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ALLAMA IQBAL OPEN UNIVERSITY, ISLAMABAD

Course: Advanced Accounting (444) • Level: B. Com/AD

Semester: Autumn 2026

Assignment No. 1 (Units 1–5)

SOLVED ASSIGNMENT GUIDE

(For Study & Reference)

Note: This guide is prepared for study and reference purposes. Students are advised to read the relevant units of the course book, understand the concepts, and then write the assignment in their own words. Total marks of the assignment are 100; each question carries the marks shown with it.

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Question 1: Joint Venture -- Memorandum Method (Books of Arshad) (20 Marks)

Q. 1: Arshad and Subhan established a joint venture relationship for dealing with some special products. They agreed to share profit or loss in the ratio of 2/3 and 1/3 for joint venture activities. The following transactions were conducted during May 2025. 06 May — Arshad purchased merchandise of Rs. 50,000 and paid expenses of Rs. 4,000. 08 May — Subhan supplied goods of Rs. 40,000 and paid expenses of Rs. 3,000. 15 May — Subhan sold all these goods at Rs. 120,000 and collected cash. 20 May — Subhan is also entitled for 3% commission on the sale of goods. 30 May — Subhan settled accounts with Arshad. Required: Prepare necessary accounts in the books of Arshad, assuming that the memorandum method of recording joint venture transactions was in vogue.

Introduction

A joint venture is a temporary partnership formed by two or more persons, called co-venturers, for carrying out a specific business operation such as the purchase and sale of a particular lot of goods, the construction of a building, or dealing in some special products. Unlike an ordinary

partnership, a joint venture is not a continuing business; it comes to an end as soon as the particular venture for which it was formed is completed and the accounts between the co-venturers are settled. There is usually no separate firm name, capital is contributed as and when required, and the profit or loss of the venture is shared in an agreed ratio. In the present question Arshad and Subhan form such a venture for dealing in some special products, agreeing to share profit or loss in the ratio of 2/3 and 1/3 respectively, and the transactions of May 2025 are to be recorded in the books of Arshad under the memorandum method.

The Memorandum Method Explained

There are different methods of recording joint venture transactions. Where a separate set of books is maintained for the venture, a Joint Venture Account, a Joint Bank Account and the personal accounts of the co-venturers are opened. However, when the venture is small or of a short duration, each co-venturer records the transactions only in his own books. Under this system two approaches are possible. In the first, each venturer records all the transactions of the venture, whether performed by himself or by the other venturer. In the second, known as the memorandum method, each venturer records in his own books only those transactions which are performed by himself, and opens a personal account of the other co-venturer, for example a 'Joint Venture with Subhan Account' in the books of Arshad. The transactions performed by the other venturer are not journalised at all; they are merely noted in a Memorandum Joint Venture Account, which is prepared outside the double entry system only to calculate the total profit or loss of the venture and each venturer's share in it.

The memorandum method therefore has three main features. First, only the venturer's own payments, purchases and receipts pass through his ledger. Secondly, a memorandum account,

which resembles a trading and profit and loss account of the venture as a whole, is prepared to ascertain the venture profit. Thirdly, when the venture is closed, each venturer's own share of the profit is brought into his books through the other venturer's personal account, and the balance of that personal account shows the exact amount payable to or receivable from the other venturer, so that the final settlement can be made in cash. This method is simple and economical, and it is well suited to small ventures, although it does not provide a complete double-entry record of the whole venture in any one set of books.

Working Notes

Before preparing the accounts, the main figures are worked out as follows. Subhan's commission is 3 per cent of the sale proceeds of Rs. 120,000, which amounts to Rs. 3,600. The total cost of the venture is made up of Arshad's purchases of Rs. 50,000 and expenses of Rs. 4,000, Subhan's goods of Rs. 40,000 and expenses of Rs. 3,000, and Subhan's commission of Rs. 3,600, giving a total cost of Rs. 100,600. Against this cost the goods were sold for Rs. 120,000, so the venture earned a profit of Rs. 19,400. This profit is divided in the agreed ratio of 2/3 and 1/3: Arshad's share is Rs. 12,933 (exactly Rs. 12,933.33) and Subhan's share is Rs. 6,467 (exactly Rs. 6,466.67); the small difference is due to rounding to the nearest rupee. Finally, Subhan, who holds the whole sale proceeds of Rs. 120,000, is entitled to recover his own outlay of Rs. 43,000 (goods Rs. 40,000 plus expenses Rs. 3,000), his commission of Rs. 3,600 and his profit share of Rs. 6,467, that is Rs. 53,067 in all. He therefore pays the balance of Rs. 120,000 minus Rs. 53,067, that is Rs. 66,933, to Arshad in final settlement. This amount also equals Arshad's own outlay of Rs. 54,000 plus his profit share of Rs. 12,933, which confirms the calculation.

