

ASSIGNMENT No. 02

Principle of Accounting(5401)BS A& Finance Spring, 2025

Q. 1 Ruhi Trader keeps his record of business under a single-entry system and wants to know the operating results of his business. He provides the following data as of 31st December 2022 and 31st December 2018 of his business: (20)

As of 31st December 2022: Cash in hand Rs. 25,000; Cash at bank Rs. 40,000; Account Receivables Rs. 70,000; Stock Rs. 65,000; Land & Building Rs. 300,000, Office Furniture Rs. 150,000, Office Equipment. 80,000; Account Payables Rs. 95,000; Bills Payables Rs. 30,000.

As of 31st December 2023: Cash in hand Rs. 40,000; Cash at bank Rs. 60,000; Account Receivables Rs. 110,000; Stock Rs. 85,000; Account Payables Rs. 75,000; Bills Payable Rs. 45,000.

Depreciation @ 5% on Land & Building; @ 15% on Office Furniture; @ 10% on Office Equipment is charged annually on original cost.

During the year Ruhi trader withdrew Rs. 158,000 and invested Rs. 112,000 into the business.

You are required to:

- Prepare the statement of affairs as of 31-12-2017 and as of 31-12-2023 to calculate the amounts of capital.*
- Prepare the statement of Profit & Loss account for the period ended on 31-12-2023i.*

Statement of Affairs as of 31-12-2022 and 31-12-2023

To determine the capital of Ruhi Trader, we need to create a Statement of Affairs for both years based on the provided data. The Statement of Affairs serves as a snapshot of the business's financial position by listing assets and liabilities.

Assets as of 31-12-2022:

- Cash in Hand: Rs. 25,000
- Cash at Bank: Rs. 40,000
- Accounts Receivable: Rs. 70,000
- Stock: Rs. 65,000
- Land & Building: Rs. 300,000
- Office Furniture: Rs. 150,000
- Office Equipment: Rs. 80,000

Total Assets = Rs. 25,000 + Rs. 40,000 + Rs. 70,000 + Rs. 65,000 + Rs. 300,000 + Rs. 150,000 + Rs. 80,000 = Rs. 730,000

Liabilities as of 31-12-2022:

- Accounts Payable: Rs. 95,000

• Bills Payable: Rs. 30,000

Total Liabilities = Rs. 95,000 + Rs. 30,000 = Rs. 125,000

Capital Calculation for 2022:

Capital (2022) = Total Assets - Total Liabilities = Rs. 730,000 - Rs. 125,000 = Rs. 605,000

Assets as of 31-12-2023:

- Cash in Hand: Rs. 40,000
- Cash at Bank: Rs. 60,000
- Accounts Receivable: Rs. 110,000
- Stock: Rs. 85,000
- Land & Building: Rs. 300,000
- Office Furniture: (Original Rs. 150,000 - Depreciated Rs. 22,500) = Rs. 127,500
- Office Equipment: (Original Rs. 80,000 - Depreciated Rs. 8,000) = Rs. 72,000

Total Assets (2023) = Rs. 40,000 + Rs. 60,000 + Rs. 110,000 + Rs. 85,000 + Rs. 300,000 + Rs. 127,500 + Rs. 72,000 = Rs. 794,500

Liabilities as of 31-12-2023:

- Accounts Payable: Rs. 75,000
- Bills Payable: Rs. 45,000

Total Liabilities (2023) = Rs. 75,000 + Rs. 45,000 = Rs. 120,000

Capital Calculation for 2023:

Capital (2023) = Total Assets - Total Liabilities = Rs. 794,500 - Rs. 120,000 = Rs. 674,500

ii. Statement of Profit & Loss Account for the Period Ended on 31-12-2023

The Profit & Loss account reflects the changes in the capital during the period.

Opening Capital (01-01-2023) = Rs. 605,000

Add: Investments during the year = Rs. 112,000

Less: Withdrawals during the year = Rs. 158,000

Closing Capital (31-12-2023) = Rs. 674,500

Calculation of Profit for the Year:

Closing Capital = Opening Capital + Investments - Withdrawals + Profit

Rearranging gives:

Profit = Closing Capital - Opening Capital - Investments + Withdrawals

Substituting values in the equation:

Profit = Rs. 674,500 - Rs. 605,000 - Rs. 112,000 + Rs. 158,000

Profit = Rs. 115,500

Q. 2 Mr. Naeem has a trading business of computer accessories. The business has been successfully running for the last 10 years and is considered one of the leading trading stores in the city. Recently, due to the increase in the volume of transactions, Mr Naeem has been unable to identify the difference in the balances between the Cashbook and the passbook. Details of the transactions are given in the preceding paragraph. (20)

