{\text{Rate of Interest}}{100}$

$= 7{,}635 \times \frac{5}{100}$

= Rs. 382

As indicated earlier, the amount calculated above is not the same as calculated in step (viii). But the difference is small i.e..Rs. 17 (382 – 365).

For Steps from (i) to (viii) following table would he helpful.

	(1) **Total Cash Price** Rs.	(2) **Instalment Paid** Rs.	(3) **Interest Paid** Rs.	(2-3) **Cash Price of the Instalment** Rs.
Total Cash Price	29,800			
Less Down Payment	8000	8000		8000
Amount outstanding at the time of Ist Instalment	21,800	8000	$(21{,}800 \times \frac{5}{100})$	(8,000-1,090)
Cash price of the Instalment	6,910		1,090	6,910
Amount outstanding at the time of 2nd Instalment	14890	8000	$(14{,}890 \times \frac{5}{100})$	(8,000-745)
Cash price of the Instalment	7,255		745	7,255
Amount outstanding at the time of 3rd Instalment Cash	7635	8,000	(8,000-7,635)	7,635
	7635		365	

You should calculate interest and cash price with the help of the above table. It makes your task easier.

b) When Total Cash Price and Instalments are given, but rate of interest is not given:

When the total cash price, down payment and the amount of each instalment is given, but the rate of interest is not given, the interest will be calculated by procedure mentioned below.

i) Calculate the total interest by subtracting the total cash price from the total hire purchase price

ii) Calculate the amounts of hire purchase outstanding at the beginning of each year after subtracting the down payment

iii) Find out the ratio of outstanding amounts calculated in step (ii). If the amount of each instalment is equal, the ascertainment of ratio is simple. For example, if there are four instalments of equal amounts, the ratio will be 4 : 3 : 2 : 1 and if there are three instalments of equal amounts, it will be 3 : 2 :1.

iv) Apply this ratio to the total interest and calculate the interest on each instalment.

Let us now take an example and clarify the calculation of interest included in each instalment.

Illustration 2

Taking the relevant data from illustration 1 excluding the rate of interest element in each instalment.

Hire Purchase Price Rs. 32,000 [8,000 + 3 (8,000)]
Cash Price Rs. 29,800
Down Payment Rs. 8,000

Solution:

Total Interest = Rs. 32,000 – 29,800
= Rs. 2,200

Beginning of the year	Amount (Rs.) Outstanding	Ratio	Interest (Rs.)
1	24,000 (32,000-8,000)	3	1,100 $(2,200 \times \frac{3}{6})$
2	16,000 (24,000-8000)	2	733 $(2,200 \times \frac{2}{6})$
3	8,000 (16,000-8,000)	1	367 $(2,200 \times \frac{1}{6})$
			2,200

You will observe that the amounts of interest for each instalment calculated with the help of ratio in illustration 2 is almost the same as calculated with a given rate of interest in illustration 1.

11.4.2 Ascertainment of Total Cash Price

Sometimes, the total cash price is not given. In such a situation, we cannot proceed with the accounting for hire purchase transaction because in the books of the buyer, the amount to be capitalised cannot be more than the cash price. The different methods of calculation of cash price are as below:

i) Without the help of annuity table

ii) With the help of annuity table

Let us now discuss both the methods

i) Without the Help of Annuity Table

Under this method, interest is calculated starting with the last instalment. Suppose there are three instalments, the interest will be calculated first on the third instalment, then on the second and lastly on the first instalment. No interest is calculated on down payment as it doesnot involve any element of interest.

You know that the interest is to be calculated on the outstanding amount of cash price. But since it is not known, it will have to be calculated with the help of total amount due on hire purchase price. For this purpose, we will have to use the following formula for calculating first the interest involved in each instalment and then subtract this amount of interest from the total amount due, so as to work out the outstanding amount of cash price.

$$\text{Interest} = \text{Total amount due at the time of instalment} \times \frac{\text{rate of interest}}{100 + \text{rate of interest}}$$

Let us now see what steps are followed for the calculation of Cash Price due at the time of each instalment assuming there are three yearly instalments.

a) Calculate the interest on the instalment of the third year, deduct interest from this instalment. The resultant figure is the outstanding cash price at the time of third (last) instalment.

b) Add the cash price calculated under (a) above to the instalment amount of the second year. Calculate the interest on the sum so obtained and subtract it from the total amount due at the end of the second year to get the outstanding cash price at the time of second instalment.

c) Add the cash price calculated under (b) above to the instalment amount of the first year and calculate the interest on the sum so obtained. Deduct this amount of interest from the total amount due at the end of the first year. The resultant figure is the cash price due at the time of the first instalment.

d) Add the cash price calculated under (c) above to the down payment, if any. The sum so obtained will be the total cash price.

Illustration 3 will help you to understand the calculation of cash price.

Illustration 3

Renuka purchased a Machine on January 1, 2015 on hire purchase basis for Rs. 5,000 payable as under :

	Rs.
Down Payment	930
At the end of 1st year (1st instalment)	1,426
At the end of 2nd year (2nd instalment)	1804
At the end of 3rd year (3rd instalment)	840

Rate of interest 5% p.a.

Calculate the Cash Price of the Machine and interest paid with each instalment.

Solution :

	Amount Rs.	Interest Rs.
Total Amount Due on 3rd Instalment (last)	840	
Less Interest	40	40
Outstanding Cash Price of 3rd Instalment	800	$(840 \times \frac{5}{105})$
Add 2nd Instalment	1,804	
Total Amount due on 2nd Instalment	2,604	
Less Interest	124	124
Outstanding Cash Price of 2nd Instalment	2,480	$(2,604 \times \frac{5}{105})$
Add 1st Instalment	1,426	
Total Amount dues on Ist Instalment	3,906	
Less Interest	186	186
Outstanding Cash Price of Ist Instalment	3,720	$(3,906 \times \frac{5}{105})$
Add Down Payment	930	
Total Cash Price	4650	350

So Total Cash Price is Rs. 4,650 and Total Interest Rs. 350.

Note: This calculation can be verified by following the procedure given for calculation of interest on each instalment when cash price, instalments, down payment and rate of interest are given.

ii) With the Help of an Annuity Table

If the annuity table is available, calculation of interest involved in each instalment is simplified. In the annuity table, the rate of interest is given in the rows and the years in the columns. With reference to the table, the present value of each instalment can be calculated. The sum of these present values as calculated, if added to the cash down payment gives us the cash price. The procedure is as follows:

a) See the given rate of interest in the row and the year in the column and find out the corresponding figure in the table.

b) This figure is the present value of Re. 1

c) Multiply the present value of Re. 1 with the amount of the instalment.

d) The resulting figure is the present value of the instalment. This is nothing but the amount of cash price included in the instalment.

e) Calculate the present values of all the instalments in same manner.

f) Add the present values of all the instalments to the down payment if any. The resultant figure will be the total cash price.

illustration 4 will help us to understand the calculation of total cash price with the help of the annuity table.

Illustration 4

X Ltd. purchased a Machine on hire purchase system. The payment is made as follows:

	Rs.
Down Payment	232.50
1st Instalment	356.50
2nd Instalment	451
3rd Instalment	210

The payments are made at the end of 1st year, 2nd year and 3rd year respectively. The rate of interest is 5% p.a. The annuity table shows that the present value of Re. 1 for one, two and three years is .9524, .9070 and .8639 respectively. Calculate the cash price of the Machine.

Solution:

	(1) Instalement	**(2) Present Value of Re. 1**	**(1×2) Present value of the instalement**
Cash Down	232.50	1	232.50
1st Instalment	356.50	.9524	339.53
2nd Instalment	451.00	.9070	409.08
3rd Instalment	210.00	.8619	189.42
Total	1,250.00		1,162.53

So the Total Cash Price is Rs. 1,162.53

Check Your Progress B

1. Calculate total interest and interest on each instalment for the following cases.

   i) Cash Price of a Machinery is Rs. 349. Down payment is Rs. 100 to be followed by three annual instalments of Rs. 100 each. The rate of interest is 10%.

   ....

   ....

   ....

   ii) Cash price of a Machine is Rs. 1900. Payment is to be made in 3 equal instalments of Rs. 800 each.

   ....

   ....

   ....

2. Calculate cash price for each of the following cases.

   i) The price of a Machinery is to be paid in four instalments of Rs. 5,000 each, the first one being made as initial payment. The rate of interest is 5% p.a. and the instalment is paid annually.

   ....

   ....

   ....

   ii) The price of a Machinery is to be paid in five annual instalments of Rs. 10,000 each. The rate of interest is 5% p.a. The first instalment is to be paid at the end of the first year. At 5% interest the present value of Re. 1 payable at the end of each year for 5 years is Rs. 4.3294.

   ....

   ....

   ....

11.5 ACCOUNTING RECORDS IN THE BOOKS OF THE PURCHASER

You know, there are two parties to a hire purchas e agreement i.e., the Vendor and the Purchaser. Both these parties have to maintain books of account and record all the transactions relating to that particular hire purchase.

Before explaining the accounting records, let us first see what information is required for recording the hire purchase transaction in the books of account. The list of items required for accounting records is as follows:

1. Date of Purchase and down payment
2. Date at which the instalments become due
3. Date of closure of accounts
4. Cash Price
5. Hire Purchase Price
6. Number, Amount and Mode of each instalment
7. Rate of Interest
8. Rate of Depreciation
9. Method of Depreciation

Let us now see how accounting records are maintained in the books of the purchaser. There are two methods by which the purchaser can record the hire purchaser transaction in the books of account. These are as follows:

i) When the asset is recorded at the full cash price, and

ii) When the asset is recorded at the cash price actually paid.

Let us now discuss these methods in detail.

11.5.1 When the Asset is Recorded at Full Cash Price

In this method, when the asset is purchased on hire purchase, it is assumed that the purchaser has full intention of paying all the instalments. It is believed that hire purchase is just a method of financing fixed assets. Under this method, on purchase of plant and machinery, the Plant & Machinery Account (Fixed Asset) is debited with the total amount of Cash Price, and the corresponding credit is given to Hire Vendor's Account. Interest is recognised and accounted for at the time of instalments becomes due by debiting the Interest Account and crediting the Hire Vendor's Account. For the purpose of accounting for initial cash down payment and annual instalments, the Hire Vendor's A/c is debited on the relevant date, and the credit is given to Bank Account. The following journal entries are passed in the books of the purchaser.

1 **When the asset is purchased on hire purchase**
Asset A/c Dr.
To Hire Vendor A/c
(With the total cash price)

2 **For cash down payment**
Hire Vendor A/c Dr.
To Bank A/c

3 **When the first instalment becomes due**
Interest A/c Dr.
To Hire Vendor A/c

4 **When the first instalment is paid**
Hire Vendor A/c Dr.
To Bank A/c

5 **For Depreciation Charge (at the end of accounting period)**
Depreciation A/c Dr.
To Asset A/c

6 **For transfer of interest and depreciation to Profit & Loss A/c**
Profit& Loss A/c Dr.
To Interest A/c
To Depreciation A/c

Entries 3 and 4 will be repeated for all subsequent instalments.

With the help of the journal entries, we can easily prepare the Asset Account and the Hire Vendor's Account. Look at illustration 5 and see how the journal entries are passed and ledger accounts are made in the books of the purchaser.

Illustration 5

ABC Ltd. bought a machine on 1.1.2016 from XYZ Ltd. under a hire purchase system of payment under which three annual instalments of Rs. 2,412 would be paid. There is no down payment and the cash price is Rs, 6,000. The rate of interest would be 10% and depreciation @20% p.a. would be charged on straight line basis.

Solution

Let us first find out all the information required.

1) Date of Purchase – January 1, 2016; No down payment.
2) Date at which the instalments become due – December 31, 2016, 2017 and 2018.
3) Date of closure of accounts – December 31.
4) Cash Price – Rs. 6,000.
5) Hire Purchase Price – Rs. 2,412 x 3 = Rs. 7,236.
6) Number, amount and mode of each instalment – 3 instalments of Rs. 2,412 each payable annually.
7) Rate of Interest – 10% p.a.
8) Rate of Depreciation – 20% p.a.
9) Method of Depreciation – Straight Line.

Journal Entries in the Books of ABC Ltd

Date	Particulars		Amount (Dr.)	Amount (Cr.)
2016			Rs.	Rs.
Jan. 1	Machinery A/c	Dr.	6,000	
	To XYZ Ltd.			6,000
	(Being a machine purchased on hire purchase)			
Dec.31	Interest A/c	Dr.	600	
	To XYZ Ltd.			600
	(Being the charge of interest @ 10% on Rs. 6,000)			
Dec.31	Depreciation A/c	Dr.	1,200	
	To Machinery A/c			
	(Being the charge of depreciation)			1,200
Dec.31	XYZ Ltd. A/c	Dr.	2,412	
	To Bank A/c			2,412
	(Being the payment of annual instalment)			
Dec.31	Profit & Loss A/c	Dr.	1,800	
	To Interest A/c			600
	To Depreciation A/c			1,200
	(Being the annual charges transferred to Profit & Loss A/c)			
2017				
Dec.31	Interest A/c	Dr.	418	
	To XYZ Ltd.			418
	(Being the charge of interest @ 10% on Rs. 4,188)			

Date	Particulars		Dr. Rs.	Cr. Rs.
Dec.31	Depreciation A/c	Dr.	1,200	
	To Machinery A/c			1,200
	(Being the annual charge of depreciation)			
Dec.31	XYZLtd. A/c	Dr.	2,412	
	To Bank A/c			2,412
	(Being the payment of annual instalment)			
Dec.31	Profit & Loss A/c	Dr.	1,618	
	To Interest A/c			418
	To Depreciation A/c			1,200
	(Being the transfer of annual charges to Profit & Loss A/c)			
2018				
Dec.31	Interest A/c	Dr.	218	
	To XYZ Ltd.			218
	(Being the charge of interest @ 10% on Rs. 2,194)			
Dec.31	Depreciation A/c	Dr.	1,200	
	To Machinery A/c			1,200
	(Being the annual charge of depreciation)			
Dec.31	XYZ Ltd. A/c	Dr.	2,412	
	To Bank A/c			2,412
	(Being the 3rd and final instalment paid)			
Dec.31	Profit & Loss A/c	Dr.	1,418	
	To Interest A/c			218
	To Depreciation A/c			1,200
	(Being the transfer of annual charges to Profit & Loss A/c)			

Ledger Accounts in the Books of ABC Ltd

Machinery Account

Dr.					Cr.
2016		Rs.	2016		Rs.
Jan. 1	To XYZ Ltd	6,000	Dec. 31	By Depreciation A/c	1,200
			Dec. 31	By Balance c/d	4,800
		6,000			6,000
2017			2017		
Jan. 1	To Balance b/d	4,800	Dec. 31	By Depreciation A/c	1,200
			Dec. 31	By Balance c/d	3,600
		4,800			4,800
2018			2018		
Jan. 1	To Balance b/d	3,600	Dec. 31	By Depreciation A/c	1,200
			Dec. 31	By Balance c/d	2,400
		3,600			3,600

XYZ LTD (Hire Vendor) Account

Dr.					Cr.
2016		Rs.	2016		Rs.
Dec.31	To Bank A/c	2,412	Jan. 1	By Machinery A/c	6,000
Dec.31	To Balance c/d	4,188	Dec. 31	By Interest A/c	600
		6,600			6,600
2017			2017		
Dec.31	To Bank A/c	2,412	Jan. 1	By Balance b/d	4,188
Dec.31	To Balance c/d	2,194	Dec. 31	By Interest A/c	418
		4,606			4,606
2018			2018		
Dec.31	To Bank A/c	2,412	Jan. 1	By Balance b/d	2,194
			Dec. 31	By Interest A/c	218
		2,412			2,412

Working Notes :

	Rs.
Cash Price	6,000
Add : Interest on Ist Instalment $(\frac{10}{100} \times 6,000)$	600
	6,600
Less : Ist Instalment	2,412
Amount outstanding at the time of 2nd Instalment	4,188
Add : Interest on 2nd Instalment $(\frac{10}{100} \times 4,188)$	418
	4,606
Less : 2nd Instalment	2,412
Amount outstanding at the time of 3rd instalment	2,194
Add : Interest on 3rd Instalment	218
	2,412

11.5.2 When the Asset is Recorded at Cash Price Actually Paid

You know that in case of hire purchase, the ownership of the goods passes to the hire purchaser after the last instalment has been paid. Since the goods do not become the property of the purchaser, he does not have any right to debit the asset at its full price. Hence, no entry is passed when the asset is purchased unless it involves down payment. The entries are passed as and when the instalments become due and the amount is paid towards the price of the article. The journal entries are as follows:

1. **When the asset is purchased**
   No entry

2. **When the down payments is made**
   Asset A/c Dr.
   To Bank A/c

3. **When the instalment becomes due**
   Asset A/c Dr. (cash price part of instalment)
   Interest A/c Dr. (interest on instalment)
   To Hire Vendor

4. **When instalment is paid**
   Hire Vendor Dr.
   To Bank A/c

5. **When depreciation is charged**
   Depreciation A/c Dr.
   To Asset A/c

6. **When interest and depreciation accounts are closed by transfer to Profit & Loss A/c**
   Profit & Loss A/c Dr.
   To Interest A/c
   To Depreciation A/c

It should be noted that though the asset account is debited with the amount of the cash price paid (not full cash price), the depreciation is charged on the full cash price. The Balance Sheet will reflect the amount of cash price debited to the asset account minus depreciation charged.

Look at the illustration 6 and see how accounting records are maintained in case the asset is recorded at cash price actually paid.

Illustration 6

Solve illustration 6 by debiting the asset account at cash price actually paid.

Solution:

Journal Entries in the Books of ABC Ltd.

Date	Particulars		Amount (Dr.) Rs.	Amount (Cr.) Rs.
2016				
Dec. 31	Machinery A/c	Dr.	1,812	
	Interest A/c	Dr.	600	
	To XYZ Ltd.			2,412
	(Being first instalment due)			
Dec. 31	XYZ Ltd Dr.		2,412	
	To Bank A/c			2,412
	(Being first instalment paid)			
Dec. 31	Depreciation A/c	Dr.	1,200	
	To Asset A/c			1,200
	(Being annual depreciation charged)			

Dec. 31	Profit & Loss A/c Dr.	1,800	
	To Depreciation A/c		1,200
	To Interest A/c		600
	(Being annual charges transferred to Profit & Loss A/c)		
2017			
Dec. 31	Machinery A/c Dr.	1,994	
	Interest A/c Dr.	418	
	To XYZ Ltd.		
	(Being third instalment due)		2,412
Dec. 31	XYZ Ltd Dr.	2,412	
	To Bank A/c		2,412
	(Being third instalment paid)		
Dec. 31	Depreciation A/c Dr.	1,200	
	To Asset A/c		1,200
	(Being annual depreciation charged)		
Dec. 31	Profit & Loss A/c Dr.	1,618	
	To Depreciation A/c		1,200
	To Interest A/c		418
	(Being annual charges transferred to Profit & Loss A/c)		
2018			
Dec. 31	Machinery A/c Dr.	2,194	
	Interest A/c Dr.	218	2,412
	To XYZ Ltd.		
	(Being third instalment due)		
Dec. 31	XYZ Ltd Dr.	2,412	
	To Bank A/c		2,412
	(Being third instalment paid)		
Dec. 31	Depreciation A/c Dr.	1,200	
	To Asset A/c		1,200
	(Being annual depreciation charged)		
Dec. 31	Profit & Loss A/c Dr.	1,418	
	To Depreciation A/c		1,200
	To Interest A/c		218
	(Being annual charges transferred to Profit & Loss A/c)		

Note: Depreciation has been charged on straight line method @20% p.a. at the full cash price of Rs. 6,000.

11.6 ACCOUNTING RECORDS IN THE BOOKS OF VENDOR

So far as the vendor is concerned, a hire purchase sale is just like an ordinary sale with the exception that payment is deferred over a period of time for which the vendor charged interest. He debits the Hire Purchaser's A/c with full cash price and credit is given to Sales A/c. The interest amount is debited to Hire Purchaser's A/c as and when the instalments become due. Instalment amounts received are credited to the Hire Purchaser's A/c and debited to Bank A/c.

The journal entries passed are as follows:

1 **On sale of goods under hire purchase**

Hire Purchaser A/c Dr
To Sales A/c (with full cash price)

2 **On receiving cash price down payment**

Bank A/c Dr
To Hire Purchaser A/c

3 **On instalment becoming due**

Hire purchaser A/c Dr.
To Interest A/c

4 **On getting payment on the due instalment**

Bank A/c Dr.
To Hire Purchaser A/c

With the help of above entries, you can easily prepare the Hire Purchaser's A/c and Interest A/c. Look at illustration 7 and see how accounting records are maintained in the books of the vendor.

Illustration

On January 1, 2017, IFB Ltd. acquired machinery from JK Ltd. for Rs. 1,886 (cash price) under a hire purchase agreement where Rs. 400 was the initial payment and two instalments of Rs. 800 each would be paid. Interest @ 6% p.a. would be charged. Prepare the ledger accounts in the books of J.K. Ltd., assuming rate of depreciation @ 10% (straight line).

Solution:

In the books of JK. Ltd.
IFB LTD.

Dr.					**Cr.**
2017		Rs.	2017		Rs.
Jan.	To Sales A/c 1	1,886	Jan. 1	By Bank A/c	400
Dec. 31	To Interest A/c	89	Dec. 31	By Bank A/c (1st Inst.)	800
			Dec. 31	By Balance c/d	775
		1,975			1,975
2018			2018		
Jan. 1	To Balance b/d	775	Dec. 31	By Bank A/c (2nd Inst.)	800
Dec. 31	To Interest A/c	25			
		800			800

Interest Account

2017		Rs.	2017		Rs.
Dec. 31	To Profit & Loss A/c	89	Dec. 31	By IFB Ltd.	89
		89			89
2018 Dec. 31	To Profit & Loss A/c	25	2018 Dec. 31	By IFB Ltd	25
		25			25

Working Note

Statement having calculation of hire purchases interest and the amount of principal in each instalment.

	Rs.	Interest Rs.	Cash Price Rs.
Cash Price	1,886	—	400
Less: Down Payment	400		
	1,486		
Add: Interest on 1st instalment to be paid on Dec. 31, 2017 @ 6%	89		
	1,575		
Less : 1st Instalment on Dec. 31, 2017	800	89	711
	775		
Add: Interest on 2nd instalment @ 6%	25		
	800		
Less: 2nd Instalment on Dec. 31, 2018	800	25	775

Check Your Progress C

1. Enlist the information required before solving the hire purchase problem.

   ....