Table 1: Memorandum Joint Venture Account (for the month of May 2025)

Particulars	Rs.	Particulars	Rs.
To Arshad — goods purchased	50,000	By Subhan — sales (15 May)	120,000
To Arshad — expenses paid	4,000		
To Subhan — goods supplied	40,000		
To Subhan — expenses paid	3,000		
To Subhan — commission @ 3% on sales	3,600		
To profit transferred:			
Arshad (2/3)	12,933		
Subhan (1/3)	6,467		
Total	**120,000**	**Total**	**120,000**

Accounts in the Books of Arshad

In Arshad's own books, only his own transactions are recorded. On 6 May 2025 he purchased merchandise of Rs. 50,000 for the venture and paid expenses of Rs. 4,000. The journal entry is: Joint Venture with Subhan Account debited with Rs. 54,000, Purchases Account credited with Rs. 50,000 and Cash Account credited with Rs. 4,000. The goods supplied by Subhan, the expenses paid by him, the sale made by him and his commission are transactions of Subhan; under the memorandum method Arshad passes no journal entry for them, but merely records them in the Memorandum Joint Venture Account shown above. When the memorandum account discloses a profit of Rs. 19,400, Arshad brings his own share of Rs. 12,933 into his books by debiting the Joint Venture with Subhan Account and crediting his Profit and Loss Account. On 30 May 2025 Subhan settles the account by paying Rs. 66,933 in cash, which closes the personal account completely.

Table 2: Joint Venture with Subhan Account (in the books of Arshad)

Particulars	Rs.	Particulars	Rs.
To Purchases A/c (goods	50,000	By Cash A/c (amount	66,933

bought for the venture, 6 May)		received in final settlement, 30 May)	
To Cash A/c (expenses paid, 6 May)	4,000		
To Profit & Loss A/c (Arshad's 2/3 share of venture profit)	12,933		
Total	**66,933**	**Total**	**66,933**

The personal account above shows clearly how the settlement figure is built up. Arshad is a creditor of the venture for the Rs. 54,000 he spent and for his profit share of Rs. 12,933, a total claim of Rs. 66,933. Because Subhan collected the entire sale proceeds, Subhan pays this whole amount to Arshad, and after the payment neither venturer owes anything to the other. The corresponding account in Subhan's own books, a Joint Venture with Arshad Account, would show the mirror image: it would be debited with the sale proceeds of Rs. 120,000 collected by Subhan and credited with his outlay of Rs. 43,000, his commission of Rs. 3,600, his profit share of Rs. 6,467 and the cash of Rs. 66,933 paid to Arshad. Students should note the treatment of commission carefully: the commission allowed to a co-venturer for selling the goods is a charge against the venture, exactly like any other expense, and it is therefore debited in the memorandum account before the divisible profit is calculated, and the venturer who earns it receives it in addition to his share of profit.

Conclusion

To conclude, under the memorandum method Arshad records only his own outlay of Rs. 54,000 in his ledger, prepares a memorandum account to find the venture profit of Rs. 19,400, takes his 2/3 share of Rs. 12,933 to his profit and loss account, and receives Rs. 66,933 from Subhan in final settlement on 30 May 2025, which closes the Joint Venture with Subhan Account. The method is straightforward, avoids duplication of entries in two sets of books, and yet produces

a correct division of profit and an exact settlement figure, which is why it is widely used for small and short-lived joint ventures.

Question 2: Consignment Accounts — Zeeshan Company and Saeed Sons (20 Marks)

Q. 2: Zeeshan Company, Karachi, purchased 20 sets of branded Laptop and consigned them to Saeed Sons, Lahore at the Cost of Rs. 40,000 each. Zeeshan Company, Karachi, incurred airfreight of Rs. 10,000 and insurance of Rs. 6,000 on dispatch. Upon receipt, Saeed Sons spent Rs. 3,000 as local Carriage expenses and Rs. 1,000 as handling expenses. Saeed Sons also paid good rent of Rs. 10,000 and salaries of Rs. 15,000 to marketing staff. Saeed Sons sold 15 sets of Laptops at Rs. 50,000 each as specified by the Consignor. The consignee is entitled to 5 % commission on the sale price of goods. Saeed Sons remitted the due amount to Zeeshan Company. Required: A) Record the above transactions in the books of the consignor and draw necessary ledger accounts. B) Present an Account Sale received by the consignor from the consignee. C) Compute the cost attributable to the unsold stock of 05 sets of Laptop computers. D) Indicate the profit or loss from this consignment sale business.

Introduction

Consignment is an arrangement under which the owner of goods, called the consignor, sends goods to another person, called the consignee, who sells them on behalf of and at the risk of the consignor in return for a commission. The consignee is not the owner of the goods; he is merely an agent, and the goods remain the property of the consignor until they are sold to outside customers. Consignment must not be confused with a sale: sending goods to a consignee is not a sale, the consignee does not become a debtor for the value of goods

received, and unsold goods still belong to the consignor and appear in his balance sheet as stock. In this question Zeeshan Company of Karachi consigns 20 branded laptop sets, costing Rs. 40,000 each, to Saeed Sons of Lahore, who sell 15 sets and earn a commission of 5 per cent on sales.

