1

INTRODUCTION TO FINANCIAL ACCOUNTS

Unit Structure :

OBJECTIVE

After Studying the module student would be able to:-

- Understand Scope and Meaning of Accounting
- Understand various Users of Financial Statements
- Know the Concepts and Conventions used in Accounting
- Study Indian Accounting standards and International Financial Reporting Standards

1.1 MEANING AND SCOPE OF ACCOUNTING

Business is carried on for the purpose of earning profits. Every business involves exchange of goods or services. A trader purchases and sells goods or services for the purpose of earning profits. In other words when a person carries on business he has to enter into various types of transactions.

Transactions means giving or taking money or money's worth. A businessman enters in to various types of transactions such as Purchasing goods, selling goods, Paying electricity bill Paying salary, Receiving commission etc.

A businessmen enters in to various types of transactions for the purpose of earning profits. At the end of the year he would like to know how much profit he has earned. Each and every transaction affects the profits of the business, for example when salary is paid to the employee the profits are reduced and when commission is received the profits increase.

If we want to find the profits of a business we have to consider all the transactions to find the profits as each and every transaction affects the profit. The transactions are numerous and it is not possible to remember all the transactions of the business. Therefore it becomes necessary that all the transactions should be recorded (written) in a proper form.

1.2 MEANING OF BOOK-KEEPING

BOOK KEEPING IS THE SYSTEM BY WHICH BUSINESS TRANSACTIONS ARE MATICALLY RECORDED IN THE BOOKS

Definition of Book-Keeping: Let us study definition of Book- keeping given by some eminent authors

J.R.Batliboi: Book-keeping is the art of recording business transactions in a set of books.

R.N. Carter: The Science and art of correctly recording in the books of accounts all those business transactions that result in the transfer of money of money's worth.

1.2.1 Features of Book-keeping

1) It is an art of recording business transactions.
2) Book- keeping involves recording of money transactions only.

It means transactions must involve money or money's worth non-monetary transactions are not recorded.

3) Recording of transactions is done in a systematic manner and according to the rules.

1.2.2 Objectives of Book-Keping:

Following are the objectives of book- keeping

1) To find the amount of profit or loss made during a year.
2) To find the amount of his capital in the business.
3) To find the amount of his assets and liabilities on a particular date.
4) To ascertain the financial position of the business.

1.2.3 Important Terms used in Book- Keeping

1) Debtor: Debtor means a person who has to pay something to us. A debtor is a person who owes something. In other words a debtor is a person from whom we have to receive something. For example if we sell goods to Mr. D on credit then Mr. D becomes our debtor .If Mr. A buys goods on credit from Mr. B For Rs. 700. In this Case Mr. A will be called a debtor as he owes (has to Pay) Rs. 700 to Mr. B.

2) Creditor: A creditor is a person to whom we have to pay something. A creditor is a person to whom we owe something. In other words a creditor is a person who has to receive something from us. For example if we buy goods on credit from Mr. X then Mr. X becomes our creditor. If Mr. A buys goods on credit from Mr. B for Rs. 700. In this case Mr. B will be called a creditor as has to receive Rs.700 from Mr. A.

3) **Assets:** Assets means all kinds of properties owned by a persons. Land and Building, Plant and Machinery, Cash Balance, Bank balance etc. are all examples of assets.

4) **Liabilities:** Liabilities means all sum of money which is payable to others. For example if Electricity bill is not paid then it is liability on us because the amount is payable.

5) **Capital:** Capital means the amount which businessman as invested in the business. For example if Mr. A starts business with Rs. 50,000 then that amount would be his capital in the business. If he brings furniture of Rs.5,000 in the business, this would also amount to his capital in the business. Capital is the amount that belongs to the trader him self which is used in the business.

Capital = Assets – Liabilities

6) **Drawings:** Drawing means amount withdrawn (taken out) by a businessman from business for his personal use. Drawing may in the form of cash or goods. Drawing reduces the capital of the business.

7) **Solvent:** A solvent is a person whose Assets are more than liabilities. or A solvent is a person whose liabilities are less than Assets. For example if Mr. X has cash Rs. 5000. Building Rs.8,000. and he has to pay Rs. 3000 to Mr. Y then his assets are worth Rs.13,000 and liabilities Rs.3,000. So, Mr. X is solvent.

8) **Insolvent:** An Insolvent is a person whose liabilities are more than his assets. or An insolvent is a person whose assets are less than his liabilities. For examples if assets of Mr. A are Rs. 10,000 and he has to Pay Rs. 15,000 to Mr. B then Mr. A is Insolvent because his assets are less then his liabilities.

9) **Goods:** Goods means all those articles and commodities in which a businessman deals. For example if Mr. A carries on business of Cloth then Cloth would be goods for him. If Mr. B is a Chemist then Medicines would be goods for him. Thus if you are dealing in furniture then furniture would be goods for you. With a commodity is to be regarded as goods or not does not depend upon the commodity but it depends upon the type of business which you are carrying on.

10) **Profit :** Profit is the excess of revenue or Income over the expenditure or expenses .

11) **Loss :** Loss is the excess of Expenditure or Expenses over the Income or Revenue.

12) **Transaction:** Exchange of goods and services for money or Money's worth between two or more persons or parties is known as Transactions.

There are two type of Transactions.

a. **Cash Transaction:** When goods are exchange for cash it is know as Cash Transaction. Example: A Purchased Goods from B and paid cash.

b. **Credit Transaction:** When cash is not paid or received for exchanges for goods and services it is know as Credit Transaction. E.g. A purchased goods from B on Two months Credit.

13) **Contingent Liabilities:** These are liabilities which may arise on happening or non – happening of a specific event in future. These liabilities are not recorded in the books of account until they arise.

E.g. A pending Suit in a coat filed by customer by demanding compensation for adverse effects of product after use.

14) **Capital Expenditures:** Cost incurred in acquiring an assets is called a capital expenditure. All capital expenditure, to repeat, is treated as asset and shown in the balance sheet. E.g. A Machinery costing Rs. 2,00,000/- was imported on which custom duty, freight and insurance Rs. 20,000/- incurred. Expense paid for customs duty, freight and insurance are capital expenditure.

15) **Revenue Expenditure:** Expenditure incurred for acquiring or producing goods for Resale is called Revenue Expenditure. In other words, expenses incurred for carrying day to day business activity is called Revenue Expenditure. E.g. Salary paid to employee. All Revenue Expenditure has to be deducted from income earned by the firm. Hence it will be taken to Profit & loss Account.

16) **Deferred Revenue Expenditure:** Expenditure is of a revenue nature but the benefit of the expenditure is available for following Two or more years. Such expenses are called Deferred Revenue Expenses.

E.g. Advertising Expenses: Normal annual advertising expenses are written – off to profit and loss account annually. Suppose a heavy advertisement campaign is carried out. The benefit of this will be available for next Two or Three years. Then so much of such expenditure as benefit In the current may be considered 'Revenue' and written off to profit loss account. The balance is carried as 'Deferred Revenue Expenditure' and appears in the balance sheet on assets side.

17) **Discount:** An allowance of concession allowed or received for carrying business transaction. There are two types of discount:

(a) **Cash Discount:** Discount allowed for spot is known as cash discount. It is generally allowed by the creditor to his debtor for immediate payment of amount due. This appears in the books of the accounts.

(b) **Trade Discount:** This discount or concession allowed for trading purpose is known as trade discount. It is usually allowed by manufacturer to a wholesaler or by a wholesaler to a retailer. It is allowed as a deduction from invoice or printed price or catalogue price. This discount is not recorded in the books of account.

18) **Accounting Year:** Business is going concern. So, the life of business is for infinite number of years. To know about his business dealing and position he breaks the life of business into small respective periods. Such periods consists of twelve months. Such year is known as accounting year. An accounting year may be calendar year, which begins on 1^{st} January an ends on 31^{st} December or financial year which begins on 1^{st} April and ends on 31^{st} March next year or other period i.e. Diwali to Diwali etc.

19) **Trading Concern:** The organization which is engaged in trading activities is known as trading concern. Aim of such organization is to earn profit.

20) **Not for profit concern or non – trading concern :** The organization which are not engaged in trading activities are called non- trading concern. Such concerns renders social service such as promotion of literature, culture, art, sport, education etc. Aim of such organization is not to earn profit but to give services.

1.3 TYPES OF ACCOUNTS AND RULES OF BOOK-KEEPING

Accounts may be classified as under

1) PERSONAL ACCOUNTS.

2) IMPERSONAL ACCOUNTS.

Impersonal accounts can be further divided into

A) REAL ACCOUNTS

B) NOMINAL ACCOUNTS

ACCOUNTS

PERSONAL A\C **IMPERSONAL A\C**

REAL A\C **NOMINAL A\C**

Personal Accounts:

Personal accounts are accounts relating to various individuals, firms, limited companies etc. with whom a businessman deals. A separate account is maintained for each person. Example Mr. X a/c Mr. Y a/c, M & Co a/c, Reliance limited A/c, etc.

In other words, the term person not only includes individuals but also includes artificial persons such as a Firm, Limited companies, etc. Separate account is maintained for each person.

Real Accounts:

These are the accounts of properties and assets of the business. For example Machinery a/c, Furniture a/c, Cash A/c, Goods A/c, Building a/c, Goodwill a/c. A separate account is maintained for each type of asset.

Nominal Accounts:

These are the accounts of expenses, losses, incomes and gains. A separate account is maintained for each Expenses and income. Examples of expenses are Electricity charges, Telephone charges, Salary paid, Discount allowed, etc. Examples of Incomes are commission received, Rent received, Interest received, etc.

Nominal accounts are different from personal accounts and real accounts. As already stated above personal accounts are accounts of various persons and real accounts are accounts of assets and properties. The persons and properties can be seen or touched but nominal accounts are accounts of expenses and incomes, which cannot be seen or touched. One cannot see or touch an expense or income but one can only feel it. For example when you pay salary, We give cash to the employee, and we say that salary is a expenses, we only feel that some expenses have been incurred.