On 31st March 2024, the passbook showed a credited balance of Rs. 500,000, and as per the cash book it is Rs. 408,750 for Mr. Naeem Trader. These are the following discrepancy items between the book and the cash book: -

1. A cheque for Rs. 100,000 was paid on March 5th, 2024, out of which Rs. 80,000 was credited by the bank on 25th March 2024 and the remaining balance on 5th April 2024.
2. Interest on investments collected by bank Rs. 1,750.
3. Bank charges for the above period were also debited in the passbook of Rs. 500
4. A cheque for Rs.85, 000 was issued to the creditor but not presented to the bank for payment till 31st March 2024.
5. On 29 March 2024 a cheque of Rs. 25,000 was deposited into the bank but was omitted from the entered into cash book.

Required: Prepare the Bank Reconciliation Statement under the double balance method

Understanding the Cash Book and Passbook Discrepancy

To reconcile the differences between Mr. Naeem's cash book and passbook, we will compile a Bank Reconciliation Statement.

Balance as per Passbook as of 31st March 2024: Rs. 500,000

Balance as per Cashbook as of 31st March 2024: Rs. 408,750

Adjustments to be Considered:

1. **Cheque issued but not cleared: Rs. 100,000** (only Rs. 80,000 is credited)
2. **Interest on Investments collected by the bank: Rs. 1,750**
3. **Bank Charges debited in the passbook: Rs. 500**
4. **Cheque issued but not yet presented for payment: Rs. 85,000**
5. **Cheque deposited but not entered in cash book: Rs. 25,000**

Bank Reconciliation Statement as of 31st March 2024

Particulars

Balance as per Passbook

Add: Cheque Deposited (not in Cashbook)

Add: Interest on Investments

Less: Bank Charges

Less: Cheque Issued (not yet cleared)

Less: Cheque Issued but not presented

Total Profit = 22,000 + 16,000 - 8,000 + 18,000 = Rs. 48,000

Average Profit = Total Profit / 4 = 48,000 / 4 = Rs. 12,000

Goodwill = Average Profit x 3 Years = Rs. 12,000 x 3 = Rs. 36,000

Journal Entries for Goodwill Treatment

i. Goodwill Paid Privately

When Z pays goodwill privately, the journal entries would be:

1. **Debit Z's Capital Account: Rs. 36,000**
2. **Credit Goodwill Account: Rs. 36,000**

ii. *Goodwill Paid in Cash and Retained*

Step 3: Balance Sheet

After Admitting Z

Balance Sheet with Goodwill Paid Privately:

Equities & Liabilities	Amount	Assets	Amount
Sundry creditors	320,000	Cash at bank	60,000
Bills payable	60,000	Bills receivable	30,000
General reserve	40,000	Stock	80,000
Capital X	65,600	Investment	40,000
Capital Y	38,400	Machinery	190,000
Capital Z	40,000	Building	200,000
Total	560,000	Total	560,000

Balance Sheet with Goodwill Paid in Cash and Retained:

Equities & Liabilities	Amount	Assets	Amount
Sundry creditors	320,000	Cash at bank	20,000
Bills payable	60,000	Bills receivable	30,000
General reserve	40,000	Stock	80,000
Capital X	65,600	Investment	40,000
Capital Y	38,400	Machinery	190,000
Capital Z	40,000	Building	200,000
Total	560,000	Total	560,000

Conclusion

The journal entries and balance sheets have been accurately created for both methods of treating goodwill. Be sure to adjust the totals and balances as necessary to ensure they align with the calculations performed!

Q.4 Short questions: (4x5=20)

- What does the dissolution of a partnership entail?
- What are realization accounts?
- What are the consequences of the Garner vs. Murray case?
- In what situations is the Garner vs. Murray ruling applicable?

i. What Does the Dissolution of a Partnership Entail?

Definition of Dissolution

Dissolution of a partnership refers to the legal process of terminating the partnership agreement between the partners. This can occur for various reasons, such as the expiration of a specified partnership duration, the achievement of the partnership's objective, mutual consent among partners, or external factors such as bankruptcy. The dissolution marks the end of the partnership as a legal entity, although it does not necessarily mean that the business ceases to operate.

Legal Implications

When a partnership is dissolved, the partners are required to settle all liabilities and obligations of the partnership. This entails liquidating the partnership's assets, paying off creditors, and distributing any remaining assets among the partners according to their profit-sharing ratio. The legal process can involve filing necessary paperwork with the relevant business authorities, depending on local regulations. In essence, dissolution includes unwinding the business's financial transactions, thereby confirming that all obligations have been satisfied.