   ....

   ....

   ....

2. State whether following statements are **True** or **False.**

   i) When the asset is recorded at full cash price, the hire purchase becomes a method of financing the fixed asset.

   ii) When the asset is recorded at the price actually paid, the Asset A/c is debited and the Hire Vendor's A/c is credited with full cash price.

   iii) The Hire Vendor debits the hire purchaser's A/c and credits the sales A/c on sale of goods with cash price.

iv) When the asset is recorded at cash price actually paid no entry is passed when the instalment becomes due.

v) The Hire Vendor's A/c is in the nature of a personal account.

11.7 LET US SUM UP

In the hire purchase agreement, the buyer takes the delivery of the goods and promises to pay the price in instalments. Under this agreement, though the buyer takes the possession of the goods, but he does not have the ownership. The ownership of the goods passes only after the last instalment has been paid. In case the buyer fails to pay any of the instalments, the seller can take back the possession of the goods.

The hire purchase price is always more than the cash price, the difference between the two is the interest charged for deferred payment. If any two of the three items of information i.e., hire purchase price, cash price and interest, are given, the third can be found out with the help of the formula HP = CP + Interest (HP is hire purchase price and CP is cash price).

Both the parties to hire purchase agreement i.e., the vendor and the purchaser, record the hire purchase transactions in their books.

The purchaser can prepare accounting records in two ways (i) when the asset is recorded at full cash price, or (ii) when the asset is recorded at the cash price actually paid.

The purchaser mainly maintains two accounts i.e., the Hire Vendor Account and the purchaser, record the hire purchase transactions in their books. The vendor on the other hand maintains the Hire Purchaser's Account and the Interest Account.

11.8 KEY WORDS

Agreement to Sell: In a contract of sale, when the ownership of goods sold is to pass to the buyer subject to fulfilment of certain conditions, such sale is termed as an agreement to sell.

Cash Price: The amount to be paid in outright sale on cash.

Down Payment: Initial payment made at the time of purchase under hire purchase agreement.

Hire Charges: If the hirer in a hire purchase agreement fails to pay even the last instalment, the amounts he has paid so far will be treated as hire charges for using the asset.

Hire Purchase: An agreement to sell under which the buyer takes the delivery of goods promising to pay the price in instalments and until full payment is made, to treat payment as hire charges for using the goods.

Hire Purchaser: The purchaser in a hire purchase contract.

Hire Vendor: The seller in a hire purchase agreement who agrees to receive the price in instalments, and has the right to treat the amounts paid by the hirer as hire charges if the hirer fails to pay the last instalment.

Instalment Payment System: When the price in a contract of sale is paid over a period of time but at fixed intervals, the system of payment is called instalment payment system.

11.9 ANSWERS TO CHECK YOUR PROGRESS

A 1. i) agreement ii) sell iii) pass, conditions iv) instalment v) hire charges vi) repossess vii) writing viii) terminate ix) right, title

2. i) False ii) True iii) False iv) True v) False vi) False

B 1. i) Total interest = Rs. 51(25+17+9)

ii) Total interest = Rs. 500 (264+178+58)

2. i) Cash Price = Rs. 18,616, ii) Cash Price = 43,294

C 1. i) True ii) False iii) True iv) False v) True

11.10 TERMINAL QUESTIONS/EXERCISES

Questions

1) What are the characteristics of a hire purchase agreement?

2) Describe the rights of a hirer under hire purchase agreement.

3) What steps would you take to calculate the interest when the total cash price instalments are given?

Exercises

1. Based on particulars given below, give entries in the books of the purchaser and the seller under the hire purchase system :

   a) Ramesh & Co. – Purchaser, Date of Purchas – Jan. 1, 2018, goods purchased – Trucks, Cash Price – Rs. 1,49,000, Instalments Rs. 40,000 on signing of the agreement. Rest in three instalments of Rs. 40,000 each, Rate of interest – 5%, Depreciation 10% on the diminishing balance.

   b) All particulars as above except that the rate of interest is not given.

   c) All particulars as in (a) above except that the cash price is not given.

2. Hire Purchases Ltd. purchased Motor Car on hire purchase system. Rs. 12,000 was payable on delivery i.e., on 1.1.18 and the rest in four equal instalments of Rs. 12,000 each payable at the end of each year. The seller, Hire Vendors Ltd. agreed to charge interest @ 5% on the yearly balances. The cash price of the Car was Rs. 54,551. Depreciation @ 25% on written down values was to be written off in each year.

   Give the necessary journal entries and ledger accounts in the books of Hire Purchasers Ltd.

   (Answer: Total Interest Rs. 5,449. The written down value of the Car at the of fourth year is Rs. 17,260)

3 Dinesh Ltd., on April 1, 2015, purchased a machine from Rajesh Ltd., on hire purchase basis. The cash price of the machine was Rs. 25,000. The payment was to be made Rs. 5,000 on the date of the contract and the balance in four annual instalments of Rs. 5,000 each plus interest at 5% per annum payable on December 31 each year, and the first such instalment being payable on 31.12.15. Depreciation is to be charged @10% on original cost.

Show the journal entries and ledger accounts in the books of both the parties.

(Answer: The amount of total interest Rs. 2,500, balance of Machinery A/c on 1.1.19 Rs. 15,000).

4. An engineering company purchased a Machine on Hire Purchase System over a period of three years paying Rs. 846 as initial payment on 1.1.16 and further annual payments of Rs. 2000 due on 31.12.16, 31.12.17 and 31.12.18. The cash price of the Machine was Rs. 6,000 and the vendor company was to charge interest at 8% p.a. on outstanding balances.

Show the appropriate ledger accounts in the books of the hire purchaser assuming depreciation @ 10% p.a. was to be charged on the Machine, Assume that capitalisation was to be done at the time of payment of each instalment.

(**Answer :** Interest (total) Rs. 846).

Note :	These questions will help you to understand the unit better. Try to write answers for them. But, do not submit your answers to the University for assessment. These are for your own practice only.

UNIT 12 HIRE PURCHASE ACCOUNTS-II

Structure

12.0 OBJECTIVES

After studying this unit, you should be able to:

- explain default and repossession in relation to a hire purchase contract;
- pass accounting entries for complete and partial repossession of goods in the books of both hire vendor and hire purchaser;
- describe the instalment payment system and distinguish it from hire purchase system;
- pass accounting entries in case an asset is bought under the instalment payment method;
- explain the basic record maintained for hire purchase transactions of goods of small value;

- explain the terms like cost price, goods sold on hire purchase, hire purchase stock, hire purchase debtors, etc. considered relevant for ascertainment of profit on hire purchase business;
- prepare hire purchase trading account and ascertain the profit/loss on hire purchase business; and
- ascertain the profit or loss on hire purchase business through stock and debtors method.

12.1 INTRODUCTION

In Unit 11, you learnt about the nature, legal position and the accounting treatment of a hire purchase contract. So far as the accounting treatment goes, we discussed a simple situation where the purchaser had paid all the instalments and consequently the ownership was transferred to him. But sometimes the purchaser is unable to pay all instalments. In such a situation, the vendor has the right to take back the possession of goods and treat the instalments paid as hire charges for the use of the asset. But, in practice, he may arrive at some compromise with the hire purchaser. In this unit, you will learn how default in payment of instalments is treated in the books of account of both the parties. We shall also discuss the accounting treatment in case the asset is purchased under instalment payment system as against the hire purchase system.

So far we have discussed the system of maintaining accounting records related to hire purchase transactions for goods of substantial sales value. In practice, however, the goods bearing small value like fridge, TV, scooter, etc. are also sold on hire purchase basis. The retailers often keep separate records for these transactions and compute the profit on hire purchase business separately. This involves a peculiar method of accounting and profit ascertainment. In this unit, we shall also discuss the accounting treatment of hire purchase transactions for goods of small value and study the methods of ascertaining the profit or loss on such transactions during an accounting period.

12.2 DEFAULT AND REPOSSESSION

‘Default’ is the failure to act, appear or pay i.e., failure to meet obligation. Under a hire purchase agreement, the hirer has obligation to pay up to the last instalment so that the ownership of goods smoothly passes to him. If he fails to meet this obligation, it will be treated as default on his part.

Possession of goods means physical holding of goods. You know that under hire purchase agreement, the vendor simply transfers the possession of goods. He does not transfer the ownership, and if the hirer fails to pay even the last instalment, the vendor has the legal right to recover the possession of the goods. This act of recovery of possession is termed as ‘repossession’.

The legal position of the hire vendor and hire purchaser (hirer) in case of default is complicated. The Hire Purchase Act of 1972 did codify this issue first, but as this Act was not put to operation, the legal position is not very clear. However, the relevant provisions of the said Act are discussed below.

12.2.1 Rights of the Hire Vendor

1. **Rights of hire vendor to terminate hire purchase agreement:** Where the hirer makes more than one default in payment of instalment as provided in the agreement, the hire vendor (the owner) shall be entitled to terminate the agreement by giving the notice of termination in writing.

2. **Rights of the hire vendor on termination:** Where a hire purchase agreement is terminated, the hire vendor (the owner) shall-be entitled (i) to enter the premises of the hirer and seize the goods, (ii) to retain the hire charges already paid and to recover the arrears of hire charges due, and (iii) to claim damages for non-delivery of the goods.

12.2.2 Restrictions on the Owner

The above rights of the owner are, however, subject to the following restrictions:

1. **Rights of hirer in case of seizure of goods by the owner:** Where the owner seizes the goods lent under a hire purchase agreement, the hirer may recover from the owner the amount, if any, by which the hire purchase price falls short of the aggregate of two amounts (a) the amounts paid in respect of the hire purchase price up to the date of seizure, and (b) the value of the goods on the date of seizure.
2. **Restrictions on owner's right to repossess:** Where goods have been let under a hire purchase agreement, and the statutory amount of the hire purchase price has been paid, the owner shall not enforce any right to recover possession of the goods from the hirer otherwise than by verdict of any competent court.

12.3 ACCOUNTING FOR DEFAULT AND REPOSSESSION

You know that when the purchaser fails to pay any of the instalments, the hire vendor can take back the possession of the goods. The amount already paid to the vendor as a part of the payment for the asset is treated as the hire charge. So far as the repossession of goods is concerned, the vendor can either take back the whole of the asset or a part of it. Let us now discuss what entries will be passed in case of (i) complete repossession and (ii) the partial repossession.

12.3.1 Complete Repossession

When the hire purchaser does not pay the instalment, the vendor can take back the possession of goods. In case the vendor takes the possession of all the goods, it is called complete repossession. It means the vendor will close Hire Purchaser's Account in his books and vice versa. The journal entries passed are as follows:

i) All the entries (except the entry for payment) are passed as usual up to the date of default.

ii) **For closing the account of the purchaser**
Goods Repossessed A/c Dr.
To Hire Purchaser
(Transfer of balance)

iii) **For repairs and other expenses on the repossessed goods**

Goods Repossessed A/c Dr.

To Cash A/c

(Repairs and other expenses)

iv) **For resale of goods repossessed**

Cash A/c Dr.

To Goods Repossessed A/c

v) **Any balance left in Goods Repossessed Account is either profit or loss, which is ultimately transferred to' Profit & Loss A/c.**

In case of profit the entry will be **:**

Goods Repossessed A/c Dr.

To Profit & Loss A/c

In case of loss, the above entry will be reversed.

In the books of Hire Purchaser

i) All the entries (except the entry for payment) are passed as usual up to the date of default, including the entry for depreciation.

ii) **For closing the account of the vendor**

Hire Vendor A/c Dr.

To Asset A/c

iii) **For closing the Asset Account**

Profit & Loss A/c Dr.

To Asset A/c

Generally there is a loss to the hire purchaser, so the above entry is passed for loss on seizure of goods. In case of profit, the above entry will be reversed.

Look at illustration 1 and see how entries are passed and the books are closed in case of complete repossession.

Illustration 1

On January 1, 2017, ABC Ltd. sold some plant & machinery costing Rs. 28,000 (cash price) to XYZ Ltd. on hire purchase. Payment was to be made as Rs. 7,500 cash down and three instalments of Rs. 7,500 at the end of each year. Rate of interest was @ 5% p.a. The rate of depreciation for the asset was 10% p.a.

XYZ Ltd. made the down payment and paid the first instalment. But they could not pay the second instalment. Consequently, ABC Ltd. repossessed the goods.

ABC Ltd. spent Rs, 300 on repairs and disposed off the asset for Rs. 15,350. Open ledger accounts in the books of both the parties.

Solution:

Books of XYZ Ltd.
Plant & Machinery Account

Dr. Cr.

Date	Particulars	Amount	Date	Particulars	Amount
2017		Rs.	2017		Rs.
Jan.1	To ABC Ltd	28,000	Dec.31	By Depreciation (10% on 28,000)	2800
			Dec.31	By Balance c/d	25,200
		28,000			28,000
2018			2018		
Jan. 1	To Balance b/d	25,200	Dec. 31	By Depreciation (10% on 25,200)	2,520
			Dec. 31	By ABC Ltd	14,726
			Dec. 31	By Profit and Loss A/c	7,954
		25,200			25,200

ABC Ltd's Account

2017		Rs.	2017		Rs.
Jan.1	To Cash A/c (down payment)	7,500	Jan. 1	By Plant & Machinery	28,000
			Dec.31	By Interest A/c	1,025
Dec.31	To Cash A/c (first instalment)	7,500			
Dec. 31	To Balance c/d	14,025			
		29,025			29,025
2018			2018		
Dec. 31	To Plant & Machinery A/c (default)	14,726	Jan.1	By Balance b/d	14,025
			Dec.31	By Interest A/c	701
		14726			14,726

Books of ABC Ltd
XYZ Ltd's Account

2017		Rs.	2017		Rs.
Jan.1	To Sales A/c	28,000	Jan.1	By Cash A/c	7,500
Dec.31	To Interest A/c (5% on 20,500)	1,025	Dec.31	By Cash A/c	7,500
			Dec.31	By Balance c/d	14,025
		29,025			29,025
2018			2018		
Jan.1	To Balance b/d	14,025	Dec.31	By Goods Repossessed A/c	14,726
Dec. 31	To Interest A/c (5% on 14,025)	701			
		14,726			14,726

Goods Repossessed Account

2018		Rs.	2018		Rs.
Dec.31	To XYZ Ltd A/c	14,726	Dec.31	By Cash A/c (sales)	15,350
Dec.31	To Cash A/c (repairs)	300			
Dec.31	To Profit & Loss A/c (profit on sale)	324			
		15,350			15,350

12.3.2 Partial Repossession

Sometimes, in case of default, the vendor enters into a compromise with the hirer and does not repossess the complete goods. But, he repossesses a part of the goods called partial repossession. In this case, some part of the asset is still left with the buyer.

So far as the accounting treatment of partial possession is concerned, interest and depreciation entries are passed as usual in the books of both the parties upto te date of default, but not the entry for payment.

As some part of the asset is left with the hire purchaser, the hire vendor does not close the Hire Purchaser's Account in his books, nor does the hire purchaser close the Hire Vendor's Account in his books. They ascertain the current value of the asset repossessed with the help of an agreed rate of depreciation (it is usually an enhanced rate). The hire vendor debits the same to the Goods Repossessed Account and credits it to the Hire Purchaser's Account. Similarly, the hire purchaser debits the Hire Vendor's Account and credits the Asset Account with the agreed value of the asset repossessed. As for the part of asset left with him, the hire purchaser applies the normal rate of depreciation and shows the depreciated value as a balance in the Asset Account. The balancing figure in the asset account will show the profit or loss on default and it will be transferred to the Profit & Loss Account.

Look at the illustration 2 and see how accounts are prepared in case of partial repossession.

Illustration 2

Jalani Distributors sold three light commercial vans to Jain Enterprises on January 1, 2017 on hire purchase system. The price of each van was Rs. 90,000 payment of which was to be made as follows

i) Rs. 30,000 as down payment for each van,

ii) Remaining amount in 3 annual equal instalments along with interest @15%.

Jain Enterprises were charging depreciation @ 20% each year on written down value method. After payment of 1st instalment as on December 31, 2017, they could not pay further instalments. It was agreed between the parties for repossession of two vans adjusting their value against the amount due. For the purposes of repossession, depreciation @ 30% p.a. was charged.

Repossessed goods were repaired at a cost of Rs. 2,000 and were then sold for Rs, 92,000, Calculate the value of repossessed stock and show the necessary accounts in the books of both the parties.

Solution

In the books of Jain Enterprises
Light Commercial Vans Account

Dr. Cr.

Date	Particulars	Amount	Date	Particulars	Amount
2017		Rs.	2017		Rs.
Jan, 1	To Jalani Distributors (Rs. 90,000×3)	2,70,000	Dec. 31	By Depreciation A/c (20% on 2,70,000)	54,000
			Dec. 31	By Balance c/d	2,16,000
		2,70,000			2,70,000
2018 Jan. 1	To Balance b/d	2,16,000	2018 Dec. 31	By Depreciation A/c (20% on 2,16,600)	43,200
			Dec. 31	By Jalani Distributors (value of two vans on repossession)	88,200
			Dec. 31	By Profit & Loss A/c (loss on repossession)	27,000
			Dec. 31	By Balance c/d	57,600
		2,16,000			2,16,000
2019 Jan. 1	To Balance b/d	57,600			

Jalani Distributors' Account

Date	Particulars	Amount	Date	Particulars	Amount
2017		Rs.	2017		Rs.
Jan. 1	To Bank A/c (down payment) (Rs. 30,000×3)	90,000	Jan. 1	By Light Commercial Vans A/c	2,70,000
Dec.31	To Bank A/c (first instalment Rs. 60,000+27,000)	87,000	Dec 31	By Interest A/c $(1{,}80{,}000\times\frac{15}{100})$	27,000
Dec.31	To Balance c/d	1,20,000			
		2,97,000			2,97,000
2018 Dec. 31	To Light Commercial Vans A/c	88,200	2018 Jan. 1	By Balance b/d	1,20,000
Dec. 31	To Balance c/d	49,800	Dec. 31	By Interest $(1{,}20{,}000\times\frac{15}{100})$	18,000
		1,38,000			1,38,000
			2019 Jan. 1	By Balance b/d	49,800

Books of Jalani Distributors

Jain Enterprises' Account

2017		Rs.	2017		Rs.
Jan.1	To Sales A/c	2,70,000	Dec. 31	By Bank A/c (down payment)	90,000
Dec. 31	To Interest A/c $(\frac{15}{100}\times 1,80,000)$	27,000	Dec. 31	By Bank A/c (Ist instalment)	87,000
			Dec. 31	By Balance c/d	1,20,000
		2,97,000			2,97,000
2018			2018		
Jan. 1	To Balance b/d	1,20,000	Dec. 31	By Goods Repossessed A/c	88,200
Dec. 31	To Interest A/c $(\frac{15}{100}\times 1,20,000)$	18,000	Dec. 31	By Balance c/d	49,800
		1,38,000			1,38,000
2019 Jan. 1	To Balance b/d	49,800			

Goods Repossessed Account

2018		Rs.	2018		Rs.
Dec. 31	To Jain enterprises	88,200	Dec. 31	By Cash A/c (sale)	92,000
Dec. 31	To Cash A/c (repairs)	2,000			
Dec. 31	To Profit & Loss A/c (profit on sale)	1,800			
		92,000			92,000

Working Notes

1 Calculation of the value of repossessed asset

		Rs.
Cost Price of two vans (90,000×2)		1,80,000
Depreciation		
First year $(\frac{30}{100}\times 1,80,000)$	54,000	
Second year $(\frac{30}{100}\times 1,80,000-54,000)$	37,800	91,800
Value of repossessed stock		88,200

2 Loss on Repossession

	Rs.
Cost Price of two vans (90,000×2)	1,80,000
Depreciation	

First year $(\frac{20}{100} \times 1,80,000)$	36,000	
Second year $(\frac{20}{100} \times 1,80,000 - 36,000)$	28,800	64,800
Depreciated value of two vans		1,15,200
Less : Value of the two vans at higher rate of depreciation for repossession		88,200
Loss on repossession		27,000

12.4 INSTALMENT PAYMENT SYSTEM

Instalment Payment System also called the Deferred Instalments is a system where the buyer is given the ownership as well as the possession of the goods right at the time of signing the contract. The buyer has the facility to pay the price in instalments. The features of Instalment Payment System are as follows:

i) It is an outright sale.

ii) The possession as well as the ownership is passed to the buyer on signing of the contact.

iii) The buyer can make the payment in instalments.

iv) In case of default in payment, the seller cannot repossess the goods.

v) The amount paid up to the default is not forfeited and the seller can sue the buyer for the amount due.

From the above discussion we can see that the Instalment Payment System has some similarities with the Hire Purchase System, but there are some points of difference as well. They are as follows:

Hire Purchase System	Instalment Payment System
i) It is an agreement of hiring.	i) It is an agreement of sale.
ii) The buyer gets only the possession of goods on signing the contract.	ii) The buyer gets possession on signing of the contract.
iii) In case of default, the goods can be repossessed	iii) The goods cannot be repossessed in case of default.
iv) In case of default, the payment made up to the date of default is forfeited and treated as hire charge.	iv) The payment made up to the date of default is a payment towards the price of the asset and cannot be forfeited. The seller can at the most sue the buyer for the amount due.
v) The buyer cannot sell, destroy, transfer, damage or pledge the . goods.	v) Buyer can sell, destroy, damage, transfer or pledge the goods.

12.5 ACCOUNTING FOR INSTALMENT PAYMENT SYSTEM

You know that the ownership of goods passes to the buyer immediately on the signing of the contract. Hence, while accounting for the purchase under the Instalment payment system, this fact should be taken into account. Accordingly, the buyer credits the vendor with the full amount payable to him (inclusive of total interest) and debits the assets with cash price and the Interest Suspense Account with the total amount of interest being the difference between the full amount payable and the cash price. The Interest Suspense Account is credited with the actual amount of interest at the time of each instalment by transferring the same to Interest Account. Similarly, the vendor debits the buyer with the full amount and credit sale with cash price and Interest Suspense Account with total interest. He transfers the actual amount of interest to Interest Account at the time of each instalment by debiting Interest Suspense Account and crediting the Interest Account.