Nominal Accounts Are Also Called Fictitious Accounts

Ex. 1 Mention the nature of the following accounts:

1. Copal Dev's A/c. 2. Goods A\C 3. State bank of India A/c. 4. Printing and stationery A/c. 5. Discount A\C 6.Vijaya 's A/c. 7. Carriage inward A/c. 8.Commission Received A/c. 9.Investment A\C. 10.Machinery A\C. 11. Repairs to machinery A/c. 12. Loss by Fire Account. 13.Shares A/c 14. Live Stock A/c. 15. Audit Fees A/c. 16.Dadar Library's A/c. 17.Capital A/c 18. Drawing A/c 19.Bad debts A/c. 20.Interest received A/c. 19.Dividend Received A/c. 20.Insurance premium A/c. 21.Brokerage A/c 22.Freight A/c 23.Lion's club A/c. 24. Bank of Baroda A/c. 25.Eagle Pvt. limited A/c. 26. Premises A/c. 27. Leasehold premises A/c. 28. Drawing A/c. 27. Trade Expenses A/c. 28.Bank charges A/c. 29.Prepaid insurance A/c. 30. Outstanding Wages A/c.

The Rules of Debit and Credit

As already stated Book-keeping is an art and science of recording business transactions in a systematic manner. We will be studying double entry system of Book-keeping. Under double entry system, each transaction has two aspects. These aspects are called as debit aspect and credit aspect. In other words, every transaction has a debit aspect and a credit aspect and the debit is equal to credit. When we record a transaction some accounts are debited and some accounts are credited but the amount of debit and credit is equal.

Rules of Personal Account

Debit the Receiver and Credit the Giver

A receiver means a person who receives something from us. When a person receives something from us, he is a receiver and his account should be debited. For example Cash paid to Mr. Manoj. Manoj is the receiver so his account should be debited.

A giver means a person who gives something (Goods or Service) to us When a person gives something to us He is a giver and his account should be credited. For Example Cash received from Mr. Sunil. Sunil is the giver so his account should be credited.

In some transactions a person receives something as well as gives something at the same time. In such transactions he is a receiver and giver at the same time so his account should be neither debited nor credited. For example sold goods to Y for cash. In such transactions Y is the receiver of goods and giver of cash so his account will be neither debited nor credited.

Note

While finding whether a party is a receiver or giver we should not consider ourselves as giver or receiver. This rule is applicable only to outside parties. We should consider only outside parties for finding out whether they are receiver or giver. In other words only outside parties can be receiver or giver.

Ex. 2 Find the receiver and giver in the following cases.

1. Sold goods to Mr. Prakash on credit.
2. Purchased goods from Ravi on credit
3. Paid cash to Anil Kapoor.
4. Received cash from Amir Khan.
5. Gave Loan to Sunil
6. Received loan from Ajay
7. Sold goods to Sanjay for cash.
8. Purchased goods from Mahesh for cash
9. Sold Machinery to Raju on credit

10. Sold Machinery to Kirit and received cash
11. Paid Rs. 500 to Rajesh.
12. Paid Rs. 500 as Rent to Rohit.
13. Paid Salary to Pankaj.
14. Received Rs. 100 from Jayesh
15. Received Commission Rs. 200 from Ashok.
16. Paid Electricity charges to BSES LTD.

RULE OF REAL ACCOUNT

DEBIT WHAT COMES IN CREDIT WHAT GOES OUT

As already discussed real accounts are accounts relating to property and assets such as cash, goods, building, etc.

Whenever some assets such as cash, goods or building comes in we should debit that asset account. Whenever some assets such as cash goods or building goes out of business we should credit the asset account.

Ex.3 Let us find whether Real accounts in the transactions given below should be debited or credited.

1. Sold goods to Mr. Ashok Rs 500 on credit
2. Purchased a Typewriter.
3. Purchased a building for Rs 50,000 and paid by cash.
4. Paid cash to Verma Rs 1000.
5. Paid Electricity charges Rs 1000.
6. Paid salary Rs 100

RULE OF NOMINAL ACCOUNT

DEBIT ALL EXPENSES AND LOSSES. CREDIT ALL INCOMES AND GAINS.

Nominal accounts are accounts relating to expense, losses, incomes and gains. One of the important characteristics of nominal account is that we cannot see the items to which the account relates. We can only feel about it. These accounts are also known as fictitious accounts.

Whenever we incur some expenses and losses we should debit expenses or losses accounts and whenever there is a income or gain we should credit income or gain account.

Ex.4 Let us find whether Nominal accounts should be debited or credited in the following transactions.

1. Paid Rent Rs 400.
2. Paid Salary Rs. 500 to Mr. Pankaj.
3. Paid Interest Rs 1000 to Ashok.

4. Paid Traveling expenses Rs 2,000.
5. Received commission from Mahesh Rs. 500.
6. Paid Freight Rs.500 to Railway.

1.4 ACCOUNTING CONCEPTS, CONVENTION AND PRINCIPLES

1.4.1. Accounting Concepts

Accounting concepts means the assumption or condition on which the whole accounting structure stands . They are predetermined conditions which a book keeper must keep in mind while recording transaction in the books of accounts.

1. **Entity Concept:** This concept is also Known as "Business Entity Concept" " Accounting Entity Concept"

   This concept requires that the business and the persons who control and own the business are two different entities. An accounting entity is regarded as separate and distinct from its owners. Due to this concept, the owners and his business are considered to be separate. I.E as two separate entities.

   All transactions of the business are recorded from the point of view of the business. Personal activities of the owners are not recorded in the accounting books of the business.

2. **Money Measurement Concept:** This concept states that only those facts will be recorded in the accounts which can be expressed in terms Money.

   If a fact cannot be measured in terms of Money, then such a fact will not be recorded in the accounts Books. Money is a common denomination in which all transactions are measured for the purpose of recording in the books of accounts. If different transactions are not expressed, in terms of money, it will become meaning less to present the transaction.

   For example if two tables and 5 Chairs are purchased. The various quantities of tables and chairs cannot be added. however the value of two tables and 5 chairs can be measured in terms of Money and their values can then be added.

3. **Cost concept**: This concept requires that Assets should be valued at acquisition cost. rather than at its Market Values. Though assets can be disclosed in the balance sheet at different values such as market value, Realisable value etc. It is proper to show asset at cost as valuing asset at cost is free from Bias. All other values involve a element of subjectivity in the valuation of the asset. For example an asset may be purchased for Rs 50,000, its market value be Rs 70,000. However Many a times, Market value of an asset may not be available. Also Many a times Market value is not real market value but it is based on estimation.

4. **Going Concern Concept:**

According to this concept, the enterprises is normally viewed as a going concern. It means that it is assumed that the enterprise will continue its operations is near or foreseeable future. It is assumed that the enterprise has neither the intention nor the necessity of liquidation. It is also assumed that the enterprise will not materially curtail down its operation in near future.

While preparing Financial statements, it is assumed the Business activity will continue and there is no intention to close the business. This concept is a Fundamental Accounting Assumption.

5. **Realisation Concept:** This concept requires that profits should be accounted for only when it is actually realised. This means that revenue or profit should be recognised only when sale is effected or services are rendered. For example if the Market value of an Asset has increased, but the profit should be recognised only when the asset is sold.

However it should be noted that revenue may be recognised before cash is received. It is not necessary that cash should be received. However Revenue should be recognised only if a legal right to receive cash is established.

6. **Accrual Concept**

This Concept requires that Revenues and costs should be recognised as and when they are earned or incurred and not as and when money is received or paid. In other words we should follow mercantile system of Accounting and not cash system of Accounting. In cash system of Accounting Revenue is recognised only when cash is received and expenses are recorded when cash is paid. However this concept requires that, income and expenditure should be recorded in the period to which the expense belong and not in the period in which income are received or expenses are paid

7. **Dual Aspect.**

This concept is the core of Accountancy.

According to this concept, every business transaction is recorded in the books has of accounts has two aspects. The two fold aspects are increase or decrease in assets and liabilities. Every transactions or event has two aspects such as

1. It increases one asset and decreases another asset
2. It increases and asset and increases Liability (including Capital)
3. It decreases one asset and decreases a liability (including Capital)

For example when expenses are incurred, cash is reduced and capital also reduces.

When Machine is purchased, cash is reduced and book value of Machine increases.

1.4.2. Accounting Conventions:- Accounting convention are the customs or traditions usually adopted in preparation of accounting conducts or statements. Accounting systems have been developed in response to the needs of the management and the outside creditors for making economic decisions.

1. **Convention of Consistency:**

   This concept requires that Accounting policies adopted in preparing the financial statements should be consistently followed.

   In other words the Accounting policies should not be changed unless it is absolutely necessary. If Accounting policies such as Method of depreciation, method of valuation of closing stock etc are frequently changed then it becomes meaning less to compare the financial statements of two different period in which different accounting policies have been followed.

2. **Convention of Disclosure:**

   This means that the accounts must be honestly prepared and they must disclose all material information. The accounting reports should disclose full and fair information to the proprietors, creditors, investors and others. This convention is specially significant in case of big business like Joint Stock Company where there is divorce between the owners and the managers. Therefore, The Indian Companies Act, 1956 not only requires that the accounts of the company must give a true and fair view of the state of affairs of the company but it has also prescribed the contents and forms of Profit and Loss Account and Balance Sheet.

3. **Convention of Materiality:**

   The accountant should attach importance to material detail and ignore insignificant details. If this is not done accounts will be overburdened with minute detail. As per the American Accounting Association, " an item should be regarded as material, if there is a reasons to believe that knowledge of it would influence the decision of informed investor." Therefore keeping the convention of materiality in view, unimportant items are either left out or merged

4. **Convention of Conservatism:**

   This convention cost of safety is a rule in the minds of businessman. As per this convention, all anticipated losses are taken into account but no profits are accounted until they arise.

1.5 INTRODUCTION TO ACCOUNTING STANDARDS:

Accounting standards are authoritative standards for financial reporting and are the primary source of generally accepted accounting principles (GAAP). Accounting standards specify how transactions and other events are to be recognized, measured, presented and disclosed in financial statements. An accounting standard is a common set of principles, standards, and procedures that define the basis of financial accounting policies and practices.

1.5.1. AS-1: Disclosure of Accounting Policies

It states that an enterprise needs to disclose significant accounting policies followed by it to prepare and present its financial statements.

The information presented in the financial statements of an organisation is of its financial position. The profit or loss can be affected to a large degree by the accounting policies followed. The accounting policies followed vary from organisation to organisation.