Working Notes

The cost of the goods sent is 20 sets multiplied by Rs. 40,000, that is Rs. 800,000. The consignor's expenses on dispatch, airfreight Rs. 10,000 and insurance Rs. 6,000, total Rs. 16,000. The consignee's expenses fall into two classes. Carriage of Rs. 3,000 and handling charges of Rs. 1,000 are non-recurring expenses, incurred to bring the goods to a saleable place and condition, so they form part of the cost of the goods. Godown rent of Rs. 10,000 and marketing staff salaries of Rs. 15,000 are recurring expenses, incurred after the goods reached the consignee's godown, so they are charged to the Consignment Account but never added to the value of closing stock. Sales amount to 15 sets multiplied by Rs. 50,000, that is Rs. 750,000, and the consignee's commission at 5 per cent is Rs. 37,500. For part (C), the cost of the 5 unsold sets is their purchase cost of Rs. 200,000 plus a proportionate share of the non-recurring expenses: the consignor's Rs. 16,000 multiplied by 5/20 gives Rs. 4,000, and the consignee's direct expenses of Rs. 4,000 multiplied by 5/20 give Rs. 1,000. The unsold stock is therefore valued at Rs. 205,000, or Rs. 41,000 per set.

Table 1: Consignment Account (in the books of Zeeshan Company, Karachi)

Particulars	Rs.	Particulars	Rs.
To Goods Sent on Consignment A/c (20 sets @ Rs. 40,000)	800,000	By Saeed Sons A/c — sales (15 sets @ Rs. 50,000)	750,000
To Cash A/c — airfreight 10,000 + insurance	16,000	By Consignment Stock A/c (5 unsold sets, as	205,000

6,000		computed)	
To Saeed Sons A/c — expenses (3,000 + 1,000 + 10,000 + 15,000)	29,000		
To Saeed Sons A/c — commission @ 5% on Rs. 750,000	37,500		
To Profit & Loss A/c — profit on consignment transferred	72,500		
Total	**955,000**	**Total**	**955,000**

Ledger Accounts in the Books of the Consignor

The transactions are first recorded through journal entries in the books of Zeeshan Company: (1) Consignment Account debited Rs. 800,000 to Goods Sent on Consignment Account, for goods consigned at cost; (2) Consignment Account debited Rs. 16,000 to Cash Account, for freight and insurance paid; (3) on receipt of the account sales, Saeed Sons debited Rs. 750,000 to Consignment Account, for the sale proceeds; (4) Consignment Account debited Rs. 29,000 to Saeed Sons, for the expenses reimbursed to the consignee; (5) Consignment Account debited Rs. 37,500 to Saeed Sons, for commission payable; (6) Consignment Stock Account debited Rs. 205,000 to Consignment Account, for the unsold stock taken over at cost; (7) Consignment Account debited Rs. 72,500 to Profit and Loss Account, transferring the profit; (8) Cash or Bank Account debited Rs. 683,500 to Saeed Sons, for the net remittance received; and (9) Goods Sent on Consignment Account debited Rs. 800,000 to Purchases or Trading Account, closing that account. The two principal ledger accounts, apart from the Consignment Account given above, are as follows.

Table 2: Saeed Sons (Consignee) Account

Particulars	Rs.	Particulars	Rs.
To Consignment A/c (sale proceeds of 15	750,000	By Consignment A/c (expenses paid by	29,000

sets)		consignee)	
		By Consignment A/c (commission @ 5%)	37,500
		By Cash/Bank A/c (net amount remitted)	683,500
Total	**750,000**	**Total**	**750,000**

Table 3: Goods Sent on Consignment Account

Particulars	Rs.	Particulars	Rs.
To Purchases/Trading A/c (transfer at the end of the period)	800,000	By Consignment A/c (20 sets @ Rs. 40,000)	800,000
Total	**800,000**	**Total**	**800,000**

Part (B): Account Sales

An account sales is the statement which the consignee sends to the consignor showing the goods sold, the gross proceeds, the expenses incurred by the consignee and his commission, and the net amount payable to the consignor. It is on the basis of this document that the consignor records sales, expenses and commission in his own books. The account sales received by Zeeshan Company from Saeed Sons would appear as follows.

Table 4: Account Sales — rendered by Saeed Sons, Lahore, to Zeeshan Company, Karachi

Particulars	Rs.	Rs.
Sale proceeds: 15 sets of branded laptops @ Rs. 50,000 each		750,000
Less: expenses paid by the consignee:		
Local carriage	3,000	
Handling charges	1,000	
Godown rent	10,000	
Salaries of marketing staff	15,000	29,000
Less: commission @ 5% on sale proceeds		37,500
Net amount due and remitted to Zeeshan Company		**683,500**

Parts (C) and (D): Unsold Stock and Result of the Consignment

For part (C), as computed in the working notes, the cost attributable to the 5 unsold laptop sets is Rs. 205,000, made up of the basic cost of Rs. 200,000, plus Rs. 4,000 as the proportionate share of the consignor's freight and insurance, plus Rs. 1,000 as the proportionate share of the consignee's carriage and handling charges. Recurring expenses such as godown rent and salaries are deliberately excluded, because they are period costs of selling and storage and do not increase the value of the stock itself; this follows the standard rule that only direct, non-recurring expenses incurred up to the point where goods reach the consignee's godown are capitalised into stock. For part (D), the Consignment Account shows a profit of Rs. 72,500. This result can be verified independently: the cost of the 15 sets sold is Rs. 600,000 plus proportionate direct expenses of Rs. 15,000 (Rs. 12,000 of freight and insurance and Rs. 3,000 of carriage and handling), that is Rs. 615,000, so the gross margin on sales of Rs. 750,000 is Rs. 135,000; deducting recurring expenses of Rs. 25,000 and commission of Rs. 37,500 leaves exactly Rs. 72,500 as the net profit, which is transferred to the consignor's profit and loss account.