Thus, from accounting point of view, the main point of difference between Instalment Payment System and the Hire Purchase System relates to the treatment of interest. But in practice, even this may be dispensed with.

The asset account is maintained by the buyer in a manner similar to that of Hire Purchase System i.e., depreciation is charged in the usual manner and the depreciated value of the asset is shown in the Balance Sheet. It should be noted that the balance in Vendor's Account shall be shown on the liability side every year.

Let us now study the journal entries both in the books of the buyer and seller under Instalment Payment System.

12.5.1 Books of the Buyer

The buyer passes the following journal entries in his books.

i) **When the Asset is purchased**

Asset A/c	Dr.	(with cash price)
Interest Suspense A/c	Dr.	(difference between cash price
To Vendor (with Instalment price)		and instalment)

ii) **For cash down payment**

Vendor A/c Dr
To Bank A/c

iii) **For interest due at the time of instalment**

Interest A/c Dr.
To Interest Suspense A/c

iv) **For the payment of instalment**

Vendor A/c Dr
To Bank A/c

v) **For Depreciation at the end of the accounting year**

Deprecation A/c Dr.

To Asset A/c

vi) **For transfer of interest and depreciation to Profit & Loss A/c**

Profit & Loss A/c Dr.
To Interest A/c
To Depreciation A/c

After passing the above mentioned journal entries, the purchaser prepares the following ledger accounts.

i) Asset A/c

ii) Vendor's A/c

iii) Interest Suspense Account

iv) Interest Account

Look at the illustration 3 and see how ledger accounts are maintained in the books of the buyer when goods are purchased under Instalment Payment System.

Illustration 3

Fire industries Ltd. purchased a plant on 1.1.2016 from MMC Ltd. under instalment payment system. The cash price was Rs. 20,000 payable as Rs, 6,384 for down payment and the balance by three equal annual instalment of Rs. 5,000 each including 5% interest. Depreciation @ 10% was to be charged as per W.D.V. method.

Show the necessary ledger accounts in the books of Fire Industries Ltd.

Solution :

In the books of Fire Industries Ltd.
MMC Ltd. Account

Dr. **Cr.**

Date	Particulars	Amount	Date	Particulars	Amount
2016		Rs.	2016		Rs.
Jan.1	To Bank A/c	6,384	Jan. 1	By Plant A/c	20,000
Dec.31	To Bank A/c (1st Inst.)	5,000	Dec.31	By Interest Suspense A/c	1,384
Dec.31	To Balance c/d	10,000			
		21,384			21,384
2017			2017		
Dec.31	To Bank A/c (2nd Inst.)	5,000	Jan. 1	By Balance b/d	10,000
Dec.31	To Balance c/d	5,000			
		10,000			10,000
2018			2018		
Dec.31	To Bank A/c (3rd Inst.)	5,000	Dec.31	By Balance b/d	5,000
		5,000			5,000

Plant Account

Date	Particulars	Amount	Date	Particulars	Amount
2016		Rs.	2016		Rs.
Jan.1	To MNC Ltd.	20,000	Dec. 31	By Depreciation A/c	2,000
			Dec. 31	By Balance c/d	18,000
		20,000			20,000
2017			2017		
Jan. 1	To Balance b/d	18,000	Dec. 31	By Depreciation A/c	1,800
			Dec. 31	By Balance c/d	16,200
		18,000			18,000
2018			2018		
Jan. 1	To Balance b/d	16,200	Dec. 31	By Depreciation A/c	1,620
			Dec. 31	By Balance c/d	14,580
		16,200			16,200

Interest Suspense Account

Date	Particulars	Amount	Date	Particulars	Amount
2016		Rs.	2016		Rs.
Jan.1	To MNC Ltd.	1,384	Dec.31	By Interest A/c	681
			Dec.31	By Balance c/d	703
		1,384			1,384
2017			2017		
Jan. 1	To Balance b/d	703	Dec. 31	By Interest A/c	465
			Dec. 31	By Balance c/d	268
		703			703
2018			2018		
Jan. 1	To Balance b/d	238	Dec. 31	By Interest A/c	238
		238			238

Interest Account

Date	Particulars	Amount	Date	Particulars	Amount
2016		Rs.	2016		Rs.
Dec.31	To Interest Suspense A/c	681	Dec. 31	By Profit & Loss A/c	681
		681			681
2017			2017		
Dec.31	To Interest Suspense A/c	465	Dec. 31	By Profit & Loss A/c	465
		465			465
2018			2018		
Dec.31	To Interest Suspense A/c	238	Dec. 31	By Profit & Loss A/c	238
		238			238

Working Note:

Statement showing calculation of Interest for deferment period

Particulars	Amount	Principal	Interest	Total
	Rs.	Rs. (a)	Rs. (b)	Rs. c = (a+b)
Cash Price (6384+13616)	20,000			
1.1.16 Less : Down payment	6,384	6,384		6,384
	13,616			
31.12.16				
Add : Interest @ 5% $(\frac{5}{100} \times 13,616)$	681			
	14,297			
Less : Ist Instalment	5,000	4,319	681	5,000
	9,297			
31.12.17				
Add : Interest @ 5% $(\frac{5}{100} \times 9,297)$	465			
	9,762			
Less : 2nd Instalment	5,000	4,535	465	5,000
	4,762			
31.12.18				
Add : Interest @ 5% $(\frac{5}{100} \times 4,762)$	238			
	5,000			
Less : 3rd Instalment	5,000	4,762	238	5,000
Total	NIL	20,000	1,384	21,384

12.5.2 Books of the Vendor

The vendor passes the following journal entries when the goods are sold on instalment payment system.

i) **When the goods are sold**

Purchaser Dr.		(with total price)
	To Sales A/c	(with cash price)
	To Interest Suspense A/c	(with the difference between the total price and cash price)

ii) **For cash received as down payment**

Bank A/c Dr.	
	To Purchaser A/c

iii) **For interest due on instalment**

Interest Suspense A/c Dr.
To Interest A/c

iv) **For receipt of the amount of instalment**

BankA/c Dr.
To Purchaser A/c

v) **For transfer of interest to Profit & Loss A/c**

Interest A/c Dr.
To Profit & Loss A/c

Like the buyer, the vendor also prepares certain Ledger accounts. They are

i) Buyer's Account

ii) Interest Suspense Account

iii) Interest Account

Look at the illustration 4 and see how the accounts are maintained in the books of the vendor when the goods are sold on instalment payment system.

Illustration 4

We consider the problem given in illustration 3 and prepare ledger accounts in the books of the vendor.

Solution:

In the books of MMC Ltd.
Fire Industries Ltd. Account

Dr. **Cr.**

Date	Particulars	Amount	Date	Particulars	Amount
2016		Rs.	2016		Rs.
Jan.1	To Sales A/c	20,000	Jan. 1	By Bank A/c (down payment)	6,384
Dec.31	To Interest Suspense A/c	1,384	Dec.31	By Bank A/c (Ist Instalment)	5,000
			Dec.31	By Balance c/d	10,000
		21,384			21,384
2017			2017		
Jan. 1	To Balance b/d	10,000	Dec.31	By Bank A/c (2nd Instalement)	5,000
			Dec.31	To Balance c/d	5,000
		10,000			10,000
2018			2018		
Jan.1	To Balance b/d	5,000	Dec.31	By Bank A/c (3rd Instalment)	5,000
		5,000			5,000

Interest Suspense Account

Dr. **Cr.**

Date	Particulars	Rs.	Date	Particulars	Rs.
2016			2016		
Dec.31	To Interest A/c	681	Jan. 1	By Fire Industries Ltd A/c	1,384
Dec.31	To Balance c/d	703	2016		
		1,384			1,384
2017			2017		
Dec.31	To Interest A/c	465	Jan. 1	By Balance b/d	703
Dec.31	To Balance c/d	238			
		703			703
2018			2018		
Dec.31	To Interest A/c	238	Jan. 1	By Balance b/d	238
		238			238

Interest Account

Dr. **Cr.**

Date	Particulars	Rs.	Date	Particulars	Rs.
2016			2016		
Dec.31	To Profit & Loss A/c	681	Dec.31	By Interest Suspense A/c	681
		681			681
2017			2017		
Dec.31	To Profit & Loss A/c	465	Dec.31	By Interest Suspense A/c	465
		465			465
2018			2018		
Dec.31	To Profit & Loss A/c	238	Dec.31	By Interest Suspense A/c	238
		238			238

Check Your Progress A

1. Fill in the blanks

   i) Default is ……………to act, appear or pay.

   ii) Possession of goods means ……………..of goods.

   iii) The act of………… of …………….is termed as repossession.

   iv) Where a hire purchase agreement is …………..due to default in payment, the hire vendor shall be entitled to enter the premises of the hirer and …………….the goods.

   v) In case of termination due to default in payment the hire vendor is entitled to …………….for non-delivery of goods.

   vi) Under an instalment payment system, the buyer gets the .... of the goods on the date of…………………

2. State whether the following statements are **True** or **False.**

   i) Under a hire purchase agreement, failure in payment of only the last instalment would be considered as a default.

ii) On default, the vendor under the instalment payment system is entitled to retain the amount which has already been paid and recover the arrears of hire due.

iii) After repossession, a hire vendor has no right to resell the goods repossessed.

iv) In case of an instalment payment system, the buyer is entitled to dispose off the goods he has bought.

v) Under an instalment payment system, the buyer can return the goods at any time.

12.6 BASIC RECORD FOR GOODS OF SMALL VALUE SOLD ON HIRE PURCHASE

You are aware of the fact that with advancement of technology and improvement in the standard of living of the people both in India and abroad, the demand, for consumer durables like fridge, T.V., automobiles, etc. has increased manifold over the years. To meet this demand explosion, the dealers have come up with innovative schemes which attract the prospective consumers to purchase such goods. One such scheme is the sale on hire purchase basis. The consumers with limited resource are naturally interested in buying under this scheme in view of the benefits of deferred payment at reasonable rate of interest. Hence, a large volume of transactions in these goods are being conducted everyday.

It should be noted that these transactions take place between a retailer (dealer) and the consumers, and not between two business units. Hence, **the accounting is important only for the vendor and not the buyer.** Let us now study how a hire vendor(retailer) maintain the account when goods of small value are sold on hire purchasebasis.

In case of hire purchase transactions of numerous goods of small value, it becomes practically inconvenient for a particular dealer of these items to maintain separate accounts for each transaction. Hence, the accounting system is designed in such a way that overall control can be exercised on all the transactions during a particular accounting period through control accounts. However, for individual transactions, detailed record may be kept in a subsidiary book called 'Hire Purchase Sale Register showing the necessary information as may be required to control individual accounts of the buyers. A specimen of the register is given in Figure 12.1.

S.No	Date of Agreement	Name of Article	Name of Customer	Cost Price	Hire Purchase Price	Cash Down Payment	No. of Instalments	Instalments Due				Total installments received	Instalments due but not paid	Instalments not yet due
								1	2	3	4			

Fig 12.1: Hire Purchase Sales Register

In Hire Purchase Sales Register as given in Figure 12.1, you will observe that, besides the details of individual hire purchase transactions, there are columns showing cost price, hire purchase price, cash down payment, instalments received, instalments due but not yet paid, and instalments not yet due. The figures are very relevant for the accounting for hire purchase transactions and the ascertainment of profit/loss from hire purchase business and, therefore, the accountant must be careful in recording the amounts and the casting (totalling) of these columns. The totals of these columns are posted to the relative control accounts periodically, say monthly, quarterly, half yearly, or yearly by passing the necessary journal entries.

12.7 RELEVANT TERMS

In connection with the accounting for goods of small value sold on hire purchase basis, we have to define certain terms before we study different methods of ascertaining the profit or loss on such transactions. These relevant terms are

1. Cost price of goods sold on hire purchase
2. Value of goods sold on hire purchase
3. Cash received
4. Hire Purchase Debtors
5. Hire Purchase Stock
6. Stock at shop

1. Cost price of Goods Sold on Hire Purchase : You know the hire vendor is only a dealer. He purchases goods from various manufacturers and sells them to the consumers under hire purchase system. Naturally, he sells the goods at a price higher than the price at which he has bought. His mark-up on hire purchase sales is bound to be more than even the cash price because he has also to cover the loss of interest on such transactions. Normally, interest is accounted for separately as you studied in the case of sale of goods of a substantial value. But, **in the case of sale of goods of small value, Interest is ignored and the profit is worked out on the basis of the difference between cost price and hire purchase price.** This is called 'loading'. Loading is generally given in terms of percentage on cost or as percentage of hire purchase price. Usually you are provided with the figure of hire purchase price and you have to work out the cost price with the help of loading. Alternatively, both the hire purchase price and cost price are given and you may have to work out the loading for the purpose of ascertaining profit or loss in hire purchase business.

2. Goods Sold on Hire Purchase: For the purpose of finding out the profit or loss on the hire purchase business during an accounting period, we need the figure of the value of goods sold on hire purchase. This reflects the hire purchase price of all the goods sold on hire purchase basis during the accounting period. This is mostly given. If, however, the value of goods sold on hire purchase is not given, it can be worked out by applying the loading rate to the cost of goods sold on hire purchase. Alternatively, it can be worked out with the help of the first part of the Hire Purchase Trading Account.

3. **Cash Received :** This refers to the total amount received during the accounting period in respect of hire purchase sales whether they relate to previous years or the current year. This includes the amount of down payment and the amount of instalments paid during the year.

4. **Hire Purchase Debtors :** It is also known as **instalments due but not yet paid' or 'Instalment due, customers paying'.** Thus, it refers to the total amount of such instalments which have fallen due during the accounting period but have not yet been paid by the hire purchase customers. For purposes of profit on hire purchase business, the total of 'cash received' and 'hire purchase debtors' is taken as the 'realised sales' during an accounting period, and not the goods sold on hire purchase.

5. **Hire Purchase Stock** : You know when goods are sold on hire purchase basis, customer makes some down payment and agrees to pay the balance in instalments. Some of these instalments become due during the accounting year when goods were sold to him while others shall become due during the following year/years. The instalments which have not become due during the current year, are called 'instalments not yet due' or 'hire purchase stock'. It should be noted that hire purchase stock does not mean stock of goods in the shop. **It is a special term used for the total amount of instalments which have not become due during the current year.** It represents the unrealised sales and needs adjustment of loading involved. This amount is required for the purpose of ascertaining profit or loss on hire purchase business.

   The amount of 'instalments not yet due' (hire purchase stock) is usually given. But, if it is not given, the same can be worked out with the help of Hire Purchase Trading A/c.

6. **Stock at Shop:** 'Stock at shop' should not be confused with 'hire purchase stock'. You know that hire purchase stock represents the instalments not yet fallen due. But, the stock at shop is a common term used for unsold goods lying in store. The amount of stock at shop is not relevant to the ascertainment of profit or loss of the hire purchase business. This however, can be helpful in ascertaining the cost of goods sold on hire purchase which, in turn, helps the ascertainment of the value of goods sold on hire purchase (if not given) by adding the loading thereto.

12.8 ASCERTAINMENT OF PROFIT

For the ascertainment of profit or loss on goods of small value sold on hire purchase, we have to prepare a 'Hire Purchase Trading Account'. It is just like the Consignment Account prepared for ascertaining the profit/loss on consignment of goods invoiced at selling price. For preparing the Hire Purchase Trading Account, we require the amounts of goods sold on hire purchase, cash received, goods repossessed, hire purchase debtors (both at the beginning and the end), and hire purchase stock (both at the beginning and at the end).

These figures can be extracted from the Hire Purchase Sales Register or the relevant control accounts and taken to Hire Purchase Trading Account by passing the necessary closing entries in the journal. Further, we shall have to ascertain the percentage of loading and the amount of expenses incurred on hire purchase business.

The proforma of Hire Purchase Trading Account is given in Figure 12.2

Hire Purchase Trading Account

Dr.		Cr.	
To H.P. Stock (opening)	...	By Cash Received	...
To H.P. Debtors (opening)	...	By Goods Repossessed (market value)	...
To Goods Sold on H.P (at H.P. price)	...	By H.P. Stock (closing)	...
To Stock Reserve (loading on closing H.P. stock)	...	By H.P. Debtors (closing)	...
To Expenses	...	By Stock Reserve (loading on opening H.P. stock)	...
To Net Profit (transferred to P&L A/c)	...	By Goods Sold on H.P. (loading)	...
	...		...

Fig. 12.2: Proforma of Hire Purchase Trading Account

The proforma of Hire Purchase Trading Account as given in Figure 12.2 is the usual form in which the Hire Purchase Trading Account is prepared. But, it is better to divide it into two parts as shown in Figure 12.3, the first part to contain only those items which are recorded at H.P. price and the second part showing the adjustment of loading and the expenses, losses, etc. relating to hire purchase business for ascertaining the profit or loss.

Hire Purchase Trading Account

Dr.		Cr.	
To H.P. Stock (opening)	..	By Cash Received	...
To H.P. Debtors (opening)	...	By Goods Repossessed (Instalments unpaids)	...
To Goods Sold on H.P (at H.P. price)	...	By H.P. Stock (closing)	...
		By H.P. Debtors (closing)	...
	...		...
To Loss on Goods Repossessed (dif. between market value or cost and unpaid instalments)	....		
To Stock Reserve (loading on closing H.P. stock)	...	By Stock Reserve (loading on opening H.P. stock)	...
To Expenses (on hire purchase business)	...	By Goods Sold on H.P. (loading)	
To Net Profit (transferred to P&L A/c)	...		
	...		...

Fig. 12.3 : Another Proforma of Hire Purchase Trading Account

It should be noted that **the totals of two sides in the first part of the Hire Purchase Trading Account will be equal.** If they are not equal, it would mean that there is some mistake. Not only that, the first part can also help us in finding out the amount of any item which is missing (being the balancing figure) provided all the other figures are given.

Look at illustration 5 and see how profit is ascertained in respect of goods of small value sold on hire purchase with the help of Hire Purchase Trading Account.

Illustration 5

Capital Electronics & Co. started business on 1.1.18 for selling electronic goods on hire purchase basis. During the year end on 31.12.18, the following transactions were made.

a Krishna purchased a T.V. costing Rs. 3,000 at Rs. 4,500 payable Rs. 1,500 as down payment and the balance in 12 monthly instalments of Rs. 250 each,

b) Vim purchased one Grinder costing Rs. 1,000 at Rs. 1,500 payable Rs. 300 as down payment and the balance in 12 monthly instalments of Rs. 100 each,.

c) Arjun purchased a Refrigerator costing Rs. 2,400 at Rs. 3,000 payable Rs. 600 as down payment and the balance in 12 monthly instalment of Rs. 200.

As on 31.12.18, Krishna could not pay one instalment out of the seven instalments due, Vim could not pay one instalment out of the five instalments due, and Arjun could not pay the two instalments out of eight instalments due.

Calculate the profit or loss on Hire Purchase Transactions.

Solution:

Hire Purchase Trading Account

Dr.			Cr.
	Rs.		Rs.
To Goods Sold on Hire Purchase	9,000	By Cash Received	5,500
		By Goods Repossessed	.....
		By Hire Purchase Stock (closing)	2,750
		By Hire Purchase Debtors (closing)	750
	9,000		9,000
To Stock Reserve (loading on closing H.P. stock)	810	By Goods Sold on Hire Purchase (closing)	2,600
To Net Profit transferred to P & L A/c	1,790		
	2,600		2,600

Working Notes:

a) Goods sold on hire purchase (H.P. Price)

		Rs.
i)	TV purchased by Krishna	4,500
ii)	Grinder purchased by Vim	1,500
iii)	Refrigerator purchased by Arjun	3,000
	Total	9,000

b) Cash received

i)	From Krishna [Rs. 1,500 + (250 × 6)]	3,000
ii)	From Vim [Rs. 300 + (100 × 4)]	700
iii)	From Arjun[Rs. 600 + (200 × 6)]	1,800
	Total	5,500

c) Amount of instalment due but not paid (H.P. Debtors)

i)	From Krishna Rs. 250 × 1	250
ii)	From Vim Rs. 100 × 1	100
iii)	From ArjunRs. 200 × 2	400
	Total	750

d) Amount of instalment which are not due (H.P. Stock)

i)	From Krishna Amount not due Rs. 250 × 5	1,250
ii)	From Vim Amount not due Rs. 100 × 7	700
iii)	From Arjun Amount not due Rs.200 × 4	800
	Total	2,750

e) Loading

i) On goods sold on hire purchase

Hire Purchase Price – Cost Price

= (4,500 + 1,500 + 3,000) – (3,000 + 1,000 + 2,400)

= 9,000 – 6,400

= Rs. 2,600

ii) On hire purchase stock (Closing)

	HP. Stock Rs.	Loading	Rs.
Krishna	1,250	$(\frac{1,500}{4,500} \times 1,250) =$	417
Vim	700	$(\frac{500}{1,500} \times 700) =$	233
Arjun	800	$(\frac{600}{3,000} \times 800) =$	160
		Total	810

12.8.1 Treatment of Goods Repossessed

You know when the hire purchase customer commits default in payment of instalments,the vendor may repossess the goods. The amount of instalments unpaid (also termed as instalments due) in respect of such goods are shown on the credit side of the first part of the Hire Purchase Trading Account as shown in its proforma given in Figure 12.3.

If the market value of such goods is given or they have been sold out immediately on repossession, the difference between the unpaid amount and the market value (or sale value, if sold out) is treated as loss or profit on goods repossessed. If it is loss, the same is debited in the second part of the Hire Purchase Trading Account, and if it is profit (it is rare), the same can be shown on its credit side. **The difficulty arises when the market value or sales value of repossessed goods is not available. In such asituation, you will have to adjust the loading involved in the unpaid instalment in respect of such goods because its true value is equal to its proportionate cost.** Thus, having credited the first part of Hire Purchase Trading Amount with amount of the unpaid instalments, you must debit the amount of loading included in the unpaid instalments. Alternatively, if you are preparing Hire Purchase Trading Account without dividing it into two parts, credit the Hire Purchasing Trading Account with its true value/market value/sale value itself. In that case, no adjustment will be necessary.

Look at illustration 6 and see how goods repossessed have been treated in the Hire Purchase Trading Account.

Illustration 6

Easy Payment Ltd. sells goods on hire purchase basis at a profit of 50% on cost, The following particulars are given for the year ending December 31, 2018. Prepare the Hire Purchase Trading Account.