It is important to disclose significant accounting policies followed to make the financial statements understandable. The disclosure is required by law in certain cases. In recent years, organisations in India have adopted the practice of including a separate statement of accounting policies followed in their annual reports to shareholders.

Many organisations followed by them in the notes to their financial statements, but there is no consistency in the disclosures among organisations.

In other words, the disclosure forms part of accounts in some cases, while in others it is given as supplementary information. The purpose of this standard is to promote a better understanding of financial statements by establishing the practice of disclosure of significant accounting policies followed and the manner in which they are disclosed in the financial statements. Such disclosure would also facilitate a more meaningful comparison between financial statements of different organisations.

1.5.2. AS-6 Depreciation

It deals with depreciation of the tangible asset. Hence, only the historical cost, accumulated depreciation on the asset and total depreciation for the period for each class of asset will be recorded. Depreciable value of asset is not to be disclosed according to AS-6.

Depreciable assets are assets which

[1] are expected to be used during more than one accounting period; and

[2] have a limited useful life; and

[3] are held by an enterprise for use in the production or supply or for administrative purposes.

Depreciable amount of a depreciable asset is its historical cost, or other amount substituted for historical cost less the estimated residual value.

Useful life is the period over which a depreciable asset is expected to be used by the enterprise. The useful life of a depreciable asset is shorter than its physical life.

There are two method of depreciation:

1] Straight Line Method (SLM)

2] Written Down Value Method (WDVM)

Note: A combination of more than one method may be used.

1.5.3. AS-9 Revenue Recognition

As per the AS 9 Revenue Recognition issued by ICAI "Revenue is the gross inflow of cash, receivables or other consideration arising in the course of the ordinary activities of an enterprise from the sale of goods, rendering of services & from various other sources like interest, royalties & dividends"

Revenue has to be measured by the amount charged to the clients for the sale of goods and services. However, in the case of the agency relationship, the revenue has to be measured by the amount charged for commission and not on the gross inflow of the cash, receivables or other consideration. There are few exceptions to the above-mentioned statement where the special consideration applies

- Revenue arising from Construction Contracts
- Revenue arising from hire-purchase, lease agreements
- Revenue arising from government grants and other similar subsidies
- Revenue of Insurance companies arising from insurance contracts

1. Revenue recognition emphasizes on the timing of recognition of revenue in the statement of profit and loss of an enterprise
2. The amount of revenue arising from a transaction is usually determined by an agreement between the parties involved in the transaction
3. When uncertainties arise regarding the determination of the amount or its associated costs, these uncertainties may influence the timing of the revenue

1.5.4. AS-10 Accounting for Fixed Assets

Accounting Standard on Accounting for Fixed Assets has now been deprecated , and new revised A.S - 10 Property, Plant and Equipment ***has been issued by ICAI*** .

Fixed Asset is an asset held with the intention of being used for the purpose of producing or providing goods or services and is not held for sale in the normal course of business. (It is expected to be used for more than one accounting period.)

The cost of fixed asset includes:

- Purchase price
- Import Duties and other non-refundable taxes
- Direct cost incurred to bring the asset to its working condition
- Installation cost
- Professional fees like fees of architects
- General overhead of enterprise when these expenses are specifically attributable to acquisition/preparation of fixed assets
- Any expenses before the commercial production, including cost of test run and experimental production

Any expenses before the asset is ready for use not put to use

- Loss on deferred payment arising out of foreign currency liability.
- Price adjustment, changes in duties and similar factors.

The cost of fixed asset is deducted with:

- Trade discounts and rebates

Kindly refer ICAI website for detailed notes on Accounting standards.

1.6 INTERNATIONAL FINANCIAL REPORTING STANDARDS (IFRS)

International companies follow the International Financial Reporting Standards (IFRS), which are set by the International Accounting Standards Board and serve as the guideline for non-U.S. GAAP companies reporting financial statements. They were established to bring consistency to accounting standards and practices, regardless of the company or the country. IFRS is thought to be more dynamic than GAAP in that it is regularly being revised in response to an ever-changing financial environment.

1.6.1. IAS-1: Presentation of Financial Statements

IAS 1 sets out overall requirements for the presentation of financial statements, guidelines for their structure and minimum requirements for their content. It requires an entity to present a complete set of financial statements at least annually, with comparative amounts for the preceding year (including comparative amounts in the notes). A complete set of financial statements comprises:

- a statement of financial position as at the end of the period;
- a statement of profit and loss and other comprehensive income for the period. Other comprehensive income is those items of income and expense that are not recognised in profit or loss in accordance with IFRS Standards. IAS 1 allows an entity to present a single combined

statement of profit and loss and other comprehensive income or two separate statements;

- a statement of changes in equity for the period;
- a statement of cash flows for the period;
- notes, comprising a summary of significant accounting policies and other explanatory information; and
- a statement of financial position as at the beginning of the preceding comparative period when an entity applies an accounting policy retrospectively or makes a retrospective restatement of items in its financial statements, or when it reclassifies items in its financial statements.

An entity whose financial statements comply with IFRS Standards must make an explicit and unreserved statement of such compliance in the notes. An entity must not describe financial statements as complying with IFRS Standards unless they comply with all the requirements of the Standards. The application of IFRS Standards, with additional disclosure when necessary, is presumed to result in financial statements that achieve a fair presentation. IAS 1 also deals with going concern issues, offsetting and changes in presentation or classification.

1.6.2. IAS-2: Inventories

IAS 2 provides guidance for determining the cost of inventories and the subsequent recognition of the cost as an expense, including any write-down to net realisable value. It also provides guidance on the cost formulas that are used to assign costs to inventories. Inventories are measured at the lower of cost and net realisable value. Net realisable value is the estimated selling price in the ordinary course of business less the estimated costs of completion and the estimated costs necessary to make the sale.

The cost of inventories includes all costs of purchase, costs of conversion (direct labour and production overhead) and other costs incurred in bringing the inventories to their present location and condition. The cost of inventories is assigned by:

- specific identification of cost for items of inventory that are not ordinarily interchangeable; and
- the first-in, first-out or weighted average cost formula for items that are ordinarily interchangeable (generally large quantities of individually insignificant items).

When inventories are sold, the carrying amount of those inventories is recognised as an expense in the period in which the related revenue is recognised. The amount of any write-down of inventories to net realisable value and all losses of inventories are recognised as an expense in the period the write-down or loss occurs.

1.7 ACCOUNTING IN COMPUTERISED ENVIRONMENT

Computerised Accounting System (CAS) is a software that helps businesses to manage the big financial transactions, data, reports, and statements with high efficiency, speed, and better accuracy. A computerized accounting system is a software application that automates financial records and reporting processes to make them faster, more accurate, and easier to manage. It reduces the manual entry of data, eliminates redundant operations, and reduces accounting error risk with built-in controls.

1.7.1. Salient Features of CAS

Following are the salient features required for CAS software:

Simple and Integrated: It is designed to automate and integrate all the business operations, such as sales, finance, purchase, inventory and manufacturing. CAS is integrated to provide accurate, up-to-date business information rapidly. The CAS may be integrated with enhanced MIS (Management Information System), Multi-lingual and Data Organisation capabilities to simplify all the business processes of the organisation easily and cost-effectively.

Transparency and Control: It provides sufficient time to plan, increases data accessibility and enhances user satisfaction. With computerised accounting, the organisation will have greater transparency for day-to-day business operations and access to the vital information

Accuracy and Speed : It provides user-definable templates (data entry screens or forms) for fast, accurate data entry of the transactions. It also helps in generalising desired documents and reports.

Scalability: It enables in changing the volume of data processing in tune with the change in the size of the business. The software can be used for any size of the business and type of the organisation.

Reliability: It makes sure that the generalised critical financial information is accurate, controlled and secured.

1.7.2. Application of CAS in various areas of accounting:

The applications of computerized accounting system are as follows:

(i) **Maintaining accounting records:** In computerized accounting system, accounting records can be maintained easily and efficiently for long time period. It does not require a large amount of physical space. It facilitates fast and accurate retrieval of data and information.

(ii) **Inventory management:** Computerized accounting system facilitates efficient management of inventory, fast moving, slow moving and obsolete inventory can be identified. Updated information about availability of inventory, Level of inventory etc, can be obtained instantly.

(iii) **Payroll Preparation:** Payroll involves the calculation of amount due to an employee. Pay of an employee may be calculated based on hours/days worked or units produced.

(iv) **Report generation:** Computerized accounting system helps to generate various routine and special purpose reports.

(v) **Data import/export:** Accounting data and information can be imported from or exported to other users within the organisation as well as outside the organisation.

(vi) **Taxation:** Computerized accounting system helps to compute various taxes and to deduct these and deposit the same to the Government account.

Review Questions:

1. Write Short note on: Salient features of CAS
2. Write short note on: AS- 6
3. Explain Briefly Accounting Concepts and Conventions
4. Explain IFRS V/S Accounting Standards
5. Objectives of Book-Keeping.

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2

ACCOUNTING TRANSACTIONS

Unit Structure :

OBJECTIVE

After Studying the module student would be able to:-

- Understand What is Journal, ledger, Subsidiary book
- Understand difference between Expenditure and Receipts.
- Know various Types of Subsidiary and Cash books

2.1 WHAT IS THE ACCOUNTING CYCLE?

The accounting cycle is a basic, eight-step process for completing a company's bookkeeping tasks. It provides a clear guide for the recording, analysis, and final reporting of a business's financial activities. A businessman has to record the transactions of the business to find the profit or loss of the business. Transactions are recorded by double entry system of Book-keeping. As already stated in double entry system every transaction has two aspects i.e. Debit aspect and Credit aspect.

Step 1: Identify Transactions

Step 2: Record Transactions in a Journal

Step 3: Posting

Step 4: Unadjusted Trial Balance

Step 5: Worksheet

Step 6: Adjusting Journal Entries

Step 7: Financial Statements

Step 8: Closing the Books

2.2 WHAT IS JOURNAL?

Journal is a book in which transactions are first recorded.

Journal is called the book of original entry or prime entry.

Each Transaction is first recorded in the Journal. The transactions are recorded in Journal by means of Journal entry.

Journal must have the following five columns:

1. Date
2. Particulars
3. Ledger Folio
4. Debit Amount
5. Credit Amount

FORM OF JOURNAL

Date	Particulars	LF	Debit	Credit

Date Column: It gives the date on which a transaction takes place.