Distinguishing Consignment from Sale

One further distinction deserves emphasis, because it explains every entry made above. In a sale, ownership passes to the buyer, the buyer becomes a debtor for the price whether or not he can resell the goods, and the risk of loss passes with ownership. In a consignment, none of this happens: Zeeshan Company remained the owner of all 20 laptop sets throughout, Saeed Sons never became liable for their cost of Rs. 800,000, and if the unsold sets had been destroyed by an accidental fire without negligence on the consignee's part, the loss would have

fallen on Zeeshan Company, not on Saeed Sons. That is why the goods sent are recorded in a special Goods Sent on Consignment Account rather than in the Sales Account, why no personal account of the consignee is debited when the goods are dispatched, and why the unsold stock of Rs. 205,000 appears in the consignor's own balance sheet at the end of the period. Treating a consignment as if it were a sale would overstate the consignor's sales and receivables and understate his stock, and is one of the most common errors in this topic.

Conclusion

To conclude, the consignment produced sales of Rs. 750,000 and a net profit of Rs. 72,500 for Zeeshan Company; Saeed Sons earned commission of Rs. 37,500, recovered expenses of Rs. 29,000 and remitted the balance of Rs. 683,500; and the 5 unsold laptop sets remain the consignor's property, carried in his books at a cost of Rs. 205,000. The key learning points are the distinction between consignment and sale, the separation of recurring and non-recurring expenses for stock valuation, and the role of the account sales as the source document for the consignor's entries.

Question 3: Branch Accounts — Islamabad Branch (Debtors System) (20 Marks)

Q. 3: Beauty Garment Industry, Karachi, established a branch in Islamabad to boost sales. Beauty Garment Industry, Karachi (home office) and Islamabad branch carried out the following transaction. a) The home office shipped garment products to the branch costing RS 800,000 at the billing price of Rs 1,200,000. b) The branch also purchased some garments from other wholesalers at the cost of Rs 500,000 on a credit basis. c) The branch sold the products at a billing price of Rs 1,000,000 at a sale price of Rs 1,400,000 to customers for cash. d) The branch

also sold the garments purchased from other vendors at a cost of Rs 400,000 for Rs 600,000 in cash. e) The branch paid rent of Rs. 40,000, utility expenses of Rs. 20,000 and the salesman's salary and commission of Rs. 50,000 for the month. f) The home office apportioned the advertising expenses of Rs 30,000 to the branch. g) The branch paid the amount owed to the credit vendors for the garments purchased. h) The branch remitted funds of Rs 1,200,000 to the home office. (The question lists the transactions of the month; the Branch Account is accordingly prepared in the books of the home office under the Debtors System, with working notes for closing stock and branch cash.)

Introduction

A branch is an extension of a business opened at another place to increase sales, while remaining under the control of the head office. Where the branch is a dependent branch, it keeps no complete double-entry books of its own; instead the head office records all branch transactions in a Branch Account in its own books. In this question Beauty Garment Industry of Karachi (the home office) supplies garment products to its Islamabad branch at a billing (invoice) price higher than cost, and the branch also buys some garments independently from outside wholesalers. Because the goods are invoiced to the branch above cost, the Branch Account is prepared at invoice price under the Debtors System, and the profit element, called loading, contained in the goods sent and in the closing stock has to be adjusted so that the branch profit is stated correctly and the closing stock is not overvalued in the head office balance sheet.

Working Notes

Working Note 1 — Loading. Goods costing Rs. 800,000 are invoiced at Rs. 1,200,000, so the total loading is Rs. 400,000, which is one-third (33 1/3 per cent) of the invoice price, or 50 per cent on cost. This ratio is used for all loading calculations. Working Note 2 — Closing stock of home office goods. The branch received goods at an invoice price of Rs. 1,200,000 and sold goods whose invoice price was Rs. 1,000,000; no returns or losses are mentioned, so the closing stock of home office goods at invoice price is Rs. 200,000, and the loading contained in it, which must be held back as stock reserve, is one-third of Rs. 200,000, that is Rs. 66,667. The cost of the home office goods sold is therefore Rs. 1,000,000 less loading of Rs. 333,333, that is Rs. 666,667. Working Note 3 — Stock of the branch's own purchases. The branch bought garments for Rs. 500,000 and sold garments costing Rs. 400,000, leaving a closing stock of its own purchases of Rs. 100,000 at cost. Working Note 4 — Branch cash. The branch received cash sales of Rs. 1,400,000 on home office goods and Rs. 600,000 on its own goods, a total of Rs. 2,000,000. Out of this cash it paid expenses of Rs. 110,000 (rent Rs. 40,000, utilities Rs. 20,000, and salary and commission Rs. 50,000), paid its credit vendors Rs. 500,000, and remitted Rs. 1,200,000 to the home office. The balance of cash remaining with the branch is therefore Rs. 2,000,000 minus Rs. 1,810,000, that is Rs. 190,000.