	Rs.
Hire Purchase Stock (opening)	18,000
Instalments due, customers paying (opening)	10,000
Goods sold on hire purchase during the year (at hire purchase price)	1,74,000
Cash received from customers	1,20,000
Goods repossessed valued at (instalments due Rs. 6,000)	3,000
Hire Purchase Stock at the end	60,000
Instalments due (at the end), customers paying	16,000
Expenses	19,000

Solutions :

Hire Purchase Trading Account

Dr. **Cr.**

Date Particulars	**Amount**	**Particulars**	**Amount**
	Rs.		Rs.
To Hire Purchase Stock (opening)	18,000	By Cash Received	1,20,000
To Hire Purchase Debtors (opening)	10,000	By Goods Repossessed (instalments unpaid)	6,000
To Goods sold on Hire Purchase	1,74,000	By Hire Purchase Debtors (closing)	16,000
		By Hire Purchase Stock (closing)	60,000
	2,02,000		2,02,000
To Loss on Goods Repossessed (diff. between instalments unpaid and market value)	3,000	By Stock Reserve (Loading on opening H.P. stock)	6,000
		By Goods sold on Hire Purchase (loading)	58,000
To Stock Reserve (loading on closing H.P. stock)	20,000		
To Expenses	19,000		
To Profit & Loss A/c (Profit)	22,000		
	64,000		64,000

Working Notes:

I **Loading**

a) On Opening H.P. Stock $(18,000 \times \frac{50}{150})$ = Rs. 6,000

b) OnGoodsSoldonH.P. $(1,74,000 \times \frac{50}{150})$ = Rs. 58,000

c) OnClosing H.P. Stock $(60,000 \times \frac{50}{150})$ = Rs. 20,000

2 **Loss on Goods Repossessed:** Amount of unpaid instalments - Market Value

= 6,000- 3,000 = Rs. 3,000

Alternatively

Hire Purchase Trading Account

Dr. **Cr.**

	Rs.		**Rs.**
To Hire Purchase Stock (opening)	18,000	By Cash Received	1,20,000
To Hire Purchase Debtors (opening)	10,000	By Goods Repossessed (market value)	3,000
To Goods sold on Hire Purchase (H.P. Price)	1,74,000	By Hire Purchase Debtors (closing)	16,000

To Stock Reserve (loading on closing H.P. stock)	20,000	By Hire Purchase Stock (closing)	60,000
To Expenses	19,000	By Stock Reserve (loading on opening H.P. stock)	6,000
To Net Profit (transferred to P & L A/c)	22,000	By Goods sold on Hire Purchase (loading)	58,000
	2,63,000		2,63,000

12.8.2 Calculation of Missing Figures

Many times some of the figures needed to calculate the profit or loss on sale of goods of small value on hire purchase are missing. These items may be H.P. Stock (at the beginning or at the end), instalments due (opening or closing), purchases, cash received, etc. Therefore, it becomes necessary to first calculate the figures of these items and then prepare the Hire Purchase Trading Account. **If there is only one figure missing, the same can be worked out with the help of the first part of the Hire Purchase Trading Account.** But, if more than one figure is missing, the following steps should be taken for the calculation of the missing figures.

1. Prepare three memorandum accounts in the order mentioned below:
   i) Memorandum Stock at Shop Account,
   ii) Memorandum Stock out with Customers Account or Hire Purchase Stock Account, and
   iii) Memorandum Instalments Due Account or Hire Purchase Debtors Account.
2. Fill up all the figures given.
3. Start with the account having maximum figures available. This will help you to find out the missing figure of that account.
4. Transfer the figure so calculated to the relevant account.
5. Stock at Shop Account shows all figures at cost, whereas Hire Purchase Stock Account and Hire Purchase Debtors Accounts show all figures at hire purchase price. Therefore, while transferring any figure from Stock at Shop Account to the other accounts, the figure should be raised to hire purchase price. Similarly, while transferring any amount from other accounts to the Stock at Shop Account, the figure has to be brought down to cost.
6. The process of transfer will continue until all the amounts are filled in these accounts. The Proforma of the three accounts is given below.

Memorandum Stock at Shop Account

Dr. **Cr.**

	Rs.		Rs.
To Balance b/d		By Goods Sold on Hire Purchase (at cost)(1)	
To Purchases		By Balance c/d	

Memorandum Hire Purchase Stock Account

Dr.	Rs.		Cr. Rs.
To Balance b/d		By Instalment Due (2)	
To Goods Sold on Hire Purchase(at HP. price) (1)		By Goods Repossessed (instalments not yet fallen due)	
		By Balance c/d	

Memorandum Hire Purchase Debtors Account

Dr.	Rs.		Cr. Rs.
To Balance b/d		By Cash Received from Customers	
To Stock with Customer Account (total instalments fallen due) (2)		By Goods Repossessed (instalment due but not paid)	
		By Balance c/d	

illustration 7 will help you to understand the calculation of missing figure for the preparation of Hire Purchase Trading Account.

Illustration 7

Home Appliances Ltd sells goods on hire purchase terms at a profit of 25% on hire purchase price. Following are the transactions for the year ended December 31, 2018.

		Rs.
January, 1	Stock out on hire at cost	6,000
	Stock on hand (at shop)	1,000
	Instalment due	600
	Cash Received	16,000
December, 31	Stock out on hire (at cost)	6,900
	Stock on hand (at shop)	1,400
	Instalment due	1,000

Calculate the profit or loss on hire purchase under Debtors Method.

Hire Purchase Trading Account

Dr.	Rs.		Cr. Rs.
To Stock with Customers	8,000	By Cash Received	16,000
To Instalment Due	600	By Stock with Customers	9,200
To Goods Sold on Hire Purchase	17,600		

		By Instalment Due	1,000
	26,200		26,200
To Stock Reserve (loading)	2,300	By Stock Reserve (loading)	2,000
To Profit & Loss A/c (Profit)	4,100	By Goods sold on Hire Purchase (loading)	4,400
	6,400		6,400

Working Note :

Calculation of Missing Figure :

Memorandum Stock at Shop Account

Dr.			Cr.
	Rs.		Rs.
To Balance b/d	1,000	By Stock with Customers	13,200
To Purchases (balance figure)	13,600	By Balance c/d	1,400
	14,600		14,600

Memorandum Stock with Customers Account

Dr.			Cr.
	Rs.		Rs.
To Balance b/d	8,000	By Instalment Due	16,400
To Stock at Shop (at hire purchase price) (missing figure)	17,600	By Balance c/d	9,200
	25,600		25,600

Memorandum Instalments Due Account

Dr.			Cr.
	Rs.		Rs.
To Balance b/d	600	By Cash Received	16,000
To Stock with Customers (missing figure)	16,400	By Balance c/d	1,000
	17,000		17,000

Check Your Progress B

1. Fill in the blanks

   i) The accounting treatment of goods of small value is recorded in the books of …………..only.

   ii) The vendor maintains a ……………….register.

iii) The vendor prepares …………………Account to calculate profit or loss on hire purchase business.

iv) Goods sold on hire purchase are shown on the …………………side of the Hire Purchase Trading Account.

v) Loss on goods repossessed by the vendor is equal to the difference between the market value of the goods repossessed and the…… in respect of such goods.

vi) Three Accounts prepared for the calculation of missing figures are stock at Shop Account, ……………Account and Instalments Due Account.

2. What do you understand by Hire Purchase Debtors?

....

....

....

....

3. What do you mean by Hire Purchase Stock?

....

....

....

12.9 STOCK AND DEBTORS SYSTEM

The profit or loss for an accounting period on goods of small value sold on hire purchase basis can also be ascertained by another method called 'Stock and Debtors System'. This system is similar to the system followed in case of branch accounts. Under this system, we make use of the four control accounts viz (i) Hire Purchase Stock Account, (ii) Hire Purchase Debtors Account, (iii) Goods Sold on Hire Purchase Account, and (iv) Goods Repossessed Account; and prepare Hire Purchase Adjustment Account for working out the profit or loss on the hire purchase business. **The Hire Purchase Adjustment Account is similar to the second part of the Hire Purchase Trading Account** wherein entries are made for the loading involved in the goods sold on hire purchase and the opening and closing balances of hire purchase stock (instalments not yet due), and shows the expenses and losses re1ating to the hire purchase business. The balancing figure in the Hire Purchase Adjustment Account represents the profit or loss on the hire purchase business.

The following journal entries are passed under this system to open the necessary accounts in the ledger.

1. **For goods sold on hire purchase**
   Hire Repossessed A/c Dr.
   To Goods sold on H.P. A/c

2. **For total instalments due during the year**
   Hire Purchase Debtors A/c Dr
   To Hire Purchase Stock A/c

3. **For cash received**
   Cash A/c Dr.
   To Hire Purchase Debtors A/c
4. **For goods repossessed (unpaid instalments)**
   Goods Repossessed A/c Dr.
   To Hire Purchase Stock A/c
5. **For loading on goods sold on H.P.**
   Goods sold on H.P. A/c Dr.
   To Hire Purchase Adjustment A/c
6. **For loading on opening H.P. stock**
   Stock Reserve A/o Dr.
   To Hire Purchase Adjustment A/c
7. **For loading on closing H.P. stock**
   Hire Purchase Adjustment A/c Dr.
   To Stock Reserve A/c
8. **For loss on goods repossessed**

   Hire Purchase Adjustment A/c Dr.
   To Goods Repossessed A/c
   (With difference between instalments unpaid and market value of goods repossessed or for loading only)
9. **For expenses on hire purchase business**
   Hire Purchase Adjustment A/c Dr.
   To Expenses A/c
10. **For transfer of profit on hire purchase business**
    Profit & Loss A/c Dr.
    To Hire Purchase Adjustment A/c

    In case of loss, the entry can be reversed
11. **For closing goods sold on Hire Purchase Account**
    Goods Sold on H.P. A/c Dr.
    To Trading (Stock at shop) A/c

Look at illustrations 8 and 9 and see how profit or loss is ascertained with the help of control accounts under the Stock and Debtors System.

Illustration 8

Prepare necessary accounts in the books of S.S.K. & Co. who sold goods at a profit @ 25% on cost price, with the help of the following information. Follow Stock and Debtors System.

Stock in Shop

On 1.4.18	15,000
On 31.3.19	12,500
Goods with customers on hire purchase on 1.4.18	18000
Purchases for shop stock	32,300
Goods sold on H.P. during the year 18-19	43,500
Instalments received	30,000

Overdue Instalments

On 1.4.18	1,000
On 31.3.19	1,500

Solution:

Hire Purchase Stock Account

Dr.			Cr.
	Rs.		Rs.
To Balance b/d	18,000	By Hire Purchase Debtors A/c (1)	30,500
To Goods Sold on Hire Purchase A/c	43,500	By Balance c/d	31,000
	61,500		61,500
To Balance b/d	31,000		

Hire Purchase Debtors Account

Dr.			Cr.
	Rs.		Rs.
To Balance b/d	1,000	By Bank A/c	30,000
To Hire Purchase Stock A/c (1) (amount of instalments due-balancing figure)	30,500	By Balance c/d	1,500
	31,500		31,500
To Balance b/d	1,500		

Goods Sold on Hire Purchase Account

Dr.			Cr.
	Rs.		Rs.
To Hire Purchase Adjustment A/c	8,700	By Hire Purchase Stock A/c	43,500
To Shop Stock	34,800		
	43,500		43,500

Hire Purchase Adjustment Account

Dr.			Cr.
	Rs.		Rs.
To Stock Reserve A/c (loading on closing H.P. Stock)	6,200	By Stock Reserve A/c (loading on opening H.P.stock)	3,600
To Profit & Loss A/c (balancing figure)	6,100	By Goods Sold on H.P. A/c (loading)	8,700
	12,300		12,300

Working Notes:

Loading is 25% on cost. The figures of items on which loading is to be calculated are given at H.P. price. Hence, the loading on various items has been calculated as follows:

i) On goods sold on H.P. $= 43{,}500 \times \frac{25}{125}$ = Rs. 8,700

ii) On opening H.P. stock $= 18{,}000 \times \frac{25}{125}$ = Rs. 3,600

iii) On closing H.P. stock $= 31{,}000 \times \frac{25}{125}$ = Rs. 6,200

Illustration 9

Taking the information from illustration 6, ascertain the profit on hire purchase business by following the Stock and Debtors system

Hire Purchase Stock Account

Dr.			Cr.
	Rs.		Rs.
To Balance b/d (at hire purchase price)	18,000	By Hire Purchase Debtors A/c (balancing figure)	1,28,000
To Goods Sold on Hire Purchase A/c (at hire purchase price)	1,74,000	By Goods Repossessed A/c	6,000
		By Balance c/d (at hire purchase price)	60,000
	1,92,000		1,92,000
To Balance b/d	60,000		

Hire Purchase Debtors Account

Dr.			Cr.
	Rs.		Rs.
To Balance b/d	10,000	By Cash A/c	1,20,000
To Hire Purchase Stock A/c. (total instalment due—balancing figure)	1,26,000	By Balance c/d	16,000
	1,36,000		1,36,000
To Balance b/d	16,000		

Goods Repossessed Account

Dr.			Cr.
	Rs.		Rs.
To H.P. Stock A/c	6,000	By H.P. Adjustment A/c (loss being the diff. between instalments unpaid and its market value)	3,000
		By Balance c/d	3,000
	6,000		6,000
To Balance b/d	3,000		

Hire Purchase Adjustment Account

Dr.			Cr.
	Rs.		Rs.
To Stock Reserve A/c (loading on closing H.P. stock)	20,000	By Stock Reserve A/c (loading on opening H.P. Stock)	6,000
To Loss on Goods Repossessed (diff. between instalment due and market price)	3,000	By Goods Sold on Hire Purchase A/c (loading)	58,000
To Expenses A/c	19,000		
To Profit & Loss A/c	22,000		
	64,000		64,000

Check Your Progress C

1. Fill in the blanks:

   i) Hire Purchase Adjustment Account shows the ……….on the opening and closing stocks, and the goods sold on hire purchase.

   ii) Hire Purchase Debtors Account is credited with the closing balance and……….

   iii) The Goods Sold on Hire Purchase are shown at …………in Shop Stock Account.

   iv) The loss on goods repossessed is shown on the debit side of …………………. Account.

   v) The balance of ……………Account represents the value of stock with customers at ………………………. Price.

2. List the accounts opened for ascertaining the profit or loss on hire purchase business under the Stock and Debtors System.

   ....

   ....

   ....

12.10 LET US SUM UP

Under the hire purchase agreement, the hire vendor delivers only the physical possession of the goods to the buyer (the hirer) and not the title of the goods. Title passes when the payment of the last instalment is made. If the buyer makes default, the hire vendor has the right to repossess the goods. But the vendor can also enter into a compromise and repossess a part of the goods. When, on default by the buyer, the vendor repossesses only a part of the goods, he reassesses its value and adjusts the same against the amount due from hirer.

The basic difference between the hire purchase system and the instalment payment system relates to the point of time when the title of the goods passes from the seller to the buyer. In case of hire purchase system, the title of the goods passes at the time of payment of the last instalment while in case of instalment payment system it passes at the time of signing the contract. Accounting treatment in both systems is more or less the same. The only difference relates to the treatment of interest. In case of hire purchase system, the actual amount of interest is debited to the purchaser as and when the instalments fall due. But, in case of instalment payment system, the buyer is debited with the total amount of interest right at the time of sale by crediting it to Interest Suspense Account. This account is debited with the actual amount of interest as and when the instalments fall due. Under this system, the buyer is treated as a debtor for the full amount including total interest. However, in practice, even this may be dispensed with.

When the goods of small value are sold on hire purchase terms, a special accounting treatment is required. The accounting records of sale of such goods are maintained by the vendor only. He keeps a Hire Purchase Sale Register with appropriate columns. The totals of these columns are posted in different control accounts periodically.

There are two methods of ascertaining profit or loss on goods of small value sold on hire purchase. They are (i) Debtors method under which Hire Purchase Trading Account is prepared, and (ii) Stock and Debtors Method.

The Hire Purchase Trading Account is like Consignment Account; the first part of which shows the opening H.P. stock, opening H.P. debtors and the goods sold on hire purchase on the debit side; and cash received, goods repossessed and closing H.P. stock and H.P. debtors on the credit side. The total of these two sides should be equal. Its second part mainly shows the loading on goods sold on hire purchase, loading on opening and closing stocks, the loss on goods repossessed and the expenses on hire purchase business. The difference represents the profit or loss on hire purchase business which is transferred to the Profit & Loss Account.

Sometimes, certain items needed to prepare Hire Purchase Trading Account may be missing. These can be ascertained by preparing three memorandum accounts (i) Stock at Shop Account, (ii) Stock with Customers Account, and (iii) Instalments Due Account. If, however, only one item is missing, it can be ascertained directly from the first part of the Hire Purchase Trading Account.

Under Stock and Debtors Method, the accounts prepared for ascertaining the profit or loss on hire purchase business are : (i) Goods sold on Hire Purchase Account, (ii) Hire Purchase Stock Account, (iii) Hire Purchase Debtors Account, (iv) Goods Repossessed Account, and (v) Hire Purchase Adjustment Account. The Hire Purchase Adjustment Account is nothing but the second part of Hire Purchase Trading Account which shows the profit or loss on Hire Purchase sale. It is similar to Branch Adjustment Account prepared in case of branch accounts.

12.11 KEY WORDS

Default: Failure on the part of the hirer (the buyer of the goods) to pay instalment.

Instalment Sale: An ordinary sale transaction where the payments are made on deferred terms, but the buyer becomes the owner of the goods immediately on completion of the transaction.

Passing of Title: Transfer of ownership.

Seizure: Repossession of goods within the provision of the law. A hire purchase agreement may give the right to the hire vendor to seize the goods he has sold if the hirer (the buyer) makes default in payment of instalments.

Control Accounts: Accounts prepared with aggregate figures to check the accuracy of respective accounts-like H.P. Stock. H.P. Debtors, etc.

Hire Purchase Debtors: Amount of instalment due but not yet paid.

Hire Purchase Stock: Instalments not yet fallen due.

Hire Purchase Trading Account: An account prepared for ascertaining the profit or loss on goods of small value sold on hire purchase basis.

Stock Reserve: Amount of loading involved in hire purchase stock.

Stock at Shop: Stock of unsold goods lying in the store.

12.12 ANSWERS TO CHECK YOUR PROGRESS

A 1. i) failure ii) physical holding iii) recovery, possession iv) terminated, seize, v) damages vi) title, initial payment.

2. i) False ii) True iii) False iv) True v) False

B 1. i) vendor ii) hire purchase sales iii) hire purchase trading iv) debit v) instalment unpaid vi) stock with customers.

C 1. i) loading ii) cash received iii) cost iv) hire purchase adjustment v) hire purchase stock, hire purchase.

12.13 TERMINAL QUESTIONS/EXERCISES

Questions

1. Explain the terms ‘Default’ and ‘Repossession’ both in relation to a hire purchase transaction and an instalment sale transaction.
2. What are the rights of a hire vendor in case of default under the Hire Purchase Act, 1972?
3. What are the rights of hirer in case of seizure and repossession of goods under the Hire Purchase Act, 1972?
4. Describe the difference between the accounting treatment under the hire purchase system and the instalment payment system.
5. Discuss in detail the similarities and dissimilarities of Hire Purchase System and Instalment Payment System.
6. Describe how you can keep a detailed record of individual transactions in subsidiary book.
7. State the journal entries passed to open various accounts under Stock and Debtors System as applicable to hire purchase business.
8. Distinguish between ‘Stock and Debtor System’ and ‘Hire Purchase Trading A/c Method’ (Debtors System) of ascertaining profit or loss on goods of small value sold on hire purchase basis.

Exercises

I. PQR Ltd. sold a piece of Machinery to RST Ltd. on 1.1.15 under a hire purchase agreement. The payments were to be made in four annual instalments of Rs. 4,230 each at the end of each year. The rate of interest @ 5% was to be charged. RST Ltd. defaulted at the time of the third instalment and POR Ltd. repossessed the machinery. RST Ltd. charged depreciation @ 10% p.a. on W.D.V. method.

Show necessary ledger accounts in the books of RST Ltd.

(**Answer :** Cash Price Rs, 15,000, Total Interest Rs. 1920, Loss on repossession Rs. 2,676).

2. Karim Ltd. purchased some furniture from Solman Ltd. on hire purchase system on 1.1.17 at a cash price of Rs. 60,000, of this Rs. 15,480 was to be paid as down payment and the balance in five annual instalments of Rs. 10,000 each. The rate of interest was charged @ 4% p.a. Karim Ltd., could only pay the first instalment and, on default, Solman Ltd. repossessed the goods which were revalued by charging depreciation @ 15% p.a. on straight line method. On 1.3.19 Solman Ltd. incurred Rs. 1,500 for reconditioning of the goods and sold them at Rs. 45,000.

Show the ledger accounts in the books of Solman Ltd.

(**Answer:** Amount due from Karim Ltd. on 31.12.18 Rs. 37,753; Profit taken to P & L A/c in 2018 Rs. 4,247 : Profit on resale in 2019 Rs. 1,500.)

3. Fair Ltd. purchased on 1.1.16 machinery valued at Rs. 12,000 from Unfair Ltd. under a hire purchase system under which the payments were to be made in three equal annual instalments of Rs. 4,000. The interest @ 6% p.a. was to be charged and paid along with the instalments. Fair Ltd. could not pay the second instalment and it was agreed that Unfair Ltd. would partly repossess Machinery costing Rs. 8,000 at Rs. 4,500 provided Fair Ltd. paid the arrear interest to-date. Show ledger accounts in the books of Fair Ltd. assuming that depreciation @ 10% p.a. was charged on W.D.V. method.

(**Answer:** Loss on partial repossession Rs. 1,980, value of the machinery carried forward Rs. 3,240. Total amount of interest paid Rs. 1,200).

4. Ajay purchased five trucks on hire purchase on July 1, 2016. The cash price of each truck was Rs. 1,00,000. He was to pay 25% of the cash price as down payment with the delivery and the balance in five yearly instalments together with the interest @ 5% per annum. Ajay fails to pay the third instalment due on June 30, 2019. It was agreed that two trucks would be returned to the vendor and the value of these two trucks would be adjusted against the amount due. The trucks to be returned will be valued at depreciation of 25% p.a. on W.D.V. method. The repossessed trucks were overhauled at a cost of Rs 4,000 and sold for Rs. 90,000.

Show the necessary ledger accounts in the books of both the parties. Books are closed on June 30 every year and depreciation @ 20% per annum is charged.