Particulars Column: It shows the account to be debited and the account to be credited. Narration is also written in this column below each entry.

L.F. Column: It shows the Folio or page number of the ledger account where posting is done.

Debit Rs. column & Credit Rs. column: These columns show the amount to be debited or credited with in the accounts specified in particulars column.

Some importance Terms:

(1) **On Account:** Some times, only part payment is made to the supplier or received from the customer. In such case, it is said that amount paid or received on account.

(2) **In Full Settlement:** Some times payment is made or received short of what is actually due. The short payment or receipt is due to discount or other factors. In such case, amount is said to be received/paid in full settlement.

(3) **Bad debts:** When a loss occurred because amount can not be recovered from debtor or customer, then such loss is called bad debts.

(4) **Bad debts recovery:** It refers to the receipt of amount which was earlier consider as irrecoverable and was written of as bad debts.

Trade Discount and Cash Discount

The term discount means any concession allowed by one person to another. Discount is an expense of the person who allows the discount and it is the income of the person who receives the discount. Two types of discounts are allowed in the business.

1. Trade Discount
2. Cash Discount

Trade Discount

Trade discount is allowed by a seller to the buyer to Encourage the buyer to buy large quantity of goods. Trade discount is allowed on the list price or marked price of the goods. Marked price of goods means the price written on the goods. For example if the marked price of the goods is Rs 5000 and trade discount allowed is 10%. Then the discount will be Rs 500 and the goods will be sold for Rs 4,500. The price at which the goods are sold is also called NET PRICE OF THE GOODS.

Cash Discount

Cash discount is allowed to encourage early payment. Cash discount is allowed by a creditor to debtor so that the debtor makes early payments. Cash discount is allowed in two types of transactions

a) When the buyer of the goods makes immediate payment at the time of purchase of goods

b) When the debtor makes the payment and the creditor allows the discount.

When cash discount is allowed at the time of purchase of goods by the buyer, cash discounted is calculated on the NET PRICE. For example A sells goods to B. The marked price of the goods is Rs 100 and A allows trade discount of 10%. The net price of the goods is Rs 90. If B makes immediate payment and a allows cash discount of 10%. This 10% will be calculated on the net price of the goods and not on the marked price. The cash discount will be Rs. 9 i.e. 10% of Rs 90. and B will pay Rs. 81 ie. (90 - 9) to A. When cash discount is allowed by a creditor to his debtor, cash discount is calculated on the amount settled. For example X has to pay Rs 1,000 to Y. Y may allow 10 % cash discount to X. In that case X will Get a discount of 10% of Rs 1,000 i.e. Rs 100 and he will pay Rs 900 to Y.

TRADE DISCOUNT	CASH DISCOUNT
1. Trade discount is allowed to encourage the encourage the buyer to buy more quantity of goods.	1. Cash discount is allowed to encourage early payments.
2. Trade discount is calculated on list price	2. Cash discount is calculated on Net price or amount settled.
3. Trade discount is allowed at the time of buying goods.	3. Cash discount is allowed at the time of buying the goods or at the time of making payment.
4. Trade discount is not recorded in the books of accounts.	4. Cash discount is recorded in the books of accounts.

Important Points for Recording Entries For Discount.

1. Remember the order given below in which discount is allowed.

MARKED PRICE OF GOODS	XXXXX
LESS TRADE DISCOUNT	XXXXX
PRICE OF GOODS SOLD OR PURCHASED	XXXXX
LESS CASH DISCOUNT	XXXXX
CASH RECEIVED OR PAID	XXXXX

2. When goods are sold, goods account is credited at NET PRICE

   When goods are purchased, goods account is debited with NET PRICE.

   In other words goods are recorded at NET PRICE AND NOT AT MARKED PRICE.

3. Cash account is debited or credited with actual cash received or paid.

4. Trade account is not recorded in the books of accounts. Cash discount is recorded in the books of accounts.

5. When goods are purchased, and cash is paid immediately the buyer may receive cash discount, In that case we must credit discount account as discount is an income. Discount account is a nominal account.

Important Note:

The Students should note that they should not apply the rule of real account to discount account. The students should not debit discount account when discount is received thinking that discount is coming in.

6. When goods are sold, and cash is received immediately the seller may give cash discount, In that case discount account will be debited as discount allowed is a expense of seller. Discount account is a nominal account. The students should note that they should not apply the rule

of real account to discount account. The students should not credit discount account when discount is allowed (given) thinking that discount is going out.

In short. When discount is received discount account is credited when discount is allowed discount account is debited

An entity named Orange Ltd. has the following financial accounting transactions.

1. It deposits Rs.10,000 into Bank
2. It buys goods worth Rs.50,000 from Apple Ltd.
3. It sells goods worth Rs.35,000 to Melon Ltd.
4. It pays Rs.12,000 as Rent for its premises
5. It earns Rs.3,000 as interest on bank account.

First of all, let us identify the accounts involved in these transactions and classify them into the different types of accounts:

Transaction	**Accounts involved**	**Type of Accounts**
Deposit Rs.10,000 in Bank	Bank Account Cash Account	Real Account Real Account
Purchase goods worth Rs.50,000 from Apple Ltd.	Purchase Account Apple Ltd. Account	Nominal Account Personal Account
Sale of goods worth Rs. 35,000 to Melon Ltd.	Sales Account Melon Ltd. Account	Nominal Account Personal Account
Pays Rs.12,000 as rent	Rent Account Bank Account	Nominal Account Real Account
Earn Rs.3,000 as interest on Bank account	Interest received Bank Account	Nominal Account Real Account

Now applying the golden rules of *Financial Accounting* to each of the transactions we will get the following journal entries :

- ***Deposit Rs.10,000 in Bank***

Both Bank and Cash are real accounts and so the Golden rule is:

- Debit what comes into the business

- Credit what goes out from the business

So the entry will be:

Bank A/C	Dr.	10,000	
To Cash A/ C			10,000

- ***Purchase goods worth Rs.50,000 from Apple Ltd.***

The Purchase Account is a Nominal account and the Creditors Account is a Personal account.

Applying Golden Rule for Nominal account and Personal account:

- Debit the expense or loss
- Credit the giver

The entry will be:

Purchase A/C	Dr	50,000	
To Apple Ltd. A/C			50,000

- ***Sale of goods worth Rs.35,000 to Melon Ltd.***

The sale account is a Nominal account and the Debtors Account is a Personal account.

Hence the Golden Rule to be applied is:

- Debit the receiver
- Credit the income or gain

Thus the entry will be:

Melon Ltd. A/C	Dr	35,000	
To Sales A/C			35,000

- ***Pays Rs.12,000 as rent***

Rent is a Nominal account and Bank is a real account.

The Golden Rule to be applied is:

- Debit the expense or loss
- Credit what goes out of business

The entry thus will be:

Rent A/C	Dr.	12000	
To Bank A/C			12000

- *Earn Rs.3,000 as interest on Bank Account*

Interest and Bank are Nominal account and Real Account.

The Golden rule to be applied is:

- Debit what comes into the business
- Credit the income or gain

Hence the entry will be:

Bank A/C	Dr	3,000	
To Interest Received A/C			3,000

Pass Journal entries for the following Transactions during the Year 2021:

1. Bought goods of Rs.4000 in cash
2. Bought goods of Rs.4000 from Mr. Ashok.
3. Bought goods of Rs.4000 from Mr. Ashok in cash
4. Bought goods of Rs.4000 on credit basis.
5. Bought goods of Rs.4000.
6. Purchased goods from Mr. Amit Rs.3000
7. Sold Goods of Rs. 4000 to Ms. Suman
8. Sold Goods of Rs.4000
9. Salary paid Rs. 3000 to Mr.Ajit
10. Received Interest Rs.2000
11. Purchased Computer of Rs.40, 000
12. Purchased Typewriter of Rs.5000 from M/S.AKS Com.

In the Books of _______

Journal Entries

Sr. No	Date	Particulars	L.F.	Dr.Rs.	Cr.Rs
1.	1	Purchases A/C Dr. TO CASH A/C (Being goods are purchased for cash)		4000	 4000
2.	2	Purchases A/C Dr. TO Mr.Ashok A/c (Being goods purchased from Mr.Ashok on credit basis)		4000	 4000

Sr. No	Date	Particulars	L.F.	Dr.Rs.	Cr.Rs
3.	3	Purchaes (Goods)A/c Dr. To Cash A/c (Being goods purchased on cash basis from Mr.Ashok)		4000	4000
4.	4	Purchases A/c Dr. To Party A/c Or To Creditor A/c (Being goods purchased on Credit basis)		4000	4000
5.	5	Purchases A/c Dr. To Cash A/c/Bank a/c (Being goods are purchased for cash)		4000	4000
6.	6	Purchases A/c Dr. To Mr.Amit a/c (Being goods purchased from Mr.Amit on credit)		3000	3000
7.	7	Suman A/c Dr. To Sales a/c (Being goods sold to Ms.Suman on Credit basis)		4000	4000
8	8	Cash A/c Dr. To Sales A/c (Being Goods sold on Cash basis)		4000	4000
9	9	Salary a/c Dr. To Cash a/c (Being salary paid to Ajit)		3000	3000
10	10	Cash A/c Dr. To Interest Received A/c (Being Interest Received)		2000	2000
11	11	Purchases A/c Dr. To Party A/c or Creditor (Being Goods purchased on Credit basis)		5000	5000
12	12	Purchases A/c Dr. To Cash A/c (Being goods purchased on cash basis from Mr.AMIT)		3000	3000

Sr. No	Date	Particulars	L.F.	Dr.Rs.	Cr.Rs
13	13	Purchases To Cash A/c (Being Goods purchased on Cash Basis)		3000	 3000
14	 14	Computer A/c Dr. To Cash A/c (Computer Purchased on cash basis)		40,000	 40,000
15	15	Type writer A/c Dr. To Aks A/c (Being Typewriter Bought on Credit basis)		5000	 5000

2.3 LEDGER

A ledger is a principal book of accounts, it contain an account for each assets, liability, capital, revenue, and expenses. The ledger contain the same information as the journal. The entries effect of a transaction is completely recorded in one place in the journal. Periodically the same information is posted to the ledger where it is accumulated according to individual items.