Table 1: Islamabad Branch Account (in the books of the Home Office — Debtors System, at invoice price)

Particulars	Rs.	Particulars	Rs.
To Goods Sent to Branch A/c (at billing price)	1,200,000	By Bank A/c (cash remitted to home office)	1,200,000
To Branch Creditors A/c (garments purchased by branch on credit)	500,000	By Branch Creditors A/c (amount paid to credit vendors)	500,000
To Head Office A/c (advertising expenses apportioned to the	30,000	By Goods Sent to Branch A/c (loading on goods sent: Rs. 1,200,000 − Rs.	400,000

branch)		800,000)	
To Stock Reserve A/c (loading on closing stock of home office goods)	66,667	By Balance c/d — closing assets at branch:	
To Profit & Loss A/c (net profit of the branch transferred)	793,333	Stock: home office goods at invoice price 200,000 + own purchases at cost 100,000	300,000
		Cash in hand at branch	190,000
Total	**2,590,000**	**Total**	**2,590,000**

Explanation of the Treatment

Each item in the Branch Account follows the logic of the Debtors System. The branch is debited with everything of value it receives or is charged with: the goods sent at invoice price, the goods it bought on credit (which create a liability of the business recorded through the branch), and the advertising cost of Rs. 30,000 which the head office apportioned to it. The branch is credited with everything it gives back or still holds on behalf of the head office: the remittance of Rs. 1,200,000, the payment to its own creditors, the closing stock of Rs. 300,000 and the closing cash of Rs. 190,000. The expenses of Rs. 110,000 paid by the branch out of its own cash collections are not debited again in the Branch Account, because they are already reflected in the smaller cash balance of Rs. 190,000; debiting them separately as well would count them twice. Two adjustments remove the unrealised profit from the account: the loading of Rs. 400,000 on goods sent is credited back, and a stock reserve of Rs. 66,667 is debited for the loading still locked up in the unsold stock, so that in the head office balance sheet the branch stock appears at its cost of Rs. 233,333 (Rs. 300,000 less the reserve). The balancing figure is the branch's net profit of Rs. 793,333.

The result can be verified through a memorandum Branch Trading and Profit and Loss Account. Total sales were Rs. 2,000,000. The cost of goods sold was Rs. 666,667 for home office goods and Rs. 400,000 for the branch's own purchases, a total of Rs. 1,066,667, giving a gross profit of Rs. 933,333. It is interesting that the gross profit on home office goods alone is Rs. 733,333, because the branch sold them for Rs. 1,400,000 although their invoice price was only Rs. 1,000,000: selling above the billing price added a further Rs. 400,000 of profit over and above the normal loading margin. From the gross profit, the branch expenses of Rs. 110,000 and the apportioned advertising of Rs. 30,000 are deducted, leaving a net profit of Rs. 793,333, exactly the figure disclosed by the Branch Account. This agreement between the two approaches confirms the accuracy of the account.

Table 2: Memorandum Branch Trading and Profit & Loss Account (verification)

Particulars	Rs.	Particulars	Rs.
To cost of goods sold: home office goods 666,667 + own purchases 400,000	1,066,667	By Sales: home office goods 1,400,000 + own goods 600,000	2,000,000
To Gross Profit c/d	933,333		
Total	**2,000,000**	**Total**	**2,000,000**
To branch expenses (rent 40,000 + utilities 20,000 + salary & commission 50,000)	110,000	By Gross Profit b/d	933,333
To advertising apportioned by home office	30,000		
To Net Profit (transferred to Head Office P&L A/c)	793,333		
Total	**933,333**	**Total**	**933,333**

Why Goods Are Invoiced to the Branch Above Cost

A word should be added on why the home office bills goods to the branch at Rs. 1,200,000 when they cost only Rs. 800,000. Invoicing at a fixed price above cost, known as the invoice or billing price, serves two control purposes. First, the branch manager need not know the true cost or the profit margin of the head office, so confidential margin information stays in Karachi. Secondly, control becomes arithmetical: at any moment the branch ought to hold stock and cash exactly equal to the invoice value of goods received less the invoice value of goods sold and the amounts remitted or paid out, so any shortage revealed by physical stock-taking points immediately to pilferage, careless handling or unrecorded sales. The price the branch must charge is also fixed centrally, although in this month's trading the branch in fact sold the home office goods for more than the billing price, which is why its gross profit is larger than the loading alone would suggest. The stock reserve adjustment then protects the head office balance sheet from counting profit on goods that have not yet been sold to outsiders.

Conclusion

To conclude, the Islamabad branch earned a net profit of Rs. 793,333 for the month. The branch remitted Rs. 1,200,000 to Karachi, and at the month end it held stock of Rs. 300,000 (at invoice price and cost combined, against which a stock reserve of Rs. 66,667 is maintained) and cash of Rs. 190,000. The exercise shows the essential features of the Debtors System: accounts are kept at invoice price so that the head office can control the branch, while the loading adjustments ensure that neither branch profit nor closing stock is overstated by the profit element added at the time of invoicing.