(**Answer:** Goods Repossessed Rs. 84,375. Loss on Goods repossessed Rs. 18,025. Balance due to Hire Vendor Rs. 1,88,297)

5. Harish purchased from Ramesh some motor pumps on 1.1.17 under instalments payment system. The cash price was Rs. 74,466 which was to be paid Rs. 20,000 as down payment and the balance in three equal annual instalments of Rs. 20,000 including interest @ 5% p.a.

   Show the ledger accounts in the books of Harish and Ramesh assuming depreciation @ 10% p.a. on straight line method.

   (**Answer:** Total Interest for Interest Suspense A/c Rs. 5,534 adjusted Rs. 2,723 in 2017, Rs. 1,859 in 2018 and Rs. 952 in 2019).

6. Lokesh purchased on 1.1.17 some machinery from Suresh under instalment payment system under which Rs. 6,000 was to be paid as down payment and the rest in 3 equal annual instalments at interest @ 5%. The cost price was Rs. 22,350. Depreciation was charged @ 10% on W.D.V. method.

   Show the ledger accounts in the books of both the parties.

   (**Answer:** Total interest for Interest Suspense A/c Rs. 1,650 adjusted as Rs. 818 in 2017, Rs. 558 in 2018 and Rs. 274 in 2019)

7. Premier Trader Co., a hire vendor, furnished the following information for the year ended 31.12.2018.

	Rs.
Goods with hire purchase Customers (at hire purchase price) on 1.1.2018	32,000
Goods sold on hire purchase during the year (at hire purchase price) ,	1,60,000
Cash received during the year	1,12,000
Goods received back (instalments unpaid Rs. 4,000) at market value	600
Goods with hire purchase customers (at hire purchase price) on 31.12.2018	72,000

   Prepare Hire Purchase Trading Account in the books of Premier Trader Co. who sold goods on hire purchase at cost plus 60%.

   (Answer: Profit Rs. 41,600; Missing figure : H.P. Debtors at the end of Rs. 4,000)

8. From the following transactions of Lee Ltd., a hire vendor, prepare the necessary accounts under Debtors Method in its books for the year ended 31.12.18. The goods are sold at cost plus $33\frac{1}{3}\%$

		Rs.
January 1, 2018	Stock in the shop	2,000
	Instalments due	1,200
	Stock with customers at H.P. price	16,000
December 31.12.18	Stock in the shop	2,800
	Instalments due and unpaid	2,000
	Stock with customers at H.P. price	18,400
	Cash received during the year	32,000
	Expenses on hire purchase business	3,000
	Purchases	27,200

(Answer: Goods sold on Hire Purchase at H.P. price Rs. 35,200; Profit Rs. 5,200)

9. H.C. Sales, a hire vendor, was engaged in hire purchase business. The following information is provided to you for the year ended December 31, 2018, in respect of his business.

January 1, 2018	Stock with Customers at H.P. price	4,500
	Instalment due	2,500
December 31,2018	Cash received form customers	30,000
	Goods repossessed (instalments due Rs. 1,000) at market value	650
	Instalment due	4,500
	Goods sold on hire purchase	43,500

Prepare necessary accounts under Stock and Debtors System assuming H.P. Price at cost plus50%.

(**Answer:** Net profit Rs. 10,650; missing figure H.P. Stock at end Rs. 15,000)

10. Following information was available for the year ended June 30, 2018, in respect of Auto Dealers Ltd. who was engaged in hire purchase business. Calculate the amount of profit under Stock and Debtors Method.

July 1, 2017	Instalments due	4,000
	Stock, at shop	12,000
	Stock out with customers (at H.P.Price)	25,000
	Cash received during the year	2,00,000

	Purchases	1,67,000
	Goods repossessed (instalments due Rs. 3,000) valued at	500
June 30, 2018	Instalments due	6,000
	Stock at shop	11,000
	Stock out with customers (at H.P. Price)	30,000

The goods were sold on purchase at 20% on hire purchase price.

(**Answer** : Profit Rs. 38,500)

11. Girdhari also sells goods on hire purchase basis. The hire purchase price is fixed by adding 50% to the cost. The following are the figures relating to his hire purchase business for the year 2018.

	Rs.
H.P. Stock as on 1.1.2018	36,000
H.P. Debtors as on 1.1.2018	900
Goods sold on hire purchase at H.P. price	2,71,800
Cash received during the year	2,77,200
Total amount of instalments that fell due during 2018	2,78,100

A customer to whom goods had been sold for Rs. 3,600 paid three instalments of Rs. 300 each. His fourth instalment fell due on December 1, 2018 which he failed to pay. Consequently, the goods were repossessed on December 27, 2018 after due legal notice. Prepare the necessary accounts under the Stock and Debtors System for the year ending December 31, 2018.

(**Answer:** Profit Rs. 92,600; Missing figures; H.P. Stock at the end Rs. 27,300 and H.P. Debtors at the end Rs. 1,500 after crediting Rs. 2,400 and Rs. 300 for goods repossessed.)

12.14 SOME USEFUL BOOKS

Maheshwari. S.N., 2018: ***Introduction to Accounting*** Vikas Publishing House, New Delhi.

MongaJ.R..Ahuja G.C. & Ashok Sehgal, 2018 :***Advanced Accounting*** National Publishing House Sew Delhi.

William Pickes, 2002, *Accountancy,* E.L.B.S. and Pitman, London

Gupta R L. and M. Radbaswamy, 2018.***Advanced Accounting*** Sultan Chand & Sons, New Delhi

Shukla.M.C..Grewal T.S. & S.C. Gupta, 2018 ***Advanced Accounts*** S. Chand & Co. Ltd., New Delhi.

Note : These questions will help you to understand the unit better. Try to write answers for them. But, do not submit your answers to the University for assessment. These are for your own practice only.

UNIT 13 BRANCH ACCOUNTS-I

Structure

13.0 OBJECTIVES

After studying this unit, you should be able to:

- describe the need for branch accounting;
- explain the different types of branches from accounting point of view;
- describe three systems of maintaining branch accounts for a dependent branch;
- prepare branch account under the debtors system both at cost price and at invoice price;
- prepare branch account under the final accounts system; and
- prepare the necessary accounts under the stock and debtors system.

13.1 INTRODUCTION

A business may be split up into a number of divisions. The divisions are known as departments if located under the same roof. On the other hand, if divisions are located at different places of the same town, country or world, they are called branches. For example, Cottage Emporium has various divisions like garments, furniture, gift items, jewellery, etc. They are located in the same building and so are called departments. Snowhite has its showrooms in Connaught Place, Nehru Place, Karol Bagh, South Extension and Kamlanagar. These are all branches of Snowhite. Similarly, Bata has its branches all over the country and Leventies all over the world. Each branch is treated as a separate profit centre and hence the profit or loss is to be worked out separately for each branch. Moreover, the firm has to keep strict control over various activities of each branch and ensure its smooth functioning. The accountants, therefore, have developed some specialised accounting methods for the recording of transactions at branch level and for incorporating the net effect of all branch transactions in the firm's books.

From accounting point of view, the branches are divided into three categories (i) dependent branches, (ii) independent branches, and (iii) foreign branches. In this unit, you will learn how the accounts of dependent branches are maintained and how their profit or loss is worked out.

13.2 NEED FOR BRANCH ACCOUNTING

As stated earlier, each branch is treated as a separate profit centre. Hence, it should record various transactions in such a manner that its profit or loss can be worked out and incorporated in the firm's overall results at the end of the accounting year. Moreover, the branches conduct all activities under the direction and control of the head office which may need a variety of information from time to time about the functioning of each branch. This becomes possible only if the branches keep proper books of account. Thus, the main reasons of keeping branch accounts can be summarised as follows :

i) to find out the profit or loss of each branch for the accounting period;

ii) to ascertain the financial position of each branch at the end of the accounting year;

iii) to incorporate the net effect of branch transactions and their assets and liabilities in a firm's final accounts;

iv) to estimate requirements of cash and stock for each branch;

v) to evaluate the progress and performance of each branch;

vi) to calculate the commission for payment to the managers, if based on profit of branch;

vii) to assess the prospects for expansion of business in each branch; and

viii) to meet audit requirements.

13.3 TYPES OF BRANCHES

From accounting point of view, the branches can be divided into the following categories:

1) Branches not keeping full system of accounting;

2) Branches keeping full system of accounting;

3) Foreign branches.

Let us have an idea about their main characteristics.

Branches not Keeping Full System of Accounting: The branches not keeping full system of accounting are also called dependent branches. The main features of such branches are:

i) They sell only those goods which are received from the head office and are not usually allowed to make purchases in the open market except with the permission of the head office.

ii) Goods are supplied by the head office to such branches either at cost price or at invoice price.

iii) All major expenses of the branch are paid by the head office. The branch manager is allowed to incur only petty expenses like cartage, postage, etc. out of the petty cash provided to him for which he is required to maintain a simple petty cash book.

iv) The amount received from cash sales and debtors is either remitted to the head office daily or deposited in the account of head office in some local bank.

v) The branch manager is normally expected to sell the goods for cash, but he may be authorised to sell goods on credit in certain cases.

vi) Such branches do not keep complete books of account. They simply maintain record of sales and prepare debtors accounts, if necessary. They are also required to maintain a stock register and furnish weekly or monthly statements giving complete information about stock position and movement of goods to the head office. This enables the head office to keep proper control over stock at branches.

Branches Keeping Full System of Accounting: Branches keeping full system of accounting are called independent branches. They are allowed to purchase goods from the market and also supply to the head office, if necessary. They can incur expenses from the cash realised and operate the bank account in their own names. Thus, they operate as independent units for all practical purposes. Their only link with the head office is that they are owned by the head office and whatever profit they earn or loss they incur ultimately belongs to the head office.

Such branches keep a complete set of books on the double entry system and prepare their own Trial Balance, Trading and Profit & Loss Account and Balance Sheet. Such branches open Head Office Account in their books and record all transactions between the branch and the head office in this account.

Foreign Branches: When a branch is located in a foreign country, it is called a foreign branch. Such branches will keep their books of account in foreign currency. The Distinctive feature of foreign branches is that financial information received from them will be in foreign currency which has to be converted into the currency of the country of the head office before it is incorporated in the head office books. For example, if an Indian company has a branch in Nairobi, the branch Trial Balance will be in Kenyan shillings. The Trial Balance must be converted into rupees before it can be incorporated in head office books. For all practical purposes, however, foreign branches are treated as independent branches.

Look at Figure 13.1 for complete classification of branches.

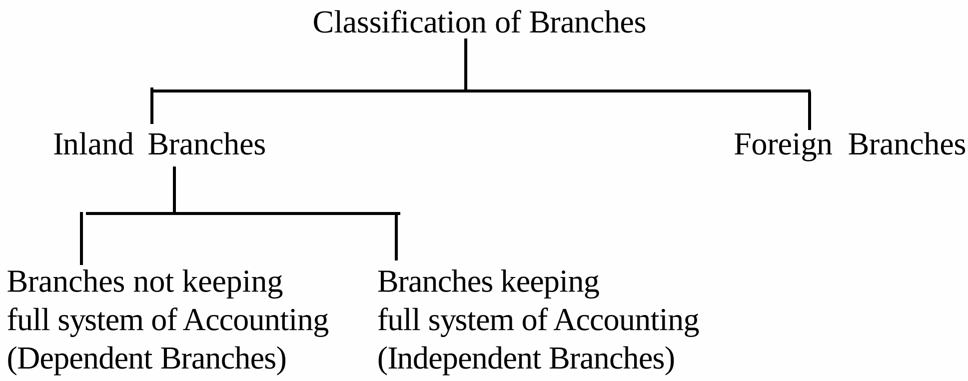

Fig. 13.1

13.4 ACCOUNTING FOR DEPENDENT BRANCHES

You know that the dependent branches do not keep a complete set of books. Most of their transactions are recorded at the head office level. The accounting system adopted by head office for a branch depends up on the size of a branch and the degree of control to be exercised by the head office. The following are the various methods by which the head office usually keeps branch accounts in its books:

i) **Debtors System:** This system is adopted generally for those branches which are fairly small in size. Under this system, the head office simply opens a Branch Account for each branch in which it records all transactions relating to the branch. The Branch Account is prepared in such a manner that it also helps in ascertaining the branch profit or loss.

ii) **Final Accounts System:** Under this system, the head office prepares a Trading and Profit and Loss Account in order to find out profit or loss of each branch and a Branch Account to find out the amount due to, or due from that branch. In this case, the Branch Account simply acts as a personal account.

iii) **Stock and Debtors System:** Under this system, the head office does not open any Branch Account. For each branch, it prepares a Branch Stock Account, a Branch Expenses Account, a Branch Adjustment Account and Goods sent to Branch Account in order to find out the profit or loss of each branch.

13.5 DEBTORS SYSTEM

As stated earlier, under debtors system, the head office simply opens a Branch Account for each branch in which it records all transactions relating to the branch. The Branch Account also helps in ascertaining the profit or loss of the branch.

Goods may be invoiced to a branch at cost or at selling price (also called invoice price). Accordingly, there are two methods of preparing the Branch Account: (1) Cost Price Method, and (ii) Invoice Price Method. Let us now study the preparation of Branch Account under both of these methods.

13.5.1 Cost Price Method

When goods are invoiced at cost, the following journal entries are passed in the books of the head office to record various transactions relating to the branch.

1) **For Goods sent to Branch**
Branch A/c Dr.
To Goods Sent to Branch A/c
(Being goods sent to branch)

2) **For return of goods to head office**
Goods Sent to Branch A/c Dr
To Branch A/c
(Being goods returned by the branch)

3) **For amount sent to branch for expenses**
Branch A/c Dr.
To Bank A/c
(Being cheque sent to branch for expenses)

4) **For amount received from branch**
Bank A/c Dr.
To Branch A/c
(Being cash or cheque received from branch)

5) **For closing goods sent to branch account**
Goods Sent to Branch A/c Dr.
To Purchases/Trading A/c
(Being balance transferred to Trading Account)

6) **For closing balances of assets at the branch**
Branch Assets A/c (Individually) Dr.
To Branch A/c
(Being closing balances of assets brought into account)

7) **For closing balances of liabilities at the branch**
Branch A/c Dr.
To Branch Liabilities A/c (Individually)
(Being closing balances of liabilities brought into account)

8) **For transferring profit or loss to the General Profit and Loss Account**

i) If profit
Branch A/c Dr.
To General Profit and Loss A/c
(Being branch profit transferred to General P & L A/c)

ii) If loss
General Profit and Loss A/c Dr.
To Branch A/c
(Being branch loss transferred to General P & L A/c)

The closing balances of branch assets and liabilities are shown in the Balance Sheet of the head office. At the beginning of the next year, the entry numbers 6 and 7 are reversed so as to show opening balances in the Branch Account.

The Branch Account will appear as given in Figure 13.2.

Figure 13.2

Branch Account

Dr.		Cr.	
To Opening Balances		**By Opening Balances**	
Stock		Creditors	
Debtors		Outstanding expenses	
Petty Cash		**By Bank**	
Furniture		Cash Sales	
Prepaid expenses		Collections from Debtors (for remittances)	
To Goods Sent to Branch A/c		By Goods Sent to Branch A/c (goods returned by the branch to head office)	
To Bank A/c (for expenses of any payment made by the H.O. on behalf of the Branch)		**By Closing Balance**	
To Closing Balances		Petty Cash	
Outstanding expenses		Stock	
Creditors		Debtors	
To Profit, if any (transferred to General Profit & Loss A/c)		Furniture (at depreciated value)	
		Prepaid Expenses	
		By Loss, if any (transferred to General Profit & Loss A/c)	

Look at illustrations 1 and 2 and study how Branch Account is prepared with the help of the given information.

Illustration 1

From the following particulars relating to Delhi Branch for the year ending December 31, 2018, prepare Branch Account in the books of head office.

	Rs.			Rs.
Stock at Branch on 1-1-2018	15,000	Cheques sent to Branch:		
Debtors at Branch on 1-1-2018	30,000	Salaries	9,000	
Petty Cash at Branch on 1-1-2018	300	Rent and Taxes	1,500	
Goods sent to Branch	2,52,000	Petty Cash	1,100	11,600
Cash sales	60,000	Goods returned by branch		2,000
Received from Debtors	2,10,000	Stock at Branch on 31-12-2018		25,000
Credit Sales	2,28,000	Petty Cash at Branch on 31-12-2018		200
		Debtors at Branch on 31-12-2018		48,000

Solution:

Head Office Ledger
Delhi Branch Account

Dr. **Cr.**

		Rs.			Rs.
To Balance b/d			By Cash:		
Branch Stock		15,000	Cash Sales	60,000	
Branch Debtors		30,000	Received from		
Branch Petty Cash		300	Debtors	2,10,000	2,70,000
To Goods sent to Branch A/c		2,52,000			
To Bank A/c			By Goods sent to Branch A/c		2,000
Salaries	9,000				
Rent & Taxes	1,500				
Petty Cash	1,100	11,600	By Balance c/d		
To Profit (transferred to General			Branch Stock		25,000
P & L A/c)		36,300	Branch Debtors		48,000
			Branch Petty Cash		200
		3,45,200			3,45,200

Illustration 2

Sankat Mochan Ltd., Varanasi opened a branch at Madras on January 1, 2018. The following particulars are available in respect of the branch for the year 2018.

	Rs.		Rs.
Goods sent to branch	75,000	Cash remittance to branch towards Petty Cash	6,000
Cash sales at branch	50,000	Petty Cash at branch on 31-12-2018	500
Credit sales at branch	60,000	Debtors at branch on 31-12-2018	5,000
Salaries of branch staff paid by Head Office	15,000	Stock at branch on 31-12-2018	27,000
Office expenses of branch paid by Head Office	12,000		

Prepare Branch Account to show the profit/loss from the branch for the year 2018.

Solution

Books of Sankat Mochan Ltd. Madras Branch Account

Dr. **Cr.**

		Rs.			Rs.
To Goods sent to Branch A/c		75,000	By Bank A/c		
To Bank A/c			Cash Sales	50,000	
Salaries	15,000		Received from Debtors	55,000	1,05,000
Office expenses	12,000	27,000			
To Bank A/c (for petty expenses)		6,000	By Balance c/d:		
To Profit (transferred to General			Branch Petty Cash		500
P & L A/c)		29,500	Branch Debtors		5,000
			Branch Stock		27,000
		1,37,500			1,37,500

Note: The amount of cash received from debtors is not given. It has been found by preparing the Memorandum Branch Debtors Account as follows:

Memorandum Madras Branch Debtors Account

Dr. **Cr.**

	Rs.		Rs.
To Credit Sales	60,000	By Cash Received (balancing figure)	55,000
		By Balance c/d	5,000
	60,000		60,000

Some Peculiar Items

Petty cash expenses: No entry is made in respect of petty cash expenses incurred by the branch out of its petty cash. As per practice, the Branch Account is debited with the opening balance of petty cash and the amount of petty cash sent by Head Office, and it is credited with the closing balance of petty cash. **This amounts to a net debit to Branch Account which is equal to the amount of petty expenses incurred by branch.** For example, the opening balance of petty cash with a branch was Rs. 200, the cash sent by Head Office for petty expenses was Rs. 300 and the petty expenses incurred by branch were Rs. 400. When we debit the Branch Account with Rs. 200 (opening petty cash balance) and Rs. 300 (amount sent by head office) and credit it with Rs. 100 (closing petty cash balance), the Branch Account stands debited by a net amount of Rs. 400 (Rs. 200 + Rs. 300 — Rs. 100) which is equal to the amount of petty cash expenses (Rs. 400) incurred by the branch.

Credit sales, sales returns, bad debts, discount allowed to debtors etc.: All these items relate to branch debtors and will not be shown in the Branch Account. The reasoning is similar to that of petty cash expenses. When the Branch Account is debited with the opening balance of branch debtors and credited with cash received from debtors and the closing balance of branch debtors, the amount of credit sales automatically stand accounted for.

Shortage or surplus of stock: It is possible that, at the time of checking the stock of a branch, certain amount of shortage or surplus is detected. These are not to be shown in the Branch Account because the closing stock credited to the Branch Account is the actual amount of stock and thus the shortage or surplus is automatically covered.

Depreciation of fixed assets: This is also not shown in the Branch Account because, as per practice, the closing balance of the fixed asset after deducting the amount of depreciation is shown on the credit side of the Branch Account.

Thus you should note that while preparing the Branch Account for dependent branches, the following Items will be ignored:

1) Petty Cash Expenses
2) Credit Sales
3) Sales Returns
4) Bad Debts

5) Discount Allowed to Debtors

6) Shortage or Surplus of Stock

7) Depreciation

Look at illustration 3 and see how Branch Account is prepared without specifically showing the above items, if given.

Illustration 3

Pratap Tractors Ltd., Allahabad, has a branch at Hissar. From the following particulars relating to the branch for the year ending December 31, 2018, prepare the Branch Account in the head office books:

Stock at Branch on 1-1-2018	10,000	Discount allowed to Debtors	100
Branch Debtors on 1-1-2018	4,000	Cash sent to Branch:	
Petty Cash on 1-1-2018	500	Rent	2,000
Furniture on 1-1-2018	2,000	Salaries	2,400
Prepaid Insurance on 1-1-2018	150	Petty Cash	1,000
Salaries Outstanding on1-1-2018	1,00,000	Insurance (upto 31-3-2019)	600
Goods sent to Branch	80,000	Good Returned by Branch	1,000
Cash Sales	30,000	Good Returned by Debtors	2,000
Credit Sales	40,000	Stock at Branch on 31-12-2018	5,000
Cash received from Debtors (direct to HO)	35,000	Petty Expenses paid by Branch	850
Cash paid by Debtors	2,000		

Provide depreciation on furniture @ 10% p.a.

Solution :

Hisar Branch Account

Dr. **Cr.**

		Rs.			Rs.
To Balance b/d			By Balance b/d		
Branch Stock		10,000	Branch Outstanding Salaries		1,00,000
Branch Debtors		4,000			
Branch Petty Cash		500	By Cash:		
Branch Furniture		2,000	Cash Sales	30,000	
Branch Prepaid Insurance		150	Cash Received from Debtors	37,000	67,000
To Goods Sent to Branch	80,000		By Balance c/d		
Less : Return from Branch	1,000	79,000	Branch Stock		5,000
To Bank			Branch Petty Cash		650
Rent	2,000		Branch Debtors		4,900
Salaries	2,400		Branch Furniture		1,800
Petty Cash	1,000		Branch Prepaid Insurance		150
Insurance	600				
		6,000			
To Profit (transferred to General P & L A/c)		77,850			
		1,79,500			1,79,500

Notes:

1) Cash received from debtors include Rs. 2,000 which the debtors directly paid to the head office.