A trader obtain all information about the business translation from the journal eg. Total amount recoverable from debtors, total amount payable to creditors, total payment on any head of expenditure etc.

Dr. **Name of A/c** **Cr.**

Date	Particulars	J.F	Amount Rs.	Date	Particulars	J.F	Amount Rs.
Year month	To Name of Account Credited		Amount of its own	Year month	To Name of Account Debited		Amount of its own

Explanation :

(1) **Date:** This column is used to show the date of the transaction

(2) **Particulars:** This column is used to write the name of the accounts debited or credited.

(3) **J.F.:** This column is used to show the page number of journal on which the transaction is recorded.

(4) **Amount :** The debit side amount column shows the amounts of the account debited, and credit side amount column shows the amount of the account credited.

LEDGER:

1. Record the following transactions in the personal account of Vipul:

1.4.2021 Sold goods to Vipul – 6,000

5.4.2021 Cash received from Vipul – 5,800 and allowed him discount – 200

18.4.2021 Vipul purchased goods – 8,000

30.4.2021 Received cash from Vipul on account Rs.4,500

1.5.2021 Balance from last month b/d – 3,500

12.5.2021 Sold goods to Vipul 12,000

22.5.2021 Received cash from Vipul – 4,850 and allowed him discount – 150

31.5.2021 Received cash in full settlement of Vipul's A/c – 10,250

Solution:

Vipul's A/c

Date	Particulars	Rs.	Date	Particulars	Rs.
1.4.2021	To Sales	6,000	5.4.2021	By cash	5,800
18.4.2021	To Sales			By Discount allowed	200
		8,000	30.4.2021	By Cash	4,500
			30.4.2021	By Balance C/d	3,500
		14,000			**14,000**
1.5.2021	To Balance b/d	3,500	22.5.2021	By Cash	4,850
12.5.2021	To Sales	12,000		By Discount allowed	150
			31.5.2021	By Cash	10,250
				By Discount allowed (Bal.fig)	250
		15,500			**15,500**

2.4 SUBSIDIARY BOOKS

Meaning:-

In a small business all transactions of purchase, sales, cash etc. are recorded in a single Journal. No attempt is made to classify the transactions. But in a large business, transactions are first classified into the following main groups:

(1) Receipt and payment of cash

(2) Purchase of goods on credit

(3) Sale of goods on credit

(4) Goods returned by our customers

(5) Gods returned by us to our suppliers and

(6) Other transactions.

When the transactions are numerous, it is better to record each such group of transactions in a separate book. Each separate book is called a subsidiary book.

2. Record the following transactions for the month of January 2021 in the purchase book of M/s.Vijay Mart:

Jan 4 Purchased from M/s Digital Mart:

20 Black & White T.Vs @ Rs.5,200 per piece. 10 Colour T.Vs @ Rs.12,000 per piece.

Trade discount on all items @ 12% Jan 10 Purchased from M/s Ashok Mart;

12 Video tapes @ Rs. 600 per piece.

8 Philips tape recorders @ Rs.2,500 per piece.

Jan 19 Purchased from M/s Reliance Mart:

10 LG Steros @ Rs. 3,500 per piece

8 LG Colour T.Vs @ Rs.25,000 per piece. Trade discount @ 15%

Jan 24 Purchased from M/s. Yadav Mart: 200 Audio Cassettes @ Rs.25 per piece 30 Equity toasters @ Rs.500 per piece

Also show posting of the above transactions into ledger accounts from purchase book.

Solution:

Books of M/s. Vijay Mart PURCHASES BOOK

Date	Name of the supplier	L.F.	Inward Invoice No.	Details Rs.	Amount Rs.
4.1.21	M/s. Digital Mart :				
	20 B/W T.Vs @ Rs.5,200 per piece.			1,04,000	
	10 Colour T.Vs at Rs.12,000 per piece.		1,20,000		
				2,24,000	
	Less: Trade discount @ 12%			26,880	1,97,120
10.1.21	M/S. Ashok Mart:				
	12 Video tapes @ Rs.600 per piece.			7,200	
	8 Philips tape Recorders at Rs.2,500 per piece				

Date	Name of the supplier	L.F.	Inward Invoice No.	Details Rs.	Amount Rs.
	M/S. Reliance Mart :			20,000	27,200
19.1.21	10 LG Stereos @ Rs.3,500 per piece.				
	8 LG Colour T.Vs @ 25,000 per piece.			35,000	
				2,00,000	
	Less: Trade discount @ 15%			2,35,000	
	M/s. Yadav Mart:			35,250	1,99,750
24.1.21	200 Audio Cassettes at Rs.25 per piece				
	30 Equity toasters @ Rs.500 per piece			5,000	
				15,000	20,000
	Total				**4,44,070**

LEDGER ACCOUTS

Purchases A/c

31.1.21	To Sundries (as per purchase book)	4,44,070			

M/s. Digital Mart A/c

			4.1.21	By Purchases A/c	1,97,120

M/s. Ashok Mart A/c

			10.1.21	By Purchases A/c	27,200

M/s. Reliance Mart A/c

			19.1.21	By Purchases A/c	1,99,750

M/s. Yadav Mart A/c

			24.1.21	By Purchases A/c	20,000

3. Enter the following transactions in the Sales book of M/s. Saroj & Sons and post them intoledger:

2.5.21 Sold to M/s. R& Bros:

200 pieces long cloth at Rs.90 per piece 300 pieces shirting @ Rs.110 per piece

5.5.21 Sold to M/s. G& Verma:

20 pieces Coating at Rs.250 per piece

16.5.21 Sold to M/s. M& Jain:250 blankets @ Rs.50 each 120 blankets @ Rs.75 each

20.5.21 Sold 20 shirts to cheap stores @ Rs.30 each for cash

25.5.21 Sold old furniture to M/s Santhosh & Co. on credit Rs.800

It is the practice followed by M/s. Saroj & Sons to allow 10% trade discount on all sales.

Solution:

Books of M/s. Saroj & Sons

SALES BOOK

Date	Name of the customer	L.F.	Outward Invoice No.	Details	Amount Rs.
2.5.21	M/s. R&Bros:				
	200 Pieces long cloth @ Rs.90			18,000	
	300 Pieces shirting at Rs.110			33,000	
				51,000	
	Less: Trade discount @ 10%			5,100	45,900
5.5.21	M/s. G & Verma:				
	20 pieces coating at Rs.250		5,000		
	Less : Trade discount @ 10%		500		4,500
16.5.21	M/s.M & Jain:				
	250 blankets @ Rs.50		12,500		
	120 blankets at Rs.75		9,000		
			21,500		
	Less: Trade discount at 10%		2,150		19,350
	Total				**69,750**

LEDGER ACCOUNTS

Sales A/c

			31.5.21	By Sundries (as per Sales Book)	69,750

M/s. R& Sons A/c

2.5.21	To Sales A/c	45,900			

M/s G & Verma A/c

5.5.21	To Sales A/c	4,500			

M/s. M & Jain A/c

16.5.21	To Sales A/c	19,350			

4. Prepare Purchase returns book and sales returns book from the following data:

1.8.21	Purchased goods returned to Aman– 205
3.8.21	Received goods returned by Akash – 300
5.8.21	Goods returned to Anuja– 500
7.8.21	Sales returns of Rs.1,260 by Suman
15.8.21	Returned defective goods to Suraj – 1,280
18.8.21	Damaged goods returned by Sahil – 1,120
23.8.21	Outward returns to Reshma - 275
29.8.21	Inward returns by Hemant– 750
30.8.21	Returned inferior goods to Riya-800
31.8.21	Reena returned goos to us – 1,330 Solution:

Purchase Returns Book

Date	**Name of the Supplier**	**Debit Note No.**	**L.F.**	**Amount Rs.**
1.8.21	Aman			205
5.8.21	Anuja			500
15.8.21	Suraj			1,280
23.8.21	Reshma			275
30.8.21	Riya			890
	Total			**3,150**

Sales Returns Book

Date	Name of the Customer	Credit Note No.	L.F.	Amount Rs.
3.8.21	Akash			300
7.8.21	Suman			1,260
18.8.21	Sahil			1,120
29.8.21	Hemant			750
31.8.21	Reena			1,330
	Total			**4,760**

TYPES:-

Each subsidiary book records a particular group of transactions. Following chart shows which subsidiary book record what group of transactions.

No	TYPE OF BOOK	TYPE OF TRANSACTIONS
1.	Cash book	Receipts and Payments of cash
2.	Purchase book	Credit Purchases
3.	Sales book	Credit sales
4.	Sales returns book	Sales returns
5.	Purchase return book	Purchase returns
6.	Journal proper	Other transactions.

ADVATAGE OR NEED:-

1. **Divisional into Small Books:-** Divisional o Journal leads to division of one big Journal Book into many smaller Subsidiary Books which are easier to handle.

2. **Divisional of Recording Work:-** Division of Journal leads to division of recording work. A single Journal can be written by a separate person at a time. Since each subsidiary book can be written by a separate person, the books are written faster and are always up-to-date.

3. **Division of Posting Work:-** Division of Journal leads to division of posting work. A single Journal can be used at a time either for recording or posting. When one subsidiary book is being written, another subsidiary book can be posted. Th7us, Ledger can be posted faster and is always up-to-date.

4. **Classified Details:-** Each subsidiary book shows detail regarding a particular group of transactions. Thus, Purchase Book shows details of total purchases, Sales Books shows details of total sales etc. Such

details are not available in the single Journal. The subsidiary books can also be designed to give more details such as Quantities purchased or sold, Product-wise details and so on.

5. **Reduces Recording & Posting Work:-** In subsidiary books the common account (purchase a/c, sales a/c, etc.) is not debited or credited for every transaction. Since it is understood that all entries say in the Purchase Book refer to credit purchases, there is no need to write narration in the subsidiary book. The posting into the common account is made only once every month and that too only for the total amount. Thus, when subsidiary books are used, the book-keeping work of recording and posting is reduced to a great extent.

2.5 CASH BOOK

It has already explained that all credit transactions of business are recorded in a separate subsidiary book according to its nature. Cash book is maintained to record all cash transactions of the business. It is a very important subsidiary book because

1. The number of cash transaction is quite large in every business,

2. The chances of fraud being committed regarding cash are higher as compared to other assets. A strict control is required. A properly maintained cash book helps in achievement this object,

3. Cash is the backbone of a business. Timely payment to its creditor increases the reputation of the business. Similarly timely payment form debtors improves the financial position of business.