Question 4: Departmental Accounts — The Health Pharmacy (20 Marks)

Q. 4: The Health Pharmacy deals in three types of medicines, cosmetics and baby clothing, which have been segregated into respective departments. The following balances of trading merchandise were taken from the accounting record for the month of May, 2024: Sales — Medicines Rs. 600,000, Cosmetics 400,000, Baby Clothing 300,000; Opening Stock — 150,000, 100,000, 50,000; Purchases — 300,000, 150,000, 150,000; Closing Stock — 50,000, 30,000, 20,000. The other available information of the business was as under for the month: Staff Salaries 44,000; Utility expenses 20,000; Rent of shop 60,000; Administrative Salaries 70,000; Advertising expenses 50,000. All the above expenses are to be prorated over the three departments equally, with the exception of Advertising expenses, which are exclusively related to the cosmetics trading activities. Required: A) Draw the trading and profit & loss account of the pharmacy for each department and as a whole for the month of May, 2024. B) Analyze the performance of each department during the Month.

Introduction

Departmental accounting is used when a single business is divided into several departments, sections or departments trading in different lines of goods under one roof and one ownership. The object is to prepare a separate trading and profit and loss account for each department, in columnar form, so that management can judge the profitability of every line of trade, compare departments with one another, reward efficient departments, and decide whether a weak department should be improved, re-priced or discontinued. Expenses which can be identified with one department are charged directly to it, while common expenses are apportioned on some fair and rational basis, such as sales, floor area, or, as instructed in this question, equally

among the departments. The Health Pharmacy of this question trades in three departments — Medicines, Cosmetics and Baby Clothing — and departmental results are required for the month of May 2024.

Basis of Apportionment and Working

The cost of goods sold of each department is opening stock plus purchases minus closing stock. For Medicines this is Rs. 150,000 plus Rs. 300,000 minus Rs. 50,000, that is Rs. 400,000, giving a gross profit of Rs. 200,000 on sales of Rs. 600,000. For Cosmetics it is Rs. 100,000 plus Rs. 150,000 minus Rs. 30,000, that is Rs. 220,000, giving a gross profit of Rs. 180,000 on sales of Rs. 400,000. For Baby Clothing it is Rs. 50,000 plus Rs. 150,000 minus Rs. 20,000, that is Rs. 180,000, giving a gross profit of Rs. 120,000 on sales of Rs. 300,000. The total gross profit of the pharmacy is Rs. 500,000. The common expenses, staff salaries Rs. 44,000, utility expenses Rs. 20,000, rent of shop Rs. 60,000 and administrative salaries Rs. 70,000, total Rs. 194,000 and are divided equally, so each department bears Rs. 64,666.67. Advertising of Rs. 50,000 relates exclusively to cosmetics and is charged wholly to that department. Because equal division produces recurring decimals, the figures are shown to two decimal places and the column totals are exact.

Table 1: Departmental Trading and Profit & Loss Account of The Health Pharmacy for the month of May 2024

Particulars	Medicines (Rs.)	Cosmetics (Rs.)	Baby Clothing (Rs.)	Total (Rs.)
Sales	600,000	400,000	300,000	1,300,000
Opening stock	150,000	100,000	50,000	300,000
Add: Purchases	300,000	150,000	150,000	600,000
Less: Closing stock	(50,000)	(30,000)	(20,000)	(100,000)
Cost of goods sold	400,000	220,000	180,000	800,000
Gross Profit	**200,000**	**180,000**	**120,000**	**500,000**
Staff salaries (equally)	14,666.67	14,666.67	14,666.67	44,000

Utility expenses (equally)	6,666.67	6,666.67	6,666.67	20,000
Rent of shop (equally)	20,000	20,000	20,000	60,000
Administrative salaries (equally)	23,333.33	23,333.33	23,333.33	70,000
Advertising (wholly to Cosmetics)	—	50,000	—	50,000
Total expenses	64,666.67	114,666.67	64,666.67	244,000
Net Profit	**135,333.33**	**65,333.33**	**55,333.33**	**256,000**

Part (B): Analysis of the Performance of Each Department

All three departments are profitable, and together they contribute a net profit of Rs. 256,000 on total sales of Rs. 1,300,000, an overall net margin of 19.69 per cent. Their individual performances, however, differ considerably, as the ratio analysis below shows. Medicines is the strongest department in absolute terms: it produces the largest sales (46.15 per cent of the total), the largest gross profit of Rs. 200,000 and the largest net profit of Rs. 135,333.33, which is more than half of the whole pharmacy's net profit. Its gross margin of 33.33 per cent is the lowest of the three, which is normal for medicines, where prices and margins are comparatively controlled, but because it bears no special advertising charge its net margin of 22.56 per cent is the best in the business. Medicines is therefore the backbone of the pharmacy: dependable, high-volume and the main source of earnings.