2) Branch petty cash balance at the end is not given. It is ascertained as follows:

Petty Cash at the beginning	500
Add: Amount sent by head office	1,000
	1,500
Less: petty cash expenses	850
Petty Cash Balance	650

3) Furniture at the end has been shown after deducting Rs. 200 for depreciation.

4) Prepaid insurance on 31-12-2018 is one-fourth of Rs. 600.

5) The closing balance of branch debtors is not given. It has been worked out by preparing the Memorandum Branch Debtors Account as follows:

Memorandum Branch Debtors Account

	Rs.		Rs.
To Balance c/d	4,000	By Cash Received from Debtors	37,000
To Sales (Credit)	40,000	By Sales Returns	2,000
		By Discount Allowed	100
		By Balance c/d (balancing figure)	4,900
	44,000		44,000

13.5.2 Invoice Price Method

As in the case of consignment, the goods may he invoiced to branches at a price higher than the cost (termed as invoice price). This is done primarily to have an effective control over stock with branches and keep the margin of profit secret from the branch manager. In such a situation, all entries relating to goods are made in the Branch Account at invoice price and necessary adjustments for loading (difference between I.P. and C.P.) are recorded at the end by passing the following **additional** journal entries:

1) **For adjustment of loading in opening stock at branch**
Stock Reserve A/c Dr.
To Branch A/c

2) **For adjustment of loading in goods sent to branch less returns**
Branch A/c Dr.
To Goods Sent to Branch A/c

3) **For adjustment of loading in closing stock at branch**
Branch A/c Dr.
To Stock Reserve A/c

Look at illustration 4 and see how Branch Account is prepared when goods are invoiced at a price higher than cost.

Illustration 4

The Mukund Gas Co., Varanasi have a sales branch at Ghaziabad and invoiced goods to the branch at cost price plus $33\frac{1}{3}$ per cent. It is arranged that all cash received by the branch is to be paid daily to the Head Office Account with the Banaras State Bank Ltd. and the necessary advice sent to the Head Office. From the following particulars, prepare Branch Account and Goods Sent to Branch Account in the Head Office ledger showing the actual profit or loss of the branch for the year ending December 31, 2018.

	Rs.		Rs..
Stock on 1.1.2018 (at invoice price)	12,000	Rent, Rates and Taxes	3,200
Goods Sent to Branch (at invoice price)	96,000	Salaries and Wages	4,800
Debtors on 1-1-2018	1,500	Debtors on 31-12-2018	1,600
Cash Sent to Head Office	77,100	Goods Returned to Head Office (at invoice price)	16,000
Sales	77,000	Shortage of stock (at invoice price)	200

Solution :

Books of Mukumd Gas. Co., Varanasi
Ghaziabad Branch Account

Dr. **Cr.**

		Rs.		Rs.
To Balance b/d				
Branch Stock		12,000	By Cash Received	77,100
Branch Debtors		1,500	By Goods Returned by Branch A/c	16,000
To Goods Sent to Branch		96,000	By Stock Reserve A/c (loading in op. stock)	3,000
To Bank A/c			By Goods Sent to Branch A/c (loading in goods sent less returns)	20,000
Rent, Rates & Taxes	3,200		By Balance c/d	
Salaries & Wages	4,800	8,000	Branch Stock	14,800
To Stock Reserve A/c (loading in Cl. Stock)		3,700	Branch Debtors	1,600
To Profit (Transferred to General P & L A/c)		11,300		
		1,32,500		1,32,500

Goods Sent to Branch Account

	Rs.		Rs.
To Ghaziabad Branch A/c	16,000	By Ghaziabad Branch A/c	96,000
To Ghaziabad Branch A/c (loading on Rs. 80,000)	20,000		
To Trading A/c (transfer)	60,000		
	96,000		96,000

Notes : 1) The branch stock at the end has not been given. It can be worked out by preparing Memorandum Branch Stock Reserve Account as follows :

2) Loading is 25% of invoice price.

Memorandum Branch Stock Account

	Rs.		Rs.
To Balance b/d	12,000	By Goods returned to Head Office	16,000
To Goods received form Head Office	96,000	By Sales	77,000
To Goods returned to Customers	...	By Shortage of stock	200
		By Balance c/d	14,800
	1,08,000		1,08,000

It should be noted that all figures in Memorandum Branch Stock Account have been recorded at the invoice price.

Check Your Progress A

1. What do you mean by dependent branch?

....

....

....

2. Fill in the blank:

   i) The branch expenses paid by the Head Office are …..........….. to the Branch Account.

   ii) The balance in Goods sent to Branch Account is transferred to…....................… Account.

   iii) If the cost price is Rs. 100 and the invoice price is cost plus 20% on invoice price, the invoice price is Rs ……………

   iv) Loading is the ……...................….between cost price and invoice price.

   v) If opening or closing stock is not given, the same can be worked out by preparing ……….. Account at ………price.

3. List the items which are not to be shown in Branch Account prepared under the Debtors System.

....

....

....

....

13.6 FINAL ACCOUNTS SYSTEM

The profit or loss of a dependent branch can also be worked out by preparing a Memorandum Branch Trading and Profit & Loss Account. This account is prepared on the basis of cost of goods sent to the branch (not the invoice price). Apart from the Branch Trading and- Profit & Loss Account, the Head Office also maintains the Branch Account. But, under this system, the Branch Account is in the nature of a personal account which shows only the mutual transactions between the head office and the branch. The balance of Branch Account, therefore, represents the net assets of the branch.

Look at illustration 5 and study how profit or loss is ascertained and how Branch

Account is maintained under the final accounts system.

Illustration 5

A-one Ltd., Bhopal has a branch at Madras to which the goods are sent at cost plus 25%. The Madras branch keeps its own Sales Ledger and remits all cash received to the Head Office every day. All expenses are paid by the head office. The transactions for Madras Branch during the year ending December 31, 2018 were as follows:

	Rs.		Rs.
Stock (1-1-2018)	11,000	Return Inwards	500
Debtors (1-1-2018)	100	Cheques Sent to Branch	
Petty Cash	100	Rent	600
Cash Sales	2,650	Wages	200
Credit Sales	23,950	Salary and other Expenses	900
Goods Sent to Branch	20,000	Stock (31.12.2018)	13,000
Collection on Ledger A/c	21,000	Debtors (31.12.2018)	2,000
Goods Returned to H.O.	300	Petty Cash (31.12.2018) (Including miscellaneous income Rs. 25 not remitted)	125
Bad Debts	300		
Allowances to Customers	250		

Prepare the Memorandum Branch Trading and Profit & Loss Account and Madras Branch Account for the year ending December 31, 2018.

Solution:

Memorandum Branch Trading and Profit & Lass Account for the year ending 31.12.2018

Dr. **Cr.**

	Rs.			Rs.
To Opening Stock	8,800	By Sales		
(11,000 – 2,200) (1/5 loading)		Cash	2,650	
To Goods sent to Branch	16,000	Credit	23,950	
(20,000 – 4,000) (1/5 loading)			26,600	
To Wages	200	Less Returns	500	26100
To Gross Profit c/d	11,740	By Goods sent to HO. (300-60) 1/5 loading		240
		By Closing Stock (13,000 – 2,600) (1/5 loading)		10,400
	36,740			36,740
To Bad Debts	300	By Gross Profit b/d		11,740
To Allowances	250	By Misc. Income		25
To Rent	600			
To Salaries and other expenses	900			
To Profit transferred to General Profit & Loss A/c	9,715			
	11,765			11,765

Madras Branch Account

	Rs.		Rs.
To Balance b/d		By Bank A/c	
Stock	8,800	Cash Received from	
Debtors	100	Debtors	21,000
Petty Cash	100	Cash Sales	2,650
To Goods sent to Branch A/c	16,000	By Goods Sent to Branch (returns to H.O.)	240
To Bank A/c		By Balance c/d	
Rent	600	Stock	10,400
Wages	200	Debtors	2,000
Salaries and other expenses	900	Petty Cash	125
To Profit as per Branch Trading and P & L A/c	9,715		
	36,415		36,415

13.7 STOCK AND DEBTORS SYSTEM

Under Stock and Debtors System, the Head Office does not open a Branch Account in its books. It maintains a few control accounts for recording the various branch transactions. These accounts usually are : (1) Branch Stock Account, (ii) Branch Debtors Account, (iii) Branch Expenses Account, (iv) Branch Cash Account, (v) Goods Sent to Branch Account, and (vi) Branch Fixed Assets Account. At the end of the accounting year, it prepares the Branch Adjustment Account and the Branch Profit & Loss Account. This system is used only when goods are invoiced at selling price which the branch is not allowed to vary.

Let us now study the working of each account opened by the Head Office when such a system is followed.

Branch Stock Account: This is the most important account which helps the Head Office in controlling the branch stock. It shows all branch transactions relating to goods. The goods sent to branches and the sales returns are shown on its debit side, and the sales (both cash and credit) and the goods returned to head office on the credit side. **All these items are recorded at the invoice price.** Hence, if the figure of any of these items is given at cost, the same should be converted into invoice price before recording it in the Branch Stock Account. The balance of this account would show the unsold goods (stock) lying with the branch. If it is found that the actual stock with the branch is less than the balance shown by the Branch Stock Account, it means that there is a 'shortage' in the stock with the branch. Similarly, if the actual stock with the branch is more than the balance shown by the Branch Stock Account, it would reflect 'surplus'. Both situations warrant investigation. But, so far as their recording goes, the shortage will be shown on the credit side of the Branch Stock Account and if there is surplus, the same will be recorded on its debit side. Then, the balance of the Branch Stock Account will be the exact amount of actual stock with the branch. In other words, while preparing the Branch Stock Account, you will show the actual stock with branch as the balance in this account, and then if the totals of both sides do not tally, you will show the difference as shortage or surplus as the case may be.

Branch Debtors Account: This account shows all transactions relating to branch debtors. The credit sales are shown on its debit side, and cash received from debtors, sales returns, bad debts, discount allowed, etc. on the credit side. The balance of this account represents the closing debtors of the branch.

Branch Expenses Account: This account shows all expenses incurred by the branch. In addition, the items like bad debts, discount allowed, depreciation on branch fixed assets, etc. are also debited to this account. This account is closed by transfer to the Branch Adjustment Account.

Branch Cash Account: This account shows all cash transactions of the branch where the branch is not required to remit all collection of cash immediately to the Head Office, but use it for branch expenses and remit the balance to the Head Office from time to time. This account helps the Head Office to keep control over branch cash. Normally, the dependent branch is not allowed the freedom to retain cash collections. Hence, this account need not be maintained.

Branch Fixed Assets Account: The Head Office maintains separate account for each type of branch asset such as furniture, equipment, building, etc. These accounts are prepared in the usual manner. The depreciation on branch fixed assets is, however, debited to Branch Expenses Account and credited to the respective account.

Goods Sent to Branch Account: This account is prepared in the same manner as in case of branches to which the goods are sent at the invoice price.

Branch Adjustment Account: This account is like a Trading Account of the branch. It is prepared to ascertain the gross profit or gross loss made at the branch by recording the loading (difference between invoice price and cost price) on various items. The loading on branch closing stock and shortage is shown on its debit side while the loading on branch opening stock, goods sent to branch (less returns) and surplus on the credit side. The balance of this account reflects the gross profit or gross loss which is transferred to Branch Profit & Loss Account.

Branch Profit & Loss Account: This account is prepared to ascertain the net profit or net loss made at the branch. As stated earlier, the gross profit or gross loss ascertained by the Branch Adjustment Account is transferred to this account. It is debited with branch expenses as per the Branch Expenses Account and the loss on account of shortage being the cost of such shortage. In case the Branch Stock Account reveals some surplus, the amount equal to the cost of such surplus will be shown on the credit side of the Branch Profit & Loss Account. The balance of the Branch Profit & Loss Account represents the net profit or net loss made at the branch which is transferred to the General Profit & Loss account.

The following journal entries are passed in the Head Office books for opening the above accounts relating to the various branch transactions:

1) **When goods are sent to the branch (at invoice price)**

   Branch Stock Ale Dr.

   To Goods Sent to Branch A/c

2) **When goods are returned by the branch to the H.O. (at invoice price)**

   Goods Sent to Branch A/c Dr.

   To Branch Stock A/c

3) **When sales are made by the branch**

   i) **For Cash Sales**

   Cash A/c Dr.

   To Branch Stock A/c

   ii) **For Credit Sales**

   Branch Debtors A/c Dr.

   To Branch Stock A/c

4) **When cash is received from debtors**

   Cash A/c Dr.

   To Branch Debtors A/c

5) **For sales returns**
Branch Stock A/c Dr.
To Branch Debtors A/c

6) **For discount allowed, bad debts, etc.**
Branch Expenses A/c Dr.
To Branch Debtors A/c

7) **For shortage of stock**
Branch Adjustment A/c Dr.
(with amount of loading)

Branch P & L A/c Dr.
(with cost of shortage)
To Branch Stock A/c
For surplus at branch, the reverse entry will be passed.

8) **For Branch expenses paid in Cash**
Branch Expenses A/c Dr.
To Cash A/c

9) **For closing branch expenses account**
Branch P & L A/c Dr.
To Branch Expenses A/c

10) **For adjustment of loading on the opening stock**
Stock Reserve A/c Dr.
To Branch Adjustment A/c

11) **For adjustment of loading on the closing stock**
Branch Adjustment A/c Dr.
To Stock Reserve A/c

12) **For adjustment of loading on net goods sent to branch**
Goods Sent to Branch A/c Dr.
To Branch Adjustment A/c

13) **For transfer of gross profit**
Branch Adjustment A/c Dr.
To Branch P & L A/c

14) **For transfer of net profit to General Profit & Loss Account**
Branch Adjustment A/c Dr
To General P & L A/c

The entry will be reversed if there is net loss.

15) **For closing the Goods Sent to Branch Account**
Goods Sent to Branch A/c Dr.
To Trading A/c

Look at illustration 6 and see how the accounts for various branch transactions are prepared under Stock and Debtors System.

Illustration 6

Indiana Traders, Jaipur opened a branch at Jodhpur on 1-7-2017. The goods were sent by the Head Office to the branch invoiced at selling price of the branch which was 125% of the cost price of the head office.

The following are the particulars relating to the transactions of Jodhpur Branch

	Rs.		Rs.	
Goods sent to branch (at cost to head office)	2,80,000	Cash sent to branch for:		
		Wages	3,000	
Sales—Cash	1,24,000	Freight	11,000	
Sales—Credit	1,75,000	Other expenses including godown rent	6,000	20,000
Cash collected from debtors	1,56,000			
Discount allowed	4,000	Stock on June 30, 2018 (at invoice price)		55,500
Spoiled cloth in bales written off at invoice price	500			

Ascertain the profit or loss for the Jodhpur Branch for the year ended June 30, 2018 by preparing accounts under the Stock and Debtors System.

Solution

Branch Stock Account

Dr.	Rs.		Cr. Rs.
To Goods Sent to Branch A/c	3,50,000	By Cash A/c (cash sales)	1,24,000
To Branch Debtors A/c (sales returns being balancing figure)	5,000	By Branch Debtors A/c (credit sales)	1,75,000
		By Branch Adjustment A/c (spoilage-loading)	100
		By Branch P & L A/ (spoilage-cost)	400
		By Balance c/d	55,500
	3,55,000		3,55,000

Note: Total of the credit side of Branch Stock A/c exceeds the debit side by Rs. 5,000. It is assumed to be on account of returns by customers.

Goods Sent to Branch Account

Dr.	Rs.		Cr. Rs.
To Branch Adjustment A/c (loading)	70,000	By Branch Stock A/c	3,50,000
To Trading A/c	2,80,000		
	3,50,000		3,50,000

Branch Debtors Account

Dr.	Rs.		Cr. Rs.
To Branch Stock A/c	1,75,000	By Cash A/c	1,56,000
		By Branch Stock A/c (returns)	5,000
		By Branch Expenses A/c (discount allowed)	4,000
		By Balance c/d	10,000
	1,75,000		1,75,000

Branch Expenses Account

Dr.	Rs.		Cr. Rs.
To Cash A/c			
Wages	3,000	By Branch Profit & Loss A/c	24,000
Freight	11,000		
Other Expenses	6,000		
To Branch Debtors A/c (discount)	4,000		
	24,000		24,000

Branch Adjustment Account

Dr.	Rs.		Cr. Rs.
To Branch Stock A/c (loading on spoilage)	100	By Goods Sent to Branch A/c (loading)	70,000
To Stock Reserve A/c (loading on closing stock)	11,100		
To Branch Profit & Loss A/c	58,800		
	70,000		70,000

Branch Profit & Loss Account

Dr.	Rs.		Cr. Rs.
To Branch Expenses A/c	24,000	By Branch Adjustment A/c	58,800
To Branch Stock A/c (spoilage-cost)	400		
To Net Profit transferred to General P & L A/c	34,400		
	58,800		58,800

It should be noted that if there is any theft or spoilage of goods at the branch, or some goods are lost in transit, these are to be treated in accounts in the same way as the shortage of goods. If, however, some amount is received from the insurance company for such abnormal losses of stock, the same will be credited to the Branch Profit and Loss Account.

Check Your Progress B

1. How is the Branch Account prepared under the Debtors System different from the Branch Account prepared under the Final Accounts System.

   ....

   ....

   ....

2. Fill in the blanks :

   i) The closing balance of Branch Account under the Final Accounts System represents ……….at the branch.

   ii) Branch Expenses Account under the Stock and Debtors System is closed by transfer to ……….Account.

   iii) Under Stock and Debtors System, all figures in Branch Stock Account are recorded at ……….price.

   iv) Under Stock and Debtors System,…………….. Account is credited when the branch returns goods to the Head Office.

   v) Under the Stock and Debtors System, Bad Debts are credited to Branch Debtors Account and debited to …………..................…….. Account.

   vi) If the balance shown by Branch Stock Account is different from actual stock with the branch, the difference reflects……………………

13.8 LET US SUM UP

From accounting point of view, each branch is treated as a separate profit-centre.

Hence, accounting for branch transaction is designed in such a way that profit or loss made at each branch can be correctly worked out and proper control can be exercised over their financial activities. For this purpose, the branches are divided into three categories: (i) branches not keeping full system of accounting (dependent branches), (ii) branches keeping full system of accounting (independent branches), and (iii) foreign branches.

Where branches do not keep full system of accounting, the Head Office has to maintain proper record of branch transactions. There are three methods that can be followed for this purpose: (i) Debtors System, (ii) Final Accounts System, and (iii) Stock and Debtors System.

Debtors System is usually adopted for small branches which merely act as sales depots. Under this system, the head office simply opens a Branch Account for each branch in which it records all related transactions. The Branch Account is maintained like a Consignment Account which also helps in ascertaining the profit or loss made by the branch.

Under the Final Accounts System of maintaining branch accounts, the Head Office prepares a Memorandum Trading and Profit & Loss Account for each branch from the data 'provided by the branch and ascertains its profit or loss for the accounting period.

Then it also maintains a Branch Account for recording mutual transactions between the Head Office and the branch which finally reveals the amount due to, or due from, the branch. Its balance will be equal to the net assets with the branch.

Stock and Debtors System is followed where the goods are invoiced to the branch at selling price. Under this system, no Branch Account is opened. The Head Office maintains (i) Branch Stock Account, (ii) Branch Expenses Account, (iii) Goods Sent to Branch Account, and (iv) Branch Fixed Assets Account. At the end of the accounting period, it prepares Branch Adjustment Account and Branch Profit and Loss Account for ascertaining the branch gross profit/ gross loss and the net profit/net loss respectively. This system also enables the Head Office to exercise effective control on branch stock.

13.9 KEY WORDS

Branch Adjustment Account: An Account prepared under Stock and Debtors System for ascertaining the gross profit or gross loss made by a branch.

Debtors System: A system of accounting for transactions of a branch by opening Branch Account which also helps to ascertain branch profit or loss.

Dependent Branch: A small branch which does not keep full system of accounting.

Final Accounts System: A system of accounting for transactions of a branch under which branch profit or loss is ascertained by preparing Memorandum Branch Trading and Profit & Loss A/c.

General Profit & Loss Account: Profit and Loss Account of the Head Office which shows the profit or loss of the business unit as a whole.

Independent Branch: Branch keeping full system of accounting.

Loading: Difference between the cost price and the price at which goods are invoiced to the branch.

Stock and Debtors System: A System of accounting for transactions of a branch without opening a Branch Account. Under the system, branch profit or loss is ascertained through Branch Adjustment Account.

13.10 ANSWERS TO CHECK YOUR PROGRESS

A 2) i) debited ii) Trading iii) 125 iv) difference

v) Memorandum Branch Stock, invoice price

B 2) i) net assets ii) Branch Adjustment iii) invoice iv) Branch Stock v) Branch Expenses vi) Shortage or surplus

13.11 TERMINAL QUESTIONS/EXERCISES

Questions

1) What are the objectives of keeping, branch accounts?
2) Name the three systems of maintaining the accounts of a dependent branch, and describe how profit is ascertained under each system.
3) Explain how Branch Stock Account helps in keeping effective control over the branch stock.

Exercises

1) Kabir & Co. of Moradabad have their branch at Kanpur. The following are the transactions relating to the branch for the year ending December 31, 2018:

		Rs.
Opening Stock on January 1, 2018		20,000
Goods supplied to Branch		50,000
Cash sent to Branch for		
Rent	200	
Other Expenses	100	300
Cash received from Branch during the year		60,000
Closing Stock on December 31, 2018		15,000
Closing balance of Petty Cash on December 31, 2018		10

From the above information, pass the necessary journal entries and prepare Kanpur Branch Account and other necessary accounts in the books of the Head Office.

(**Answer:** Branch Net Profit Rs. 4,710)

2) A Meerut Company has a retail branch in Kota which is supplied with all goods from Meerut. The branch keeps its own Sales Ledger, receives cash against the ledger accounts and remits the whole of the cash received daily to the Head Office. All wages and branch expenses are drawn by cheque weekly from the Head Office upon the imprest system. From the under mentioned particulars supplied by the Branch Manager, show how the Branch Account would appear in the Head Office books as on December 31, 2018.