4. Cash book performs dual function of journal as well as ledger. All cash transactions are directly recorded in the cash book so it serves the purpose of journal. Every page of the cash book displays a cash account, and hence it is not necessary to open cash account in the ledger.

The main purpose of maintaining cash book is to achieve the following four objects:

1. Recording all transaction pertaining to cash, either receipts or payments,

2. ascertainment of the balance of cash on hand and a bank balance,

3. Verification of correctness of cash and bank balance, and

4. To save time and labour by writing cash and bank transactions without passing journal entries.

Meaning :

Cash book is a book wherein all day – to – day cash transaction are recorded directly. It is a book of original entry. It is written on the basis of cash receipts and cash vouchers. It avoids the requirement of journal entries and ledger posting of cash transactions in journal and ledger. It has two sides namely –

1. Left-hand side or receipt side.

2. Right-hand side or payment side.

Like ledger account, all cash receipts are entered o the debit side (receipts side) and all cash payments are entered on the credit side (payments side). The proforma of Cash Book is as follows:

Dr. **Cash Account** **Cr**

Date	Particulars	L.F.	Rs.	Date	Particulars	L.F.	Rs.
	Total				**Total**		

Cash Book is also known as Cash Journal.

Features:

The following are the main features of cash book –

1. It is a book of original entry.
2. It records only the transactions pertaining to cash.
3. It functions as cash journal as well as a ledger account for cash.
4. It is written on the basis of cash memo, receipts, vouchers form.
5. It shows receipts (debit)and payment (credit) side.
6. It results in saving of labour, time, stationary, and business cost.
7. It is considered as an asset of the business organization.

Types of Cash Book:

The following are the different types of Cash Book :

- Simple or Single Column Cash Book.
- Double or Two Columns Cash Book.
  - Cash Book with Cash and Discount columns.
  - Cash Book with Bank and Discount columns.
  - Cash Book with Cash and Bank Columns.
- Triple or Three Columns Cash Book or Cash Book with Cash, Discount and Bank Columns.
- Petty Cash Book or Multi Columns Cash Book.

Types of Cash Book :

2.5.1. Simple/Single column cash book : Such cash book appears like an ordinary account with one amount column on each side. Unlike an account it has an additional receipt and voucher column on debit side and credit side respectively. The debit side of the cash book is meant for recording all the receipts and so it is known as "Receipt Side". The credit side of the cash book is meant for recording all payments so it is known as "Payment Side". On receipt side the word "To" appears because cash comes in the business. Similarly on payment side the word "By" appears because cash goes out from the business. The cash book always shows debit balance.

Performa of Simple/Single Column Cash Book :

Dr Cash Book Cr

Date	Receipts	R.N.	L.F.	Amt (Rs.)	Date	Payment	V.N	L.F.	Amt. (Rs)
	Total					**Total**			

Source Documents for Accounting:

1. **Source Documents:** Source Document (also known as voucher) is a record of each transaction. As soon as any transaction takes place, a voucher is prepared giving details of the transactions. For example, As soon as cash is paid, a Cash payment voucher is prepared. The vouchers is prepared on the printed from with the name of the concern printed on top. It contains details such as the Serial Number of Voucher, Date of Payment, name of payee, head of account to be debit, discription of transaction, amount etc. The cash payment voucher is sign by the receiver to acknowledge receipt of cash, by the authorized officer to indicate approval of payment and by the person preparing the voucher.

1. **Debit Note:** It is a statement including the value of goods returned by the buyer to supplier. It is sent by the buyer to the seller along returned. It states that the party to whom is prepared. It is printed usually on red colour paper.

2. **Credit Note:** Creditor/ Supplier prepares Credit note on receipt of goods returned by customer/debtor. It is sent by the seller to the buyer. This note states the value of the goods received on return and the party to whom it was sent is credited in the books. It is the source of document from which Sales Return Book is prepared. It is printed usually on the Yellow colour paper.

Bank Documents:

(1) **Pay in Slip:** Pay in Slip is a document prepared by the depositor of bank for depositing cash or Cheques. Pay in slip shows details regarding from whom cash or cheque is received. While depositing

Cheques, they are attached to the pay in slip and deposited in the bank. Bank collects the amount of cheque. It is evidence of the cash or cheque depositing in to the bank account. The pay in slip has a detachable part called counter foil. The receiving cashier of the bank affixes the bank rubber stamp on the counter foil to acknowledge the receipt of cash or cheque. The cheque is sent to the concerned bank of the payer for collection.

(2) Withdrawal Slip: It is a document used in bank for withdrawing amount from the account when account-holder does not possess the cheque-book. He uses this document to withdraw the money from his/her account. Only an account-holder can use this document.

2.5.2 Double \ Two column Cash book:

Simple cash book does not have discount column. Hence, the exact nature of receipts and payments cannot be ascertained. However the cash discount received and allowed both recorded in the cash book along with cash receipt and payments respectively. This becomes necessary for a businessmen who receives discounts form his supplier \ creditors and allows discounts to his customers\ debtors. Trade discount does not appear in the books of accounts. So, the cash book contains two columns on both the sides of cash book such as –

1. Cash and discount column
2. Cash and bank column
3. Bank and discount column.

1. Cash Book with cash and discount columns: Double column Cash book is often used by a trader who allows discounts when payment is received from a customer or debtor and earns discount when payment is made to suppliers or creditor. Cash received will be entered on receipt side in cash column and discount allowed is entered in the discount column on receipts side only. Similarly actual cash paid will be entered in discount column on payment side itself. Cash book also performs the function of cash account. Therefore, a separate cash account need not be open in the ledger. But in cash of discount it is not so. Positing from the discount column will be made to ledger account. The discount column of the both side are not to be balance since they perform different function. The debit side discount column show total amount of discount allowed, whereas credit side discount column represents total amount of discount received and earned. At the end of specific period (i.e. day, week or month) the total of debit discount column is posted to discount allowed account, whereas the total of credit side discount column is posted to discount received earned account.

Balance of discount column: It should be noted that the discount column are not balanced. They are merely totaled. Then the total of discount received column will be created in Discount Received A/C in the ledger and total of discount allowed column will be debited in Discount Allowed A/C in the ledger.

Cash column are balanced in similar way as in simple cash book already shown.

Ruling of Double/Two Column Cash Book:

Dr. Cash Book with Cash and Discount Column Cr.

Date	Receipt	R.N.	L.F	Dis.	Cash	Date	Payment	V.N.	L.F	Disc.	cash

2. **Cash Book with Bank And Discount columns:** Few traders, to maintain complete control on amount received and paid, deal exclusively through Bank. They deposit all cash received into the Bank and make all payment by cheques.

   On receipts of cash \ cheque, a recording is made on receipts side in cash Book as

   1. Date of receipt in date column
   2. Name of the account from whom the benefit of cash had been received in receipt column
   3. The amount of cash \ cheque received in bank column.
   4. If any discount to the party in discount column.

   If any payment is made to a creditor or supplier or for ant other purpose a recording is made on payment side of cash book as

   1. Date of payment in fate column
   2. Name of account to whom the benefit of cash has been given in payments column.
   3. Amount of cheque issued \ paid in the column.
   4. Discount received \ earned from the party in discount column.

   All account from which cash benefit is received are credited whereas all accounts to whom cash benefit is given are debited in the ledger. Discount columns are totaled and posted as (1) Total on receipts side to the debit on Discount Allowed Account, (2) Total of payment side to the credit of discount Received account. Bank A/c need not be opened in the ledger, as the Bank column in Cash book performs all the functions of Bank A/c.

3. **Three Column Cash Book:** In Day to Day business only hard cash is not used. Along with cash, bank money (i.e. cheque) is also used. Trader must record both the transaction as cash transaction only but actual cash must be recorded in cash column and bank money must be recorded in bank column. Therefore, he operates such a cash book which contains three column on both side such cash column, bank column and discount column. Such type of book is known as "Three column cash book."

   In three column cash book, the cash column represents cash a/c and bank column represents bank a/c. Therefore, it is not necessary to open separate bank a/c or cash a/c in ledger. Specimen of three column cash book such as_

Date	Recpt	R. No.	L.F.	Disc. (Rs.)	Cash (Rs.)	Bank (Rs.)	Date	Payments	V. No.	L.F.	Disc. (Rs.)	Cash (Rs.)	Bank (Rs.)
	Total							**Total**					

Simple Cash Book

Enter the following transactions in a simple Cash Book of M/S. Suryabhan 2021

1.4.21 Commenced business with Cash – 24,000

5.4.21 Bought goods for Cash -6,000

10.4.21 Goods Sold for Cash – 11,200

13.4.21 Paid into Bank – 2,500

14.4.21 Sold goods to Ganesan on Credit -9,000

15.4.21 Bought goods from Mohan on Credit -13,600

20.4.21 Purchased furniture -9,600

21.4.21 Purchased Stationery -160

23.4.21 Received Cheque from Ganesan – 9,000

25.4.21 Paid Mohan -13,600

26.4.21 Received Commission -740

27.4.21 Paid Telephone Chages -300

30.4.21 Drawn from Bank -3,800

Solution:

Cash Book of M/s. Suryabhan (Single Columm)

Date	Particulars	R.N.	L.F.	Amount	Date	Particulars	V.N.	L.F.	Amount
1.4.21	To Capital			24,000	1.4.21	By Purchases			6,000
10.4.21	To Sales			11,200	13.4.21	By Bank			2,500
23.4.21	To Ganesan			9,000	20.4.21	By Furniture			9,600
26.4.21	To Commission			740	21.4.21	By Stationery			160
30.4.21	To Bank			3,800	25.4.21	By Mohan			13,600
					27.4.21	By Telephone Charges			300
					30.4.21	By Balance C/ d			16,580
				48,740					**48,740**
1.5.21	To Balance c/d			16,580					

5. DOUBLE COLUMN CASH BOOK

Enter the following transactions in Aman's Cash book with discount and Cash Columns