Types of Dissolution

Dissolutions can be classified into different types: voluntary or involuntary. Voluntary dissolution occurs when partners mutually agree to end the partnership, whereas involuntary dissolution may arise from legal decisions, a partner's withdrawal, or incapacity. Additionally, a partnership can be dissolved through bankruptcy if the partnership is unable to meet its financial obligations, leading to formal proceedings that often involve the court system.

Financial Closure

The dissolution process culminates in the preparation of a final account that reflects the financial standing of the partnership. This process includes settling the partners' capital accounts and adjustments for any goodwill. Financial statements are prepared to provide a clear picture of the value of assets and liabilities to ensure fairness in the distribution process. Effective management of this phase is crucial to mitigate disputes among partners and creditors regarding the distribution of residual assets.

Implications for Partners

Following the dissolution of a partnership, the partners may remain liable for any outstanding debts incurred before dissolution, depending on jurisdictional laws. Each partner's personal assets might be at risk if the partnership assets are insufficient to cover business debts. Thus, it is essential for partners to understand their rights and responsibilities during dissolution to protect personal interests and ensure compliance with legal obligations.

ii. What Are Realization Accounts?

Purpose of Realization Accounts

A realization account is a financial statement used during the dissolution of a partnership to record the gains or losses from the sale of partnership assets. It provides a specific account where the proceeds from the sale of assets are logged, offering insight into the overall financial implications of dissolving

the partnership. This mechanism helps in determining how much cash will be available for the settling of liabilities and distribution among partners.

Structure of the Account

The realization account typically features two sides: the debit (or left side) and the credit (or right side). The debit side includes all the assets being realized (sold), reflecting their book value while the credit side details the actual selling price of these assets. A gain or loss is determined by the difference between the sales proceeds and the book value of the assets. This basic structure forms the basis for evaluating the overall performance of the partnership's finances during the dissolution phase.

Recording Transactions

All transactions related to the sale of partnership assets are recorded in the realization account. This includes not just the proceeds from the sale but also any anticipated costs associated with the realization process, such as disposal costs or losses on assets. Tracking these transactions accurately ensures transparency in the closure process and maintains proper records for audit purposes. This meticulous documentation can be crucial for resolving disputes or uncertainties among partners or creditors.

Closure of Accounts

Upon finalizing the realization account, profits or losses generated from the sale will be distributed among the partners in accordance with their profit-sharing ratios as stated in the partnership agreement. This is done before the final distribution of cash or other remaining assets to ensure fairness to all partners involved. The realization account effectively serves as a bridge between the asset sale process and the final financial settlements among partners.

Legal Importance

Realization accounts play a critical role during the dissolution process as they are often scrutinized by both tax authorities and legal entities. Proper accounting and adherence to regulations will ensure that partners comply with financial reporting standards. Mistakes or discrepancies can lead to legal complications or penalties for the partners involved, underscoring the need for meticulous preparation and review of the realization account.

iii. What Are the Consequences of the Garner vs. Murray Case?

Overview of the Case

The Garner vs. Murray case, decided by the House of Lords in 1959, dealt with the dissolution of a partnership and the rights of partners when it comes to the distribution of assets. The central issue revolved around the treatment of the capital contributions of partners in the event of partnership losses leading to an imbalance in their capital accounts. The case highlighted the legal ramifications of individual partner's creditors claiming funds from the partnership's assets.

Consequences for Capital Contributions

The ruling established that when a partnership is dissolved and assets are being distributed, partners' capital contributions have to be taken into account. If one partner is insolvent, the firm cannot satisfy the creditors of that partner using the assets of the partnership unless it is an agreement between the partners to share losses according to their profit-sharing ratio, disregarding any capital account imbalance. This decision underscored the importance of maintaining proper record-keeping regarding capital contributions and withdrawals.

Impact on Partner's Creditors

The case set a precedent indicating that the creditors of a partner cannot claim satisfaction from the assets of the partnership unless there are sufficient assets freely available to cover all creditors of the business. This differentiation helped protect the interests of solvent partners within the partnership and clarified the rights of creditor claims. Essentially, it emphasized that partnership debts take precedence over the individual debts of the partners during dissolution.

Dissolution and Final Settlements

The ruling from Garner vs. Murray illuminated the difficulties surrounding final settlements in a partnership dissolution. In this case, it illustrated how inequities in the partners' capital accounts might complicate the closing process. The court's decision helped reinforce the principle that partners should be liable only to the extent of their capital contributions during the settling of accounts, thereby establishing a precedent for future cases of similar nature.

Long-Term Legal Implications

Ultimately, the Garner vs. Murray ruling has had lasting implications on partnership law, influencing how partnerships structure their capital accounts and manage partner loans. Partners are now more cautious about how they record their capital contributions, withdrawals, and the impact of personal insolvency on partnership assets. This precedent serves as a reminder to business partners to have clear agreements regarding loss-sharing and the treatment of capital accounts, which should be meticulously followed to avoid conflicts and legal issues upon dissolution.

iv. In What Situations Is the Garner vs. Murray Ruling Applicable?