	Rs.		Rs.
Six months credit sales	2,387	Stock on December 31, 2018	1,121
Return inwards	20	Debtors July 1, 2018	1,227
Cash received on Ledger accounts	2,384	Goods received from Head Office	2,178
Cash Sales	1,214	Rent, Taxes etc. paid	375
Stock on July 1,2018	720	Sundry Expenses	396
Bad Debts	100		

(**Answer :** Net Profit Rs 933; Missing Figure; Closing Debtors Rs. 1,110)

3) Royal Store of Kanpur opened a selling branch at Madras on July 1, 2018. Goods are sent to branch from the head office at cost plus 25%. The branch is advised to deposit cash every day in the bank in head office account. From the following particulars, prepare Branch Account in the books of head office for the period ending December 31, 2018. Petty Cash at branch is maintained on imprest system.

		Rs.		Rs.
Cash sent to branch for meeting petty expenses		1,500	Cash sales by the branch	80,000
Furniture purchased for the branch		12,000	Credit sales during 6 months	30,000
Goods sent to branch at invoice price		1,60,000	Cash received from debtors Discount allowed to the debtors	22,000 400
Expenses paid by Head Office:			Goods returned by debtors (at invoice price)	800
Rent	2,200		Bad debts written off	100
Advertisement	800		Petty expenses paid by the branch	1,000
Salaries	4,600			
Insurance (up to June 30, 2019)	400		Stock at invoice price on December 31 (excluding stock received from debtors)	40,000

Provide depreciation on furniture at 10% p.a.

(**Answer:** Profit Rs. 3,940; Debtors at the end Rs. 6,700)

4) X Ltd. of Bombay has a branch in Delhi. The head office sends goods to the branch at cost plus 50%. From the following data, prepare the necessary accounts in the books of head office under Stock and Debtors System.

	Rs.		Rs.
Goods sent from Head Office (at invoice price)	50,000	Credit Sales	8,000
Returned to Head Office	1,000	Opening Stock	10,000
Cash Sales	35,500	Closing Stock	11,000

(**Answer:** Profit Rs. 11,500; Shortage of Goods Rs. 4,500)

5) Shyam Brothers of Delhi has a branch at Hyderabad. In order to maintain strict control over stocks, it invoices goods to the branch at selling price including profit of 25% on selling price. From the following particulars, prepare Branch Stock Account, Branch Debtors Account, Goods Sent to Branch Account, Branch Adjustment Account, and Branch Profit and Loss Account.

	Rs.
Stock January 1, 2018	30,000
Debtors on January 1, 2018	22,800
Goods invoiced to Branch at invoice price	1,34,000
Sales at the branch	
Cash	62,000
Credit	74,800
Cash received from Debtors	80,000
Bad Debts written off	500
Discount allowed to customers	600
Expenses at the branch	13,400
Stock on December 31, 2018	26,800

(**Answer:** Gross Profit Rs. 34,200; Net Profit Rs. 19,400)

Note : These questions will help you to understand the unit better. Try to write answers for them. But, do not submit your answers to the University for assessment. These are for your own practice only.

UNIT 14 BRANCH ACCOUNTS-II

Structure

14.0 OBJECTIVES

After studying this unit, you should be able to:

- describe the features of the accounting system of an independent branch;
- make adjustment entries in the books of both Head Office and branch for certain peculiar items relating to independent branches;
- pass necessary journal entries for the incorporation of branch balances in the books of the Head Office;
- make closing entries in the books of the branch; and
- prepare consolidated balance sheet of the business.

14.1 INTRODUCTION

In Unit 13, you learnt about the systems of accounting for a dependent branch. Dependent branch is usually a small branch which merely functions as a sales depot. It does not keep full system of accounting. The main accounting records for such branches are maintained at the Head Office level. But, when a branch functions as an independent unit and enjoys certain amount of operational autonomy, it keeps full system of accounts. Such branches are termed as independent branches and maintain complete set of books on double entry system. They prepare their own Trial Balance, Profit & Loss Account and Balance Sheet. At the end of the accounting year, their summarised results and the assets and liabilities are incorporated in the books of the Head Office. In this unit, you will learn how does the Head Office incorporate all branch balances in its books and what sort of records are maintained for mutual transactions between the branch and the Head Office.

14.2 ACCOUNTING SYSTEM OF AN INDEPENDENT BRANCH

You know an independent branch enjoys certain amount of operational autonomy. Besides receiving goods from the Head Office, it may also purchase goods from the outside parties. It maintains its own bank account and remits money from time to time to Head Office as per the instructions of the Head Office. It is treated as a separate accounting entity. The main features of the accounting system of independent branches are as follows:

1) The branch maintains complete set of books on double entry system.

2) The branch opens a Head Office Account in its books. It is a personal account wherein, all transactions between the branch and the Head Office are recorded at the branch level. This account is debited with cash sent to the Head Office and the goods returned or supplied to the Head Office, and is credited by goods received from the Head Office and the Head Office expenses charged to the branch for centralised services.

3) The Head Office also maintains a Branch Account in its books for all transactions, it makes with a particular branch. It is also a personal account which shows the same entries as the Head Office Account in branch books, but on the reverse sides.

4) At the end of the accounting period, the branch prepares its trial balance and the final accounts, and send their copies to the Head Office.

5) As soon as the Head Office receives the trial balance from a branch, it compares the balance in Head Office Account as shown in the branch Trial Balance with the balance in the Branch Account as it appears in the Head Office books. The difference, if any, is investigated and, after ascertaining the causes thereof, the necessary adjustment entries are passed.

6) After reconciling the Head Office Account balance with the Branch Account balance, the Head Office passes the necessary entries for incorporating various branch balances in its books.

14.3 SOME PECULIAR ITEMS

In respect of independent branches, there are certain items which require special accounting treatment. These items are:

i) Goods in transit

ii) Cash in transit

iii) Head Office expenses chargeable to branch

iv) Depreciation on branch fixed assets, the accounts of which are maintained at the head office level

v) Inter-branch transactions

Let us discuss these items one by one.

14.3.1 Goods in Transit

The Head Office and the branch send goods to each other quite frequently. When goods are sent by the Head Office to the branch, the Head Office debits the Branch Account in its books immediately. But the branch credits the Head Office Account only when it receives the goods. Similarly, when the branch sends or returns some goods to the Head Office, it (the branch) debits the Head Office Account in its books immediately, but the Head Office credits the Branch Account only when it receives the same. It is quite possible that goods sent in the later part of the accounting year may not have been received by the closing date of the accounting year by the Head Office or the branch, as the case may be. Such goods are called 'goods in transit' for which no entry will appear in the books at the receiving end at the time of the closing the accounts. Hence, the balance in the Head Office Account in branch books will not tally with the balance in the Branch Account in the Head Office books. This will require an adjustment entry which may be passed either in the Head Office book or in the branch books, but not in both sets of books.

If the Head Office decides to pass the adjustment entry, it will be as follows:

Goods in Transit A/c	Dr.
To Branch A/c	

If, however, the adjustment is made in branch books, the entry will be:

Goods in Transit A/c	Dr.
To Head Office A/c	

It should be noted that the adjustment entry for goods in transit shall be passed only in one set of books, either at the Head Office level or the branch level. **Usually, such entry is made in the books of the Head Office.**

14.3.2 Cash in Transit

Like goods, cash is also regularly remitted by the Head Office and the branch to each other. For this, the entries are made in both sets of books in the same manner, as they are made for the goods. In this case also, it is possible that some remittances are in transit at the time of closing the books for the accounting year. This would again lead to difference in Branch Account balance in the Head Office books and Head Office Account balance in branch books. Hence, an adjustment entry will have to be passed to reconcile the same. This may be done either by the Head Office or by the branch, but not by both.

In case the Head Office decides to pass the adjustment entry, it will be as follows:

Cash in Transit A/c	Dr.
To Branch A/c	

If, however, the adjustment is made in the branch books, the entry will he:

Cash in Transit A/c Dr.
To Head Office A/c

It should be noted that for cash in transit also, the entry shall be passed in one set of books, either at the Head Office level or at the branch level. This entry is also made usually at the Head Office level. The reason for passing such adjustment entries in Head Office books lies in the fact that all in-transit items are noticed by the Head Office at the time of receiving the branch Trial Balance and, at this stage, it is not considered desirable to alter the balances in the branch books.

Look at illustration 1 and see how are the amounts of goods in transit and cash in transit ascertained and the adjustment entries passed to reconcile the difference between the Branch Account balance and the Head Office Account balance.

Illustration 1

Following are the extracts from the Trial Balances of a Head Office and a branch. You are required to pass the necessary journal entries for reconciling the balances of the Head Office Account and the Branch Account.

Trial Balance

Particulars	**Head Office**		**Branch Office**	
	Dr.	**Cr.**	**Dr.**	**Cr**
	Rs.	Rs.	Rs.	Rs.
Current Accounts	1,00,000			90,000
Goods sent/received by Branch		1,50,000	1,45 ,000	

Solution

The current accounts represent the Branch Account in the Head Office books and the Head Office Account in the branch books. As per the above Trial Balance, there is a difference of Rs. 10,000 between the two current account balances. It is observed that there is a difference of Rs. 5,000 in the goods sent received by branch. This can be attributed to goods in transit. The remaining difference of Rs. 5,000 may be taken to be on account of the cash in transit. The required adjustment entry may be passed in the books of Head Office as follows:

Cash in Transit A/c	Dr.	5,000
Goods in Transit A/c	Dr.	5,000
To Branch A/c		10,000

(Being cash in transit and goods in transit adjusted)

If, however, this entry is passed in the books of the branch. it will be as follows:

Cash in Transit A/c	Dr.	5,000	
Goods in Transit A/c	Dr.	5,000	
To Head Office A/c			10,000

(Being cash in transit and goods in transit adjusted)

14.3.3 Head Office Expenses Chargeable to Branch

The Head Office may like to allocate a part of its expenses to branches for the centralised services at the Head Office level. As a matter of fact, quite a good amount of time of the Head Office staff may be spent in doing the work of the branches. Hence, it may decide to charge a part of its expenditure on salaries to the branches. The same thing may be true for certain other items of expenses. If the Head Office so decides to charge some expenses to the branch, the journal entry passed in the books of the Head Office is as follows:

Branch A/c Dr.
To Expenses (Salaries A/c)
(Being Head Office expenses chargeable to branch)

The branch will also pass a corresponding entry in its books as follows:

Head Office Expenses A/c Dr.
To Head Office
(Being Head Office expenses chargeable to branch)

Like all other expenses accounts, the Head Office Expenses Account will be closed by transferring its balance to the Profit & Loss Account at the end of the accounting year.

14.3.4 Depreciation on Branch Fixed Assets, Accounts Maintained by Head Office

Sometimes, the accounts for the fixed assets of independent branches are maintained at the Head Office level. In such a situation, all entries in respect of branch fixed assets are made in the Head Office books. For example, when a fixed asset is purchased for the branch, the Head Office debits the Branch Fixed Assets Account and credits the Cash Account. No entry for this transaction is passed by the branch unless the payment is made by the branch for this purchase. Even if the payment for the purchase of such fixed assets is made by the branch, it will not debit the Fixed Assets Account. In fact such payment is treated like a remittance to the Head Office, Therefore, is debited to the Head Office Account. But when it comes to depreciation on such fixed assets, the branch has to pass the necessary entry in its books because the assets were used by the branch and not by the Head Office. Normally an entry for the depreciation on fixed assets is passed by debiting the Depreciation Account and crediting the Fixed Asset Account. But in this situation, the branch cannot credit the Fixed Asset Account because the accounts for its fixed assets are maintained at the Head Office level. Hence, the entry passed for depreciation on such fixed assets is different from the normal entry for depreciation. It is as follows:

Depreciation A/c Dr.
To Head Office A/c
(Being depreciation on fixed assets)

Since the account for the branch fixed assets is maintained in head office books, the Head Office must reduce the balance in Branch Fixed Assets Account by the amount of depreciation thereon. But, it cannot debit the Depreciation Account because the loss relates to the branch. Hence, it makes the following journal entry for depreciation on branch fixed assets when their accounts are maintained by the Head Office:

Branch A/c Dr.
    To Branch Fixed Assets A/c
(Being depreciation on branch fixed assets)

It should be noted that the above entries are passed only for such branch fixed assets accounts of which are maintained by the Head Office. **Any branch fixed assets for which the branch itself maintains the accounts, the branch will pass the normal entry for depreciation.** The Head Office need not pass an entery in its books for the amount of depreciation on such fixed assets.

14.3.5 Inter-branch Transactions

When an organisation has more than one branch, it is possible that some transactions take place between one branch and the other. This usually happens under instructions from the Head Office. For example, a branch may be asked to transfer its surplus stock to some other branch which may need the same (it may be facing shortage). In such a situation, the usual practice for the sending branch is to regard it as a transaction of returning the goods to the Head Office. Similarly, the receiving branch shall regard it as a transaction of receiving the goods from the Head Office. Hence, entries are passed on the same basis in the books of the branches and the Head Office. These are as follows:

In the books of the Head Office

Receiving Branch A/c Dr.
    To Sending Branch A/c
(Being goods transferred from .... branch to .... branch)

In the books of the sending branch

Head Office A/c Dr.
    To Goods Sent to H.O. A/c
(Being goods sent to .... branch under instructions from H. O.)

In the books of the receiving branch

Goods from H.O. A/c Dr.
    To Head Office A/c
(Being goods received from .... branch under instruction from H.O.)

Look at illustration 2 and see how the above-mentioned peculiar items are recorded in the books of the Head Office and the branches.

Illustration 2

Give the journal entries that would be passed in the books of the Head Office to record the following transactions:

i) Goods amounting to Rs. 1,000 transferred from Madras branch to Bombay branch under instructions from the Head Office.

ii) Depreciation on branch fixed assets accounts maintained by the Head Office: (Bombay Rs. 4,000 and Madras Rs. 6,000).

iii) A remittance of Rs. 6,000 made by Bombay branch to Head Office on December 27, 2018 and received by Head Office on January 7, 2019.

iv) Goods worth Rs. 10,000 sent by the Head Office on December 25, 2018 and received by Madras branch latter on January 15, 2019.

v) A sum of Rs. 10,000 is to be charged to the Madras branch for administrative services rendered by the Head Office.

Solution

Head Office Books
Journal

		Rs.	Rs
i)	Bombay Branch A/c Dr. To Madras Branch A/c (Being goods transferred from Madras branch to Bombay branch)	1,000	1,000
ii)	Bombay Branch A/c Dr. To Branch Fixed Assets A/c (Being depreciation)	4,000	4,000
iii)	Madras Branch A/c Dr. To Branch Fixed Assets A/c (Being depreciation)	6,000	6,000
iv)	Goods in Transit A/c Dr To Bombay Branch A/c (Being Goods in transit adjusted)	6,000	6,000
v)	Goods in Transit A/c Dr To Madras Branch A/c (Being Goods in transit adjusted)	10,000	10,000
vi)	Madras Branch A/c Dr. To Gen. P & LA/c (Being Administrative expenses charged to Madras branch)	10,000	10,000

Check Your Progress A

1. What do you mean by Cash in Transit?

....

....

....

....

....

2. Why does Head Office charge a part of its expenses to branches?

....

....

....

3. Put tick (√) mark against the correct answer:

i) An independent branch

a) receives the goods from the Head Office.

b) purchases the goods from outside parties.

c) receives the goods from both (a) and (b) sources.

ii) The Head Office Account in the books of branch is debited with

a) cash sent to the Head Office and goods returned to the Head Office.

b) cash and goods received from Head Office, and Head Office expenses allocated to branch by Head Office.

c) none of the above.

iii) The adjustment entry for goods in transit is passed in the books of

a) either the branch or the Head Office.

b) branch as well as the Head Office.

c) none of them.

iv) For depreciation on fixed assets. whose accounts are maintained by the Head Office, the Head Office

a) debits Fixed Assets A/c and credits Branch A/c.

b) debits Branch A/c and credits its Fixed Assets A/c

c) none of the above.

v) In case of inter-branch transactions, each branch

a) opens separate accounts for other branches.

b) passes no entry.

c) may treat such transactions as the transactions with the Head Office.

vi) The Head Office Account maintained by the branch is of the nature of

a) Real Account.

b) Personal Account.

c) Nominal Account.

14.4 INCORPORATION OF BRANCH TRIAL BALANCE IN THE HEAD OFFICE BOOKS

Just because an independent branch keeps full system of accounting and prepares its own final accounts does not mean that its year-end results will not form part of the final accounts of the Head Office. In fact, as in case of dependent branches, the profit or loss made by an independent branch shall also be included in the General Profit and Loss Account which shows the profit or loss of the company as a whole. Similarly, its assets and liabilities shall also be shown as part of the assets and liabilities of the company. This is done by preparing the combined (consolidated) Balance Sheet of the Head Office and its branches. Thus, it becomes necessary for the Head Office to incorporate the branch balances in the Head Office books by means of suitable journal entries at the end of the accounting period.

The incorporation of branch balances involves the following two steps:

i) incorporation of branch profit or loss, and

ii) incorporation of branch assets and liabilities.

For incorporation of the branch profit or loss, the Head Office may either pass various entries to include all revenue items and prepare a proper Branch Trading and Profit & Loss Account or simply pass one entry for profit or loss made by the branch after working it out with the help of a Memorandum Branch Trading and Profit & Loss Account. The first method is called 'detailed incorporation' and the second method is called 'abridged incorporation' (or simply short cut method). Whatever the method for incorporating branch profit or loss, the entries for incorporating branch assets and liabilities remain the same.

14.4.1 Detailed Incorporation

As stated earlier, under this method, the Head Office prepares a proper Branch Trading and Profit & Loss Account and makes entries for all revenue items before incorporating the branch assets and liabilities in its books. The entries passed under this method are as follows:

1) **For items on the debit side of the Trading Account**
Branch Trading A/c Dr.
To Branch A/c
(This entry is passed for the total amount of items like opening stock, net purchases, wages, goods received from HO., carriage inwards, etc.)

2) **For items on the credit side of the Trading Account**
Branch A/c Dr.
To Branch Trading A/c
(This entry is passed for the total amount of items like net sales, closing stock, etc.)

3) **For branch gross profit**
Branch Trading A/c Dr
To Branch Profit & Loss A/c
(In case of gross loss, the above entry will be reserved)

4) **For items on the debit side of the Profit and Loss Account**
Branch Profit & Loss A/c Dr.
To Branch A/c
(This entry is passed for the total amount of items like salaries, rent, bad debts, repairs, depreciation, etc.).

5) **For items on the credit side of the Profit & Loss Account**
Branch A/c Dr
To Branch Profit & Loss A/c
(This entry is passed for total amount of items like interest received, discount received, commission received, etc.)

6) **For branch net profit**
Branch Profit & Loss A/c Dr.
To General Profit & Loss A/c
(If there is net loss, the above entry will be reversed)

7) **For branch assets**
Branch Assets A/c Dr.
To Branch A/c
(Each asset should be debited individually)

8) **For Branch liabilities**
Branch A/c Dr.
To Branch Liabilities A/c
(Each liability credited individually. This should not include H.O. A/c balance)

As a result of the last two entries (7 and 8), the Branch Account in the Head Office books will stand closed because the net assets (assets minus liabilities) of the branch are equal to the balance in the Branch Account after branch net profit or net loss has been incorporated in Head Office books. In order to open the Branch Account in the next year's books of the Head Office and show the amount due from the branch, the entries for branch assets and branch liabilities (7 and 8 above) shall be reversed at the beginning of the next year.

Look at illustration 3 and see how branch balances are incorporated in the Head Office books when detailed incorporation method is followed.

Illustration 3

On December 31, 2018, the Trial Balance of the Kanpur branch stood as follows:

	Dr.	Cr.
	Rs.	Rs.
Stock on January 1, 2018	12,000	
Furniture	4,800	
Debtors	11,200	
Goods received from H.O.	32,000	
Salaries, rent and expenses	4,400	
Cash in hand	3,600	
Head Office Account		22,000
Sales		45,600
Sundry creditors		400
	68,000	68,000

Stock on December 31, 2018 was Rs. 9,200.

Pass the necessary journal entries to incorporate Kanpur branch balances in the Head Office books, and prepare the Kanpur Branch Account in the books of the Head Office.

Solution

Head Office Books

JOURNAL

		Rs.	Rs
2018			
Dec.31	Kanpur Branch Trading A/c Dr To Kanpur Branch A/c (Being incorporation of opening stock and goods received from HO.)	44,000	44,000
" 31	Kanpur Branch A/c Dr. To Kanpur Branch Trading A/c (Being incorporation of branch sales and closing stock)	54,800	54,800
" 31	Kanpur Branch Trading A/c Dr. To Kanpur Branch P&L A/c (Being gross profit transferred to Branch P & L A/c)	10,800	10,800
" 31	Kanpur Branch P & LA/c Dr. To Kanpur Branch A/c (Being incorporation of branch expenses)	4,400	4,400
" 31	Kanpur Branch P & LA/c Dr. To General Profit & Loss A/c (Being incorporation of branch expenses)	6,400	6,400
" 31	Branch Closing Stock A/c Dr. Branch Furniture A/c Dr. Branch Debtors A/c Dr Branch Cash **A/c** Dr. To Kanpur Branch A/c (Being incorporation of branch assets)	9,200 4,800 11,200 3,600	 28,800
" 31	Kanpur Branch A/c Dr. To Branch Creditors A/c (Being incorporation of branch liabilities)	400	400

Kanpur Branch Account

Dr. **Cr.**

	Rs.		Rs.
To Balance b/d	22,000	By Branch Trading A/c	44,000
To Branch Trading A/c	54,800	By Branch P & L A/c	4.400

To Creditors	400	By Closing Stock	9,200
		By Furniture	4,800
		By Debtors	11,200
		By Cash	3,600
	77,200		77,200

14.4.2 Abridged Incorporation

Incorporation of branch balances in the Head Office books can also be effected with the help of a short cut method known as the 'abridged incorporation'. Under this method, we prepare a Memorandum Branch Trading and Profit & Loss Account and pass a journal entry only for the net profit or net loss. Thus, the six entries passed under the detailed incorporation method are replaced by just one entry which is as follows:

Branch Account Dr.
To General Profit & Loss A/c
Being branch net profit incorporated)

In case of net loss, the above entry shall be reversed.

Look at illustration 4 and see how branch balances are incorporated in the Head Office books with the help of the short cut method.