Table 2: Comparative Performance Ratios — May 2024

Measure	Medicines	Cosmetics	Baby Clothing	Whole Pharmacy
Sales (Rs.)	600,000	400,000	300,000	1,300,000
Share of total sales	46.15%	30.77%	23.08%	100%
Gross profit (Rs.)	200,000	180,000	120,000	500,000
Gross profit ratio (GP ÷ Sales)	33.33%	45.00%	40.00%	38.46%
Net profit (Rs.)	135,333.33	65,333.33	55,333.33	256,000
Net profit ratio (NP ÷ Sales)	22.56%	16.33%	18.44%	19.69%

Cosmetics presents an interesting contrast. It earns the highest gross margin of all, 45 per cent, because cosmetics are fashion and beauty products on which higher mark-ups can be charged, and its gross profit of Rs. 180,000 is not far behind that of Medicines although its sales are one-third lower. Yet its net profit ratio, 16.33 per cent, is the lowest of the three departments. The reason is visible in the accounts: the entire advertising expenditure of Rs. 50,000 is charged to cosmetics, and this single item absorbs more than one-quarter of its gross profit. Management should ask whether the advertising is truly productive: if the campaign is building the cosmetics trade, the cost may be justified as an investment, but if sales do not respond, the department's spending should be controlled or the advertising should be evaluated campaign by campaign. Baby Clothing is the smallest department, with 23.08 per cent of sales, a healthy gross margin of 40 per cent and a net profit of Rs. 55,333.33, a net margin of 18.44 per cent, which is better than that of cosmetics. For its size it performs creditably, and its margins suggest room for expansion, for example by widening the range, since it converts sales into profit more efficiently than cosmetics despite receiving no special promotional support.

Three general conclusions follow from the analysis. First, no department is loss-making, so the question of closure does not arise; rather, the issue is how to improve the weaker converters of gross profit into net profit. Secondly, the equal apportionment of common expenses, while simple and adopted here as instructed, is rough: rent would more fairly follow floor area and staff salaries the number of employees in each department, and under an equal split the small Baby Clothing department bears the same overhead as the much larger Medicines department, which flatters Medicines and penalises the smaller departments. Management should keep this distortion in mind when judging departmental managers. Thirdly, working capital and stock

deserve attention: total stock fell from Rs. 300,000 to Rs. 100,000 during the month, showing fast movement, but the Medicines department, with the thinnest margin, depends heavily on volume, so any fall in its sales would quickly reduce total profit.

Recommendations for Management

On the basis of this analysis, four practical steps are recommended. First, the cosmetics advertising of Rs. 50,000 should be reviewed against the sales it generates; if a similar spend is repeated, its effect on cosmetics turnover should be measured so that the department is neither starved of promotion nor loaded with unproductive cost. Secondly, because medicines provide more than half of the total profit on the thinnest margin, stock availability in that department must be protected at all times, since a stock-out there costs more profit per day than in any other department. Thirdly, baby clothing, which already returns an 18.44 per cent net margin on the smallest sales base, is the natural candidate for extra shelf space and a wider range, as additional sales there would add profit at a good rate without any extra fixed overhead under the present apportionment. Fourthly, in future months the pharmacy should apportion rent by floor area occupied and staff salaries by the number of staff actually working in each department, so that departmental results guide decisions more fairly than the rough equal division used this month.

Conclusion

To conclude, for May 2024 the pharmacy earned a combined net profit of Rs. 256,000: Medicines contributed Rs. 135,333.33, Cosmetics Rs. 65,333.33 and Baby Clothing Rs. 55,333.33. Medicines is the largest and most profitable department in absolute terms and in net margin, Cosmetics has the richest gross margin but the weakest net margin because of the

Rs. 50,000 advertising charge, and Baby Clothing is a small but efficient performer. Departmental accounts have thus served their purpose: they reveal not merely that the business is profitable, but exactly where the profit is earned and where management attention is needed.

Question 5: Hire Purchase System — Features, Comparison and Repossession (20 Marks)

Q. 5: Describe the main features of hire purchase. Distinguish between the hire purchase and installment sale systems. Also, narrate the accounting treatment of repossessed goods due to default made by the hire-purchaser.

Introduction

The hire purchase system is a method of buying costly goods, such as vehicles, machinery, furniture and household appliances, by paying for them in instalments over a period of time while using them from the very beginning. Many buyers cannot pay the full cash price at once, and many sellers cannot sell for cash in a competitive market; hire purchase bridges this gap by combining the features of hiring and of purchase. Under this system the buyer, called the hire purchaser, obtains possession and use of the goods immediately, but the ownership remains with the seller, called the hire vendor, until the last instalment is paid. The price paid by the hire purchaser, called the hire purchase price, is higher than the cash price, because it includes interest for the credit period. This answer explains the main features of the system, distinguishes it carefully from the instalment sale system, with which it is often confused, and then narrates the accounting treatment when the vendor repossesses the goods because the hire purchaser defaults in paying instalments.

Main Features of Hire Purchase

- Hire purchase is governed by a written agreement between the hire vendor and the hire purchaser, which specifies the goods, the cash price, the hire purchase price, the down payment and the amount and dates of the instalments.
- Possession and use of the goods pass to the hire purchaser immediately on signing the agreement, but the legal ownership (title) remains with the vendor until all instalments have been paid and the option to purchase is exercised.
- The hire purchaser initially stands in the position of a bailee or hirer of the goods; each instalment he pays is treated in law as hire charges for the use of the goods, although in accounting it is analysed into capital (cash price) and interest.
- The hire purchase price exceeds the cash price; the difference between the two is the interest (hire purchase charges) for the credit facility, which is spread over the instalment period.
- Usually a part of the price, called the initial payment, down payment or deposit, is paid at the time of delivery, and the balance is paid in equal monthly, quarterly or yearly instalments.
- The vendor has the right to repossess (take back) the goods if the hire purchaser defaults in paying any instalment, and the amounts already paid may be forfeited as hire charges, subject to the terms of the agreement and the law.
- The hire purchaser has an option, not an obligation, to buy: he may return the goods and terminate the agreement at any time before the final instalment, instead of completing the purchase.