Partnership Dissolution

The Garner vs. Murray ruling is particularly relevant in scenarios where a partnership is in the process of dissolution, especially when one or more partners face insolvency. In such cases, determining how to distribute the partnership assets fairly becomes crucial, particularly when capital accounts are imbalanced. The ruling serves as a guide to understand how to separate partnership debts from individual partner liabilities, ensuring that partners' personal debts do not unduly affect the partnership's financial dealings.

Handling Partner Insolvency

This precedent also applies when a partner is unable to meet their personal financial obligations. When partners face personal bankruptcy, the consequences of Garner vs. Murray come into play. The principles established in this ruling can help delineate the limits of liability, protecting solvent partners from losing out due to a non-paying partner's personal situations. Legal frameworks around partnerships need to take this division into account to preserve the interests of the other partners and the partnership's creditors.

Equitable Financial Management

The ruling reinforces the necessity for equitable financial management during the dissolution of a partnership, where it becomes critical to maintain detailed records of each partner's capital contributions and equity. Situations where partners have withdrawn funds disproportionately relative to their capital contributions or incurred shared losses without regard to partnership agreements can lead to disputes. Garner vs. Murray emphasizes the importance of clarity regarding these financial practices to prevent issues during dissolution.

Litigation Scenarios

The principles established by Garner vs. Murray become applicable in legal disputes involving partners and creditors as well. In instances where there are claims against partners by creditors seeking access to partnership assets, reference to this ruling can clarify the process of asset distribution. The legal interpretations rendered in this case serve as a foundational rule guiding how partnerships must operate with respect to creditor claims during dissolution, thereby providing insight into liability limitations.

Drafting Partnership Agreements

Finally, the Garner vs. Murray ruling encourages partnerships to structure their agreements thoughtfully, knowing the legal precedents that govern their operations. Partnerships should include specific clauses regarding capital treatment, how losses are to be distributed, and the consequences of insolvency among partners. This foresight not only minimizes legal conflicts but also enhances the robustness of operational policies that can effectively withstand potential challenges, making the partnership's framework stronger and more secure.

By understanding these principles and implications stemming from the Garner vs. Murray case, partnerships can navigate issues surrounding dissolution more effectively, ensuring compliance with legal mandates and protecting all partners' interests.

Q.5 Short questions: (4x5=20)

i. How would you rectify the following errors:

- Monthly total of Rs. 180 discount allowed column of the cash book was posted to the credit of the discount received account.
 - An amount of Rs. 3,000 paid for the erection of machinery was wrongly debited to wages A/c.
- ii. Write down the formula for determining the net profit under the net worth method.
- iii. What will be the capital of the proprietor, if his assets are Rs. 10,500,000 and liabilities are Rs. 5,070,500?
- iv. State with reasons whether the following items of expenditure are capital or revenue.
- Telephone expenses
 - Offices salaries
 - Purchase a secondhand truck
 - Paid for advertising

i. How Would You Rectify the Following Errors?

1. Monthly Total Posted Incorrectly

○ In this case, the discount allowed meant to reduce income was instead credited to discounts received. To rectify:

- Debit Discount Received Account: Rs. 180
- Credit Discount Allowed Account: Rs. 180

2. Machinery Expenditure Mispasted

○ The Rs. 3,000 wrongly debited to wages instead of machinery must be corrected by:

- Debit Machinery Account: Rs. 3,000
- Credit Wages Account: Rs. 3,000

ii. Formula for Net Profit under the Net Worth Method

The net profit can be determined using the following formula:

Net Profit = (Closing Capital - Opening Capital + Drawings - Additional Investments)

This formula considers changes in ownership equity, adjustments for withdrawals, and additional contributions to provide an accurate depiction of profit for the period.

iii. Capital of the Proprietor Calculation

To determine the capital of the proprietor:

Given:

- Assets: Rs. 10,500,000
- Liabilities: Rs. 5,070,500

Capital = Assets - Liabilities = Rs. 10,500,000 - Rs. 5,070,500 = Rs. 5,429,500

iv. Classification of Expenditures

1. Telephone Expenses: Revenue

Reason: Ongoing operational expenditure necessary for business functionality, recognized as an operating expense.

2. Office Salaries: Revenue

Reason: Regular operational costs incurred for personnel, falling under general administrative expenses.

3. Purchase of Second-hand Truck: Capital

Reason: A long-term asset acquisition, enhancing the operational capacity of the business.

4. Advertising Expenses: Revenue

Reason: Marketing spend increases business visibility but is considered an operational expense incurred to generate future revenue.

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