1.1.21 Cash balance – 18,500

3.1.21 Cash Sales – 33,000

7.1.21 Paid Dravid -15,850

Discount allowed by him – 150

13.1.21 Sold goods to Manohar on credit – 19,200

15.1.21 Cash withdrawn for personal expenses – 2,400

16.1.21 Purchased goods from Charles on credit – 14,300

22.1.21 Paid into Bank -22,750

25.1.21 Cash received from Manohar – 19,000

Allowed him discount – 200

26.1.21 Drew a Cheque for office use – 17,500

27.1.21 Paid Cash to Saravanan – 2,950

Discount received from him – 50

28.1.21 Paid Cash to Charles less discount -14,200

29.1.21 Cash Purchases – 13,500

30.1.21 Paid for Advertising – 600

31.1.21 Paid Salaries -12,000

Solution:

Cash Book of Mr. Aman (Double Column)

Date	Particulars	R.N.	L.F.	D/A	Cash	Date	Particulars	R.N.	L.F.	D/R	Cash
1.1.21	To Bal b/d				18,500	7.1.21	By Dravid			150	15,850
3.1.21	To Sales				33,000	15.1.21	By Drawings				2,400
25.1.21	To Manohar			200	19,000	22.1.21	By Bank				22,750
26.1.21	To Bank				17,500	27.1.21	By Saravanan			50	2,950
						28.1.21	By Charles			100	14,200
						29.1.21	By Purchases				13,500
						30.1.21	By Advertising				600
						31.1.21	By Salaries				12,000
						31.1.21	By Bal c/d				3,750
				200	**88,000**					**300**	**88,000**
1.2.21	To Bal b/d				3,750						

6. TRIPLE COLUMN CASH BOOK

From the following transactions, prepare Three-Column Cash book of Sadanand for the month of Aug.2021

1.8.21 Cash balance – 20,000

Bank balance -23,000

3.8.21 Paid rent by Cheque – 5,000

4.8.21 Cash received on account of Cash sales - 6,000

6.8.21 Payment for Cash purchases -2,000

8.8.21 Deposited into Bank – 8,000

9.8.21 Bought goods by Cheque -3,000

10.8.21 Sold goods to Nathan on Credit – 7,120

12.8.21 Received Cheque from Madan -2,900

Discount allowed to him – 100

13.8.21 Withdrew from Bank for office use -4,350

14.8.21 Purchased furniture by cheque -1,260

15.8.21 Received a cheque for Rs. 7,000 from Nathan in full settlement of his account, which isdeposited into Bank.

17.8.21 Withdrew cash for personal use from the Bank – 1,200

18.8.21 Swamy, our customer has paid directly into our Bank A/c – 4,000

19.8.21 Parthi settled his account for Rs.1,250 by giving a Cheque for -1,230

20.8.21 Parthi's Cheque sent to Bank for Collection –

21.8.21 Received from Ravi a Currency note for Rs. 1,000 and gave him Change for it.

22.8.21 Received Cheque from Kamal for Rs. 6,000 in full settlement of his account of Rs.6,200 Deposited Kamal's Cheque into Bank.

25.8.21 Paid into Bank – 9,000

29.8.21 Parthi's Cheque returned dishonoured.

31.8.21 Paid Salaries – 10,000

Solution:

Cash Book of Mr. Sadanand (Three Column)

Date	Particulars	R.N.	L.F.	D/A	Cash	Bank	Date	Particulars	V.N.	L.F	D/R	Cash	Bank
1.8.21	To Bal b/d				20,000	23,000	3.8.21	By Rent					5,000
4.8.21	To Sales				6,000		6.8.21	By purchases				2,000	
8.8.21	To Cash (c)					8,000	8.8.21	By Bank (c)				8,000	

12.8.21	To Madan A/c			100	2,900		9.8.21	By Purchases					3,000
13.8.21	To Bank (c)				4,350		13.8.21	By Cash (c)					4,350
15.8.21	To Nathan A/c			120		7,000	14.8.21	By Furniture					1,260
18.8.21	To Swamy A/c					4,000	17.8.21	By Drawings A/c					1,200
19.8.21	To Parthi A/c			20	1,230		20.8.21	By Bank (c)				1,230	
20.8.21	To Cash (c)					1,230	25.8.21	By Bank (c)				9,000	
22.8.21	To Kamal A/c			200		6,000	29.8.21	By Parthi A/c					1,230
25.8.21	To Cash (c)					9,000	31.8.21	By salaries				10,000	
							31.8.21	By Bal c/d				4,250	42,190
				440		**34,480**	**58,230**					**34,480**	**58,230**
1.9.21	To Bal b/d					4,250	42,190						

7. PETTY CASH BOOK

Petty Cashier received Rs. 600 on April 1, 2021 from the head cashier. Prepare a Petty cash book on theimprest system for the month of April 2021 from the following items:

3.4.21 Stamps – 50

5.4.21 Taxi fare – 100

6.4.21 Pencils & Pads -75

7.4.21 Registry -25

10.4.21 Speed Post -45

12.4.21 Telegram – 35

15.4.21 Refreshment – 55

16.4.21 Auto fare -20

19.4.21 Typing Paper -60

20.4.21 Bus fare -15

22.4.21 Trunk calls -43 25.4.21 Office cleaning – 18

30.4.21 Courier Services -17

Show the analysis of payments as Postage & Stamps. Telephone and Telegrams, Conveyance, Stationeryand Sundry expenses.

Assume imprest amount of Rs 600

Solution:

PETTY CASH BOOK

Amount Received	CBFN	Date	Particulars	V.N.	Total Payments Rs.	Postage & stamps	Telephone & Telegram	Conveyance	Stationery	Sundries
600		1.4.21	To Cash		-					
		3.4.21	By Stamps		50	50				
		5.4.21	By Taxi fare		100			100		

		6.4.21	By Pencils & Pads		75				75	
		7.4.21	By Registry		25	25				
		10.4.21	By Speed post		45	45				
		12.4.21	By Telegram		35		35			
		15.4.21	By Refreshment		55					55
		16.4.21	By Auto fare		20			20		
		19.4.21	By Typing paper		60				60	
		20.4.21	By Bus fare		15			15		
		22.4.21	By Trunk calls		43		43			
		25.4.21	By office cleaning		18					18
		30.4.21	By courier services		17	17				
					558	**137**	**78**	**135**	**135**	**73**
		30.4.21	By Bal c/d		42					
600					**600**					
42		1.5.21	To Bal b/d							
558			To Cash							

Journal entry

Date	Particulars		L.F.	Debit	Credit
30.4.21	Postage A/c	Dr.		137	
	Telephone & Telegram A/c	Dr.		78	
	Conveyance A/c	Dr.		135	
	Stationery A/c	Dr.		135	
	Sundry Expenses a/c	Dr.		73	
	To Petty Cash A/c				558
	(Being the analysis of Petty cash book for the month of April)				

8. Bills Receivable Book and Bills Payable Book

Record the following transactions in B/R and B/P Books of Mr. Gemi and Post them into ledger

1.3.21 Received a bill from Velu at 3 months for Rs. 1,000

3.3.21 Accepted a bill 2 m/d for Rs. 3,000 drawn by Saravana & Co.

8.3.21 A bill at 60 dd for Rs. 1,200 drawn by M/'s. Sarathy & Sons was accepted this day

15.3.21 Acceptance received from Mary & Sons for 2 months for Rs. 1,150

25.3.21 Gave acceptance to Mr. Balaji's bill for Rs. 1,300, payable 3 M/d.Solution

Bills Receivable book

Serial No.	Date of Receipt	From Whom Received	Name of Acceptor	Where payable	Date of bill	Term	When due	L.F.	Amount	Remarks
1	1.3.21	Velu	Velu	-	1.3.21	3 months	June 4		1,000	
2	15.3.21	Mary & Sons	Mary & Sons	-	15.3.21	2 months	May 18		1,150	
							Total		**2,150**	

Bills Payable book

Serial No.	Date of Bill	Name of Drawers	Name of Payee	Term	When Due	L.F.	Amount	Remarks
1	1.3.21	Saravan & Co.	-	2 months	May 6		3,000	
2	8.3.21	M/s. Sarathy & Sons	-	60 days	May 10		1,200	
3	25.3.21	Mr. Balaji	-	3 months	June 28		1,300	
					Total		5,500	

LEDGER ACCOUNTS

Bills Receivable A/c

31.3.21	To Sundries (as per B/R book)	2,150			

Velu A/c

			1.3.21	By B/R A/c	1,000

Mary & Sons A/c

			15.3.21	By B/R A/c	1,150

Bills payable A/c

			31.3.21	By Sundries (as per B/P book)	5,500

Saravanan & Co. A/c

3.3.21	To B/P A/c	3,000			

M/s. Sarathy & Sons A/c

8.3.21	To B/P A/c	1,200			

Balaji A/c

25.3.21	To B/P A/c	1,300			

Bank Reconciliation Statement

A bank reconciliation statement could be defined as the summary of the banking and business accounts that reconciles a company's bank account with its financial record. The statement contains a record of all the deposits, withdrawals and other financial activities with a bank over a certain period of time.

Steps Involved in Preparation of Bank Reconciliation Statement :

1. Start with your closing balance for the prior month. That will be your starting number.

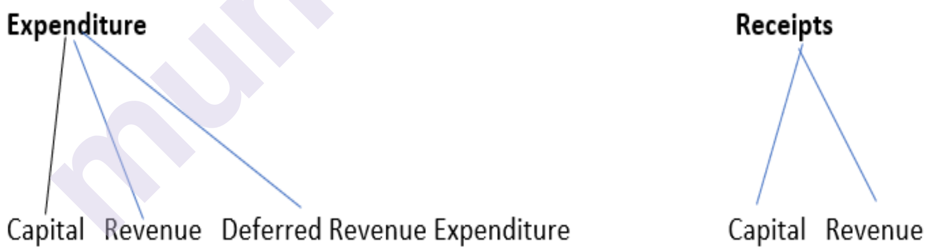
2. Add any deposits that may not have cleared or deduct any checks in transit. This is your adjusted cash balance.

3. Now that you have your adjusted cash balance, add in any earned interest or deduct any fees, non-sufficient funds (NSF) checks, or penalties that may not have been recorded in your company records.

4. Make sure that your deposits and cleared checks match the amounts that the bank recorded. The ending balance should then be the same.

5. If there are discrepancies, investigate to see what might have been missed in your recording or errors that may have been made at the bank.