Illustration 4

From the particulars given in illustration 3, prepare Memorandum Branch Trading and Profit & Loss Account, pass the necessary journal entries to incorporate the Kanpur branch balances, and prepare Kanpur Branch Account in the books of the head office.

Solution :

Books of Head Office

Memorandum Kanpur Branch Trading and Profit & Loss Account for the year ended December 31, 2018

Dr.	Rs.		Rs. Cr.
To Opening Stock	12,000	By Sales	45,600
To Goods Received from H.O.	32,000	By Closing Stock	9,200
To Gross Profit c/d	10,800		
	54,800		54,800
To Salaries, Rent and Expenses	4,400	By Gross Profit b/d	10,800
To Net Profit	6,400		
	10,800		10,800

Solution

Journal

		Rs.	Rs.
2018 Dec. 31	Kanpur Branch A/c Dr. To General Profit & Loss A/c (Being branch net profit incorporated)	6,400	 6,400
" 31	Kanpur Branch Closing Stock A/c Dr. Kanpur Branch Furniture A/c Dr. Kanpur Branch Debtors A/c Dr. Kanpur Branch Cash A/c Dr. To Kanpur Branch A/c (Being branch assets incorporated)	9,200 4,800 11,200 3,600	 28,800
" 31	Kanpur Branch A/c Dr. To Kanpur Branch Creditors A/c (Being branch liabilities incorporated)	400	 400

Kanpur Branch Account

Dr. Cr.

	Rs.		Rs.
To Balance b/d	22,000	By Closing Stock	9,200
To General Profit & Loss A/c	6,400	By Furniture	4,800
		By Debtors	11,200
To Creditors	400	By Cash	3,600
	28,800		28,800

14.5 CLOSING ENTRIES IN BRANCH BOOKS

At the end of the accounting period, the branch books have also to be closed. For this purpose, the branch can pass the usual closing entries for transferring all revenue items to its Trading and Profit & Loss Account and ascertaining its net profit or net loss. The amount of net profit or net loss should be transferred to the Head Office Account by passing the following journal entry.

In case of net profit

Profit and Loss A/c Dr.
  To Head Office A/c

In case of net loss

Head Office A/c Dr.
  To Profit and Loss A/c

After the above entry for transferring net profit or net loss to the Head Office Account has been passed, the balance in the Head Office Account will be equal to the branch net assets (assets minus liabilities). The branch can then prepare its Balance Sheet by showing the Head Office Account balance on the liabilities side as this account would normally show a credit balance. If, the Head Office Account shows a debit balance, the same will appear on the assets side of the Balance Sheet.

The accounts pertaining to assets and liabilities can also be closed, if required, by transferring their balances to the Head Office Account. For this purpose, the following two journal entries will be passed in the branch books.

1) **For transfers of assets**
   Head Office A/c Dr.
   To Assets A/c
   The assets should be credited individually

2) **For transfer of liabilities**
   Liabilities A/c Dr.
   To Head Office A/c
   (The liabilities should be debited individually)

As a result of the above entries, the Head Office Account shall also be closed as it will not show any balance.

Look at illustration 5 and see how does a branch close its books.

Illustration 5

A Delhi trader has independent branch at Patna. Its Trial Balance for the year ending December 31, 2018 is given below. Pass journal entries to close the books of Patna branch and prepare its Head Office Account.

Trial Balance

Dr.			Cr.
	Rs.		Rs.
Purchases	25,600	Creditors	5,400
Stock on 1.1.18	16,400	Sales	69,900
Wages	13,100	Head Office	28,000
Factory Expenses	6,800	Discount	300
Salaries	8,000	Purchase Returns	600
Rent	3,400		
Sundry Expenses	4,000		
Goods Received from HO.	14,400		
Debtors	11,000		
Cash	1,500		
	1,04,200		1,04,200

Additional information

1) The accounts of the branch fixed assets were maintained in the Head Office which show machinery of Rs. 50,000 and furniture of Rs. 2,000

2) Depreciation is to be charged @ 10% on Machinery and 15% on Furniture.

3) Rs. 300 are due for salaries.

4) A remittance of Rs. 8,000 made by branch on December 29, 2018, was received by head office on January, 3, 2019

5. Clossing stock at branch was Rs. 28,700

Solution

Books of Patna Branch
Journal

2017		Rs.	Rs.
Dec.31	Depreciation A/c Dr.	5,300	
	To Head Office A/c		5,300
	(Being depreciation on fixed assets accounts maintained by Head Office)		
" 31	Cash in Transit A/c Dr.	8,000	
	To Head Office A/c		8,000
	(Being outstanding salaries)		
" 31	Salaries A/c Dr.	300	
	To Salaries Outstanding A/c		300
	(Being outstanding salaries)		
" 31	Profit & Loss A/c Dr.	2,200	
	To Head Office A/c		2,200
	(Being net profit transferred)		
" 31	Head Office A/c Dr.	49,200	
	To Debtors		
	To Cash A/c		11,000
	To Cash in Transit A/c		1,500
	To Closing Stock A/c		8,000
	(Being assets account balance transferred)		28,700
" 31	Creditors A/c Dr.	5,400	
	Salaries Outstanding A/c Dr.	300	
	To Head Office A/c		5,700
	(Being liabilities account balances transferred)		

Head Office Account

Dr. **Cr.**

	Rs.		Rs.
To Balance c/d	43,500	By Balance b/d	28,000
		By Depreciation A/c	5,300
		By Cash in Transit A/c	8,000
		By Profit & Loss A/c	2,200
	43,500		43,500
To Debtors	11,000	By Balance b/d	43,500
To Cash A/c	1,500	By Creditors	5,400
To Cash in Transit A/c	8,000	By Salaries outstanding A/c	300
To Closing Stock A/c	28,700	A/c	
	49,200		49,200

Working Notes

Trading and Profit & Loss Account

Dr.		Rs.	Cr.	Rs.
To Opening Stock A/c		16,400	By Sales	69,900
To Purchases	25,600		By Closing Stock	28,700
Less Return	600	25,000		
To Goods from H.O.		14,400		
To Wages		13,100		
To Factory Expense		6,800		
sTo Gross Profit c/d		22,900		
		98,600		98,600
To Salaries	8,000		By Gross Profit b/d	22,900
Add O/s	300	8,300	By Discount	300
To Rent		3,400		
To Depreciation		5,300		
To Sundry Expenses		4,000		
To Net Profit		2,200		
		23,200		23,200

Notes: 1) The closing entries for transfer of revenue items have been omitted.

2) The balance in Head Office Account after adjustment entries and transfer of net profit is Rs. 43,500. This is equal to the net assets at Patna as given below:

		Rs.	Rs.
Assets			
	Debtors	11,000	
	Cash	1,500	
	Cash in Transit	8,000	
	Closing Stock	28,700	
Liabilities:			49,200
	Creditors	5,400	
	Salaries O/s	300	5,700
Net Assets			43,500

3) After the assets and liabilities are transferred to Head Office Account, it stands closed.

Check Your Progress B

1. Why is the incorporation of branch balances necessary in the books of the Head Office?

....

....

2/ Name the two methods of incorporating branch balances in the books of the Head Office?

....

....

....

3. Fill in the blanks:

i) The short cut method of incorporating the branch balances is called ………….

ii) The branch net profit can be incorporated in the Head Office books by debiting the …………..Account and crediting the …………… Account.

iii) The net assets of the branch are equal to the …………… of the Branch Account after the entry of branch net profit or net loss has been passed in Head Office books.

iv) The balance in the Head Office Account in branch books represents the branch………………. after the net profit or not loss has been transferred to this account.

14.6 A COMPREHENSIVE ILLUSTRATION

As stated earlier, any organisation having branches has to present the final accounts of the organisation as a whole and not separately for the Head Office and for the branches. Hence, it prepares General Profit and Loss Account which includes the profit or loss made by the branches and draws a consolidated Balance Sheet to show the assets and liabilities of both the Head Office and the branch office. Illustration 6 below will help you to understand the preparation of a consolidated Balance Sheet.

Illustration 6

Following are the Trial Balances of the Head Office and its branch as on December 31, 2018.

Particulars	**Head Office**		**Branch Office**	
	Dr.	**Cr.**	**Dr.**	**Cr**
	Rs.	Rs.	Rs.	Rs.
Capital		1,50,000		
Fixed Assets	86,000		26,000	
Stock	34,700		20,700	
Debtors and Creditors	17,820	13,900	14,800	23,000
Cash	10,740		1,500	
Profit & Loss		14,720		13,100
Branch Office	29,360			
Head Office A/c				26,900
	1,78,620	1,78,620	63,000	63,000

Prepare the Balance Sheet of the business as on December 31, 2018 and pass the necessary journal entries in both sets of books to record the adjustments dealing with the following.

a) On December 28, the branch had sent a cheque for Rs. 1,600 to the Head Office but not yet received by them.

b) Goods valued at Rs. 560 had been forwarded by the Head Office to the branch and invoiced on December 30, but were not yet received by the branch.

c) It was agreed that the branch should be charged with Rs. 400 for administration services rendered by the Head Office during the year.

d) Rs. 1,250 for depreciation on branch assets, the accounts of which are maintained by the Head Office, is to be provided for.

e) The balance of profit shown by the branch is to be transferred to the Head Office books.

Solution

Head Office Journal

2018		Rs.	Rs.
1	Cash in Transit A/c Dr. To Branch A/c (Being cash sent by branch but not received by H.O. till December31)	1,600	1,600
2	Goods in Transit A/c Dr. To Branch A/c (Being goods invoiced on December 31 not yet received by the branch)	460	460
3	Branch A/c Dr. To Gen. Profit & Loss A/c (Being administrative expenses charged by H.O. to the Branch)	400	400
4	Branch A/c Dr. To Branch Fixed Assets A/c (Being depreciation on branch fixed assets accounts provided by H.O.)	1,250	1,250
5	Branch A/c Dr. To General P & L A/c (Being profit of branch transferred to General P & L A/c)	11,450	11,450

Branch Journal

2018		Rs.	Rs.
1	Profit & Loss A/c Dr To Head Office A/c (Being administrative expenses charged by H.O.)	400	400

2	Depreciation A/c Dr. To Head Office A/c (Being depreciation on Branch fixed assets accounts which are maintained by H.O.)	1,250	 1,250
3	Profit & Loss A/c Dr. To Head Office A/c (Being transfer of profit credited to Head Office A/c)	11,450	 11,450

Balance Sheet as on December 31, 2018

Liabilities			Rs.	Assets			Rs.
Capital			1,50,000	**Fixed Assets**			
Creditors				H.O.		86,000	
H.O.	13,900			Branch	26,000		
Branch	23,000		36,900	Less Dep.	1,250	24,750	1,10,750
Profit & Loss A/c				**Stock**			
H.O.	15,120			H.O.		34,700	
Branch	11,450		26,570	Branch		20,700	
				Goods in Transit		460	55,860
				Debtors			
				H.O.		17,820	
				Branch		14,800	32,620
				Cash			
				H.O.		10,740	
				Branch		1,500	
				Cash in Transit		1,600	
				Cash for Exp.		400	14,240
			2,13,470				2,13,470

Working Notes

1) The profits at branch and Head Office have been ascertained by preparing Profit and Loss A/c of the Head Office as well as that of branch.

Branch Profit and Loss Account

Dr. **Cr.**

	Rs.		Rs.
To Head Office Exp.	400	By Profit (as given)	13,100
To Depreciation	1,250		
To Profit taken to General P & L A/c	11,450		
	13,100		13,100

General (H.O.) Profit and Loss Account

Dr.			Cr.
	Rs.		Rs.
To Profit c/d	15,120	By Profit (as given)	14,720
		By Branch A/c	400
	15,120		15,120
To Net Profit (taken to Balance Sheet)	26,570	By Profit b/d	15,120
		By Branch A/c (profit made by branch)	11,450
	26,570		26,570

2) The Head Office A/c in the books of branch and Branch A/c in the books of Head Office will appear as follows:

Branch Books
Head Office Account

Dr.			Cr.
	Rs.		Rs.
To Balance c/d	40,000	By Balance b/d	29,900
		By H.O. Exp. A/c	400
		By Depreciation	1,250
		By P & L A/c	11,450
	40,000		40,000

Head Office Books
Branch Account

Dr.			Cr.
	Rs.		Rs.
To Balance b/d	29,360	By Goods in Transit	460
To Branch Assets A/c	1,250	By Cash in Transit	1,600
To General P & L A/c	11,450	By Balance c/d	40,000
	42,060		42,060

3) The balance in the Branch Account in Head Office books and the balance in Head Office Account in branch books show the same amount. i.e.. Rs. 40,000. But, the Branch Account balance is a debit balance while the Head Office Account balance is a credit balance. Having merged branch accounts with the Head Office accounts, these two balance cancel each other and so they do not appear in the consolidated Balance Sheet.

14.7 LET US SUM UP

Independent Branches are those branches which keep full system of accounting and enjoy certain amount of autonomy in functioning. They maintain complete records on double entry system and prepare their own trial balances. The Head Office simply maintains a personal account for each branch which shows all transactions that take place between the branch and the Head Office. Similarly, each branch maintains a Head Office Account to show the corresponding entries.

There are certain transactions which require special treatment both in Head Office and branch books. These are: (i) goods in transit, (ii) cash on transit, (iii) Head Office expenses chargeable to branch, (iv) depreciation on branch fixed assets the accounts of which are maintained at the Head Office level, and (v) inter-branch transactions.

At the end of the accounting year, the branch sends its Trial Balance to the Head Office. This enables the Head Office to incorporate all branch balances in its books so as to include them in the final accounts of the organisation. The incorporation entries can be passed for all items given in branch Trial Balance (called detailed incorporation), or simply for branch profit/loss (based on Memorandum Branch Profit and Loss Account) and for branch assets and liabilities (called abridged incorporation or short cut method). After the incorporation entries have been passed, the Branch Account stands closed. At the beginning of the next year, the opening entries are passed for branch assets and liabilities which restores the balance in the Branch Account. The branch closes its books by transferring its profit or loss to Head Office Account which then shows a credit balance equal to the net assets with the branch.

14.8 KEY WORDS

Abridged Incorporation: A short cut method of incorporating the branch balances in Head Office books.

Cash-in-transit: Cash remitted by branch to Head Office, but not received by Head Office by the end of the accounting year,or vice versa.

Consolidated Balance Sheet: Combined Balance Sheet showing both Head Office and branch assets and liabilities.

Goods-in-transit: Goods sent by Head Office to branch but not received by branch by the end of the accounting year, or vice versa.

Inter-branch transactions: The transactions between two or more branches under the same Head Office.

14.9 ANSWERS TO CHECK YOUR PROGRESS

A 3. i) c

ii) a

iii) a

iv) b

v) c

vi) b

B 3. i) Abridged Incorporation

ii) Branch Account, General Profit & Loss Account

iii) balance

iv) net assets

14.10 TERMINAL QUESTIONS/EXERCISES

Questions

1) How are branch balances incorporated in Head Office books at the end of the accounting year?

2) Write short notes including accounting treatment on the following:

   a) Cash in Transit

   b) Goods in Transit

   c) Head Office Expenses Chargeable to Branch

   d) Inter-branch Transactions

3) How do you deal with purchase and depreciation of branch fixed assets whose accounts are maintained at the Head Office level?

Exercises

1) Show what entries would be passed by the Head Office to record the following transactions in their books.

   a) Goods amounting to Rs. 1,000 transferred from Varanasi branch to Allahabad branch under intimation from H.O.

   b) Depreciation amounting to Rs. 2,000 on branch fixed assets when such assets' accounts are opened in the Head Office books.

   c) A remittance of Rs. 3,000 made by the Calcutta branch to Head Office on December 25, 2018 and received by Head Office on January 4, 2019.

   d) Goods of Rs. 10,000 sent by the Head Office on December 27, 2018 and received by Calcutta branch on January 10, 2019.

   e) The Allahabad branch collected Rs. 4,000 from Allahabad customers of Head Office.

   f) The Varanasi branch paid Rs. 25,000 for machinery purchased by the Head Office at Varanasi.

2) Show the journal entries that will be passed by Surat branch to record the following transactions in its books.

   a) Goods amounting to Rs. 6,000 transferred from Surat branch to Lucknow branch under instructions from Calcutta Head Office assuming that Head Office keeps a control on inter-branch transactions.

   b) Depreciation on Lucknow Branch Machinery Rs. 4,000 and Surat Branch Machinery Rs. 3,000, when the Branch Machinery Account is maintained in Head Office books.

   c) A remittance of Rs.10,000 made by Surat branch to Head Office on December 28, 2018 but received by the Head Office on January 4, 2019.

d) Goods worth Rs. 15,000 sent by Head Office to Surat branch on December 26, 2018 but received by the latter on January 2, 2019.

3) On December 31, 2018, the Trial Balance of Varanasi branch stood as follows:

Particulars	Debit Rs.	Credit Rs.
Stock on January 1, 2018	12,000	
Furniture	4,800	
Debtors	11,200	
Goods Received from Delhi HO.	32,000	
Salaries, Rent and Expenses	4,400	
Cash in Hand	3,600	
Delhi Office Account		22,000
Sales		45,600
Sundry Creditors		400
Total Rs.	68,000	68,000

Stock on December 31, 2018 was Rs. 9,200. Prepare (1) Trading and Profit & Loss Account, Balance Sheet and Head Office Account in Varanasi branch books (2) Prepare journal entries necessary to incorporate the Varanasi Branch Trial Balance and show the Varanasi Branch Account in the Head Office books.

Answer: Branch Profit Rs. 6,400; Balance Sheet Total Rs. 28,800; Head Office A/c Balance Rs. 28,400 and Total of Varanasi Branch A/c Rs, 77,200)

4) The Kanpur branch of Wahi Bros. sent the following Trial Balance to Head Office, as on December 31, 2018:

	Rs.		Rs.
Sundry Debtors	12,000	Sundry Creditor	8,600
Cash in hand	6,250	Goods returned to H.O.	2,250
Furniture	1,900	Sales	1,12,500
Stock on 1-1-88	2,250	Head Office A/c	10,250
Goods from H.O.	34,000		
Purchases	66,450		
Wages & Salaries	5,500		
Trade Expenses	5,250		
	1,33,600		1,33,600

The stock on December 31, 2018 was Rs. 5,200. Pass the necessary journal entries to incorporate the above figures and show Branch A/c in Head Office books, and Trading and Profit & Loss A/c and Balance Sheet in the branch books.

(**Answer:** Branch profit Rs. 6,500; Balance Sheet Total Rs. 25,350; Total of Branch A/c Rs. 1,38,800.)

5) Following is the Trial Balance of Kanpur Branch of Varanasi Head Office. Prepare Trading and Profit & Loss A/c and Balance Sheet in the books of branch. Also show Head Office A/c in the books of branch:

	Rs.		Rs.
Furniture & Fixtures	1,500	Cash in Bank	3,000
Purchases	20,000	Carriage etc.	150
Goods from H.O.	40,000	Bad Debts	100
Sales	80,000	Allowances to Customers	200
Sundry Debtor	10,000	Bills Receivable	4,000
Sundry Creditors	12,000	Stock on 1-1-2018	10,000
Head Office A/c Salaries	6,400	Returns Inwards	1,000
General Exp.	600	Returns to H.O.	400
Rent & Taxes	600		

Closing Stock on December 31, 2018 Rs. 9,000

(**Answer:** Branch Net Profit Rs. 10,350; Balance Sheet Total Rs. 27,500; H.O. A/c Balance including net profit Rs. 15,500.)

6) From the following balances, prepare the Branch Current Account in the books of head office and Head Office Current A/c in the books of branch.

Particulars	Head Office		Branch	
	Dr. Rs.	Cr. Rs.	Dr. Rs.	Cr. Rs.
Branch Current A/c	5,000	-	-	-
Goods sent to Branch	-	7,800	-	-
Goods received from H,O.	-	-	7,000	-
Head Office Current A/c	-	-	-	1,400

(**Answer:** Goods in Transit Rs. 800: Cash in Transit Rs. 2,800.)

7) A limited company with its Head Office in Delhi has a branch at Kota which obtains goods from the Head Office as well as from outside suppliers. The branch keeps a separate set of books on June 30, 2019. The trial balances of the Head Office and its branch were as follows:

Particulars	Head Office		Branch	
	Dr. Rs.	Cr. Rs.	Dr. Rs.	Cr. Rs.
Share Capital	–	30,000	–	–
P & L Account balance on 1-7-18	–	4,000	–	–
Fixed Assets	16,000	–	8,000	–
Opening Stock	14,000	–	1,900	–
Debtors and Creditors	17,000	10,000	1,500	2,050
Cash	3,000	–	1,000	–
Purchases and Sales	1,20,000	1,40,000	6,750	20,500
Sundry Expenses	15,000	–	2,250	–
Goods from HO. to Branch	–	12,000	11,500	–
Current Accounts on 30-6-19	11,000	–	–	10,350
	1,96,000	1,96,000	32,900	32,900

The difference between the balances of Head Office and the Branch Current Accounts is due to goods and cash being in transit at the close of the year. Fixed assets are to be depreciated at 10 per cent. Stocks on June 30, 2019 were: Head Office Rs. 10,000 and Branch Rs. 2,100.

Prepare consolidated Balance Sheet of the company. Also show journal entries for the adjustments and the incorporation of Branch Trial Balance.

(**Answer:** Balance Sheet Total Rs. 56,850.)

Hints: Goods in Transit Rs. 500; Cash in Transit Rs. 150; Branch Net Loss Rs. 600; H.O. Net Profit (excluding branch net loss) Rs. 11,400.

14.11 SOME USEFUL BOOKS

Maheshwari. S.N., 1998: ***Introduction to Accounting*** Vikas Publishing House, New Delhi. (Chapters 4 & 5, Section II).

Gupta R L. and M. Radbaswamy, 1998.***Advanced Accounting*** Sultan Chand & Sons, New Delhi (Chapters 19 & 20).

Shukla.M.C..Grewal T.S. & S.C. Gupta, 1998 ***Advanced Accounts*** S. Chand & Co. Ltd., New Delhi, Chapter 11.

MongaJ.R..Ahuja G.C. & Ashok Sehgal, 1998 :***Advanced Accounting*** National Publishing House Sew Delhi.

Note : These questions will help you to understand the unit better. Try to write answers for them. But, do not submit your answers to the University for assessment. These are for your own practice only.