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- Although not the owner until the end, the hire purchaser bears the risks of loss, damage and maintenance of the goods and is expected to keep them in good condition and insured, because the goods are in his possession and use.
- Both parties keep accounts: the hire purchaser records the asset and his liability towards the vendor, while the vendor records the hire purchase debtors and the interest earned period by period.

In short, the essence of hire purchase is the separation of possession from ownership: use begins at once, while ownership is earned gradually through the payment of instalments, and the vendor's ownership is his security against default.

Hire Purchase Distinguished from Instalment Sale System

Under the instalment (or deferred payment) sale system, the transaction is a genuine and complete sale from the outset: ownership passes to the buyer immediately, and the price is merely payable in instalments. Although the two systems look similar because in both the price is paid in parts, they differ fundamentally in law and in accounting, as the following comparison shows.

Table 1: Hire Purchase System vs. Instalment Sale System

Point of Difference	Hire Purchase System	Instalment Sale System
Nature of agreement	An agreement of hire with an option to purchase	An outright agreement of sale
Transfer of ownership	On payment of the last instalment	Immediately, at the time of the agreement
Position of the buyer	Hirer / bailee until the last instalment is paid	Owner of the goods from the beginning
Risk of loss	Borne by the purchaser in practice, though ownership is with the vendor	Borne by the buyer as owner
Right to return goods	Purchaser may return the goods and end the agreement	Buyer cannot return the goods; he must pay the full price

Right of seller on default	Vendor may repossess the goods	Seller can only sue for the unpaid price; he cannot repossess
Right to sell or pledge	Hire purchaser cannot sell or pledge the goods before final payment	Buyer may sell or pledge the goods, being the owner
Amounts paid on default	Instalments paid are treated as hire charges and may be forfeited	Seller must recover only the balance due; the sale is not cancelled
Treatment in purchaser's books	Asset account debited with cash price only; interest charged each period	Asset and liability recorded at full cash price; interest charged each period
Insolvency of buyer	Vendor can take back the goods, as they are still his property	Seller ranks only as an unsecured creditor for the balance

Accounting Treatment of Repossessed Goods

Repossession occurs when the hire purchaser defaults in paying one or more instalments and the vendor exercises his contractual right to take back the goods. Repossession may be complete, when the vendor takes back all the goods covered by the agreement and the agreement comes to an end, or partial, when the vendor takes back only some of the goods and the agreement continues for the remainder. In the books of the hire vendor, a Repossessed Goods (or Goods Repossessed) Account is opened. On repossession, the vendor first ascertains the amount due from the purchaser: the instalments fallen due and unpaid, together with interest, after giving credit for all amounts already received. The goods taken back are valued at an agreed value or at their estimated realisable value, usually after considering depreciation and the cost of reconditioning. The entry passed is: Goods Repossessed Account debited with the value of the goods taken back, Profit and Loss Account debited with the loss, if the value of the goods is less than the amount due, and the Hire Purchaser's Account credited with the total amount due, thereby closing his account (in complete repossession). If the value of the repossessed goods happens to exceed the amount due, the difference is a gain credited to the

Profit and Loss Account, although in practice vendors value repossessed goods conservatively, so a loss is more common.

After repossession, any expenses incurred by the vendor on repairs and reconditioning of the goods are debited to the Goods Repossessed Account, and when the goods are resold, the sale proceeds are credited to that account; the balance then shows the profit or loss on the resale of repossessed goods, which is transferred to the Profit and Loss Account. In the books of the hire purchaser, on complete repossession he closes the Vendor's Account and the Asset Account: the vendor's account is debited with the amount due, the Asset Account is credited with the book value of the goods surrendered, and the difference between the book value of the asset and the amount due to the vendor is the loss on default, debited to the Profit and Loss Account (if, unusually, the amount due is less, the difference would be a gain). The purchaser thus loses both the goods and the instalments already paid, which stand forfeited as hire charges. In partial repossession, the purchaser's asset account is credited only with the value of the goods taken back, the vendor's account is reduced by the agreed value of those goods, and the agreement continues for the goods retained, whose written-down value remains in the asset account. Both parties should disclose the agreed valuation of repossessed goods clearly, because the profit or loss of both sides depends directly upon it.

Conclusion

To conclude, hire purchase is a system of credit trading in which possession passes at once but ownership passes only on payment of the last instalment, the price includes interest, and the vendor protects himself by the right of repossession. It differs from an instalment sale, where ownership passes immediately and the seller's only remedy on default is to sue for the price.

When default actually occurs and goods are repossessed, the vendor records the goods in a Goods Repossessed Account at their estimated value, charges any shortfall against the amount due to profit and loss, and accounts for reconditioning and resale through the same account, while the purchaser writes off the asset surrendered and bears the resulting loss in his own profit and loss account.

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