2.6 EXPENDITURE AND RECEIPTS



2.6.1 MEANING AND PURPOSE OF CAPITAL EXPENDITURE

Capital expenditure is that expenditure, the benefit of which is enjoyed, not only in the year in which such expenditure is incurred but over many years. Such expenditure usually results in purchase or acquisition of assets and properties which may be used for many years. The main purpose of such an expenditure is to increase the earning capacity of the business. For example Purchase of Plant and machinery, land and building etc is a capital expenditure. Capital expenditure is shown in the balance sheet.

The features of capital expenditure are:

1. The benefit of such an expenditure is not exhausted in one year but the benefit of such an expenditure is enjoyed for a longer period.

2. Such an expenditure is of a non-recurring nature. It does not occur regularly.

3. The amount spent on such an expenditure is generally large but not always large.

Expenditure incurred for the following purpose is capital expenditure.

1. Purchases of assets such as plant and machinery, Land and Building.

2. Expenditure incurred on an old asset bought to put it in a working condition. For example repairs expenditure incurred on an second hand machine bought.

3. Expenditure incurred for putting a new asset to use e.g. installation charges for Machine.

4. Expenditure incurred so it becomes economical to operate a asset, thereby reducing the cost of operation. For example converting a petrol engine taxi in to a diesel engine taxi.

5. Expenditure incurred on extension or improvement of an asset, so as improve the earning capacity of the business. e.g. expenditure incurred on converting a 35MM screen in to 70 MM screen.

6. Expenditure incurred for acquiring a benefit of a permanent nature or a valuable right e.g. expenditure incurred for acquiring patent rights.

7. Expenditure incurred on improving the existing fixed assets.

However expenditure incurred on maintaining fixed asset is a revenue expenditure.

2.6.2. MEANING AND PURPOSE OF REVENUE EXPENDITURE

Following are the features of revenue expenditure.

1. The benefit of such an expenditure is exhausted in a short period which is less than the accounting period.

2. Such an expenditure is incurred to carry on day to day business activities.

3. Such an expenditure is a recurring expenditure

4. Such an expenditure may be incurred to maintain the assets.

5. The amount of such expenditure is generally small, but not always small.

6. Such an expenditure is shown in profit and loss account.

Revenue expenditure may be incurred for the following purposes.

1. Expenditure for purchasing the goods for resale or using them in manufacturing.

2. Expenditure incurred on maintaining and operating the asset.

3. Expenditure incurred on protection of business.

2.6.3. MEANING OF DEFERRED REVENUE EXPENDITURE

All expenditure incurred for carrying on the normal business activity is known as revenue expenditure. The benefit of such expenditure is enjoyed in the year in which it is incurred. However, sometime a heavy revenue expenditure may be incurred in one year such that its benefit of it may arise or enjoyed not in one year but also in the following two or more years. So much of revenue expenditure which is likely to benefit in future is called deferred revenue expenditure. Consider Advertisement expenditure. Normal Advertisement expenditure incurred is a revenue expenditure which is written off to profit and loss account. However, heavy expenditure incurred on advertisement for launching a new product may benefit for two or more years. In such a case, so much of the expenditure which benefits the current year can be treated as revenue expenditure, and debited to profit and loss account and the balance may be carried forward as Deferred revenue expenditure, i.e., the revenue expenditure which is postponed.

2.6.4. Write Short Notes on

i) Capital Receipts.

ii) Revenue Receipts.

i) Capital Receipts are those receipts which are non-recurring in Nature.

Such receipts usually result on account of Sale of Asset or Increase in Liability. Examples of Such Receipts are Amount of Loan raised, Receipts on account of sale of assets, or Amount received on account of issue of Shares. Such Receipts affect the items appearing in the Balance Sheet. Such Receipts are not considered as Income and hence are not included in Profit and loss Account.

ii) Revenue Receipts:

Such Receipts result from normal business Transaction. Such receipts do not result in reduction of Assets or increase of Liability. Such Receipts are treated as income are credited to Profit and Loss Account. Examples of such receipts are receipts on account of Interest, commission, sales, Royalties etc.

2.6.5. Distinguish between capital Expenditure and Revenue Expenditure?

CAPITAL EXPENDITURE AND REVENUE EXPENDITURE

The following are the points of distinction.

1. Benefit

The benefit of capital expenditure is not exhausted in year but is enjoyed for many years. The benefit of revenue expenditure is exhausted in a short period which is less than the accounting period.

2. Result

Capital expenditure results in acquisition of an asset. Revenue expenditure is incurred in the normal course of business to carry on the routine business transactions.

3. Occurrence.

A Capital expenditure is usually non recurring in nature. Revenue expenditure is of a recurring nature.

4. Object.

The object of capital expenditure is to improve the earning capacity of the business. Revenue expenditure is incurred for normal business operations.

5. Improvement

Capital expenditure is incurred to bring improvement in the assets. Revenue expenditure is incurred to maintain the asset.

6. Disclosure

Capital expenditure is disclosed in the balance sheet. Revenue expenditure is shown in Profit and loss account

2.6.6. IMPORTANCE OF ALLOCATION

Importance of Allocation :-

Final accounts prepared at the end of the year consist of profit and loss Account or Income Statement and Balance sheet. These final accounts or Income Statement and Balance sheet are prepared from the Trial Balance. All the accounts appearing in the trial balance are to be taken to either Trading and Profit and loss Account or Balance sheet. It is therefore, necessary to know what is meant by revenue expenses and capital expenses, and revenue receipts and capital receipts and their importance in the preparation of final accounts. Any error on this account will falsify th final accounts. It is really difficult to lay down the clear cut rule for distinguishing between capital an revenue items. But y applying certain normal norms, they can be distinguished form each other.

If capital expenditure is debited to P & L A/c the asset to which capital expenditure relates will be undervalued and secret reserve will be created to the extent of under valuation of assets. Creation of a secret reserve by a public company is not permitted by law. More ever, p & L A/c will be unnecessarily debited and the profit disclosed by profit and loss account will be less than actual profits.

If revenue expenditure is not debited to P & l A/c the profit will be inflated. As a result dividend will be paid out of capital which is against the provisions of law. In such a case the auditor can be held responsible for such payment. He may be asked to refund the amount of dividend wrongly paid.

The importance of the concept of capital and revenue can be summarized as follows:-

1. It helps to show correct value of assets and liabilities
2. It facilities to show true and fair view of the state of affairs.
3. It facilities to have better future planning of the resources.
4. It enable to have optimum use of the resources.
5. Unpleasant consequences of wrong allocation can be avoided.

2.6.7. PRINCIPLES OF ALLOCATING EXENDITURE

The correct allocation of expenditure between capital, Deferred Revenue and Revenue is one of the fundamental problem of accountancy. The difficult of allocating an expenditure between capital and Revenue can be removed by observing the following principles.

1. **Acquisition of Assets or goods.**

   If the expenditure is incurred for acquiring the fixed assets then it will be treated as capital Expenditure, but if the expenditure is incurred for acquiring or producing goods, then it has to be treated as Revenue Expenditure.

2. **Improvement or Maintenance.**

   If the expenditure is incurred to extend or improve the fixed Assets it will be regarded as capital Expenditure. If it is incurred to maintain the fixed asset in a god working condition, the expenditure is to be treated as Revenue Expenditure.

3. **Increase in earning capacity :**

   If the expenditure increases the earning capacity of the business e.g. cost of improving sitting accommodation by a cinema house, then it is to be regarded as capital expenditure but if the expenditure does not result I the increase in the earning capacity of the business then it is to be regarded as Revenue Expenditure.

4. **Benefit of the Expenditure**

   If the benefit of the expenditure extends for a long period then it is to be regarded as capital Expenditure. If the benefit of the expenditure is exhausted within the accounting period, it has to be regarded as Revenue expenditure.

2.6.7. In some circumstances, expenditure which is primarily of a revenue nature is treated as capital Expenditure. Some of the examples about the same are given below :

1. Legal costs, Brokerage and Stamp duty

These expenses in the normal course are revenue expenses. However, legal charges and stamp duty paid in connection with the acquisition of any property are capital expenditure. Also brokerage paid in connection with purchase of shares or any other property is treated as capital Expenditure.

2. Productive Wages

Wages paid for manufacturing finished gods for resale is a revenue expenditure. But if wages are paid to workers in connection with the extension to the factory building or for installing a machine has to be capitalized.

3. Freight & Carriage.

In the normal course, if freight is paid on Raw Material it will be a Revenue Expenditure but if it is paid on a newly purchased machine then it will be capitalized.

4. Customs & clearing charges.

Customs and clearing charges paid in connection with imported machine is to be treated as capital expenditure.

2.6.8. Classification of items into Capital and Revenue.

	Item	**Nature of Expenditure / Receipt**	**Reason**
(1)	Cost of replacing costly spare parts of a machine	Revenue	For maintenance of an asset
(2)	Cost of acquisition of copyrights	Capital	New asset acquired
(3)	Cost of designing a new product which did not come up for production	Deferred revenue	Amount spent on developing a product. (Basically, it is a capital loss/expenditure)
(4)	Heavy current repairs to roof of factory building	Revenue	For maintenance of an asset
(5)	Cost of alteration of cinema theatre in accordance with municipal law	Revenue	Normal day-to-day business expenditure

Review Questions:

Q1. Journalise, Post in to ledger for the following transactions.

1. Bought Motor Car worth Rs. 1,00,000 for cash.
2. Purchased Machinery worth Rs. 1,16,000 amount paid in cash.
3. Purchased Typewriter for cash worth Rs. 7,500
5. Purchased a horse for cash Rs 25,000
6. Purchased Machinery from Godrej Ltd. worth Rs. 50,750.
7. Bought goods from Pratik Ltd. Rs 9,000, paid by cheque.
8. Paid cheque of Rs. 17,000 to Tata Ltd for the goods bought earlier.
10. Sold goods worth Rs 1,700 to Gajanan.
11. Sold goods for cash for Rs. 1,400 to Sudhakar.
12. Sold old typewriter for Rs 2500.
13. Cash sales to Vinod Mills Rs. 16,000.
14. Cash sales Rs 2,540.
15. Invoiced goods worth Rs. 1700 to Robert. Robert presented a cheque for the same.
16. Credit sales to Sawant Rs. 5,920.
17. Sold buildings for Rs. 10,000 to Shankar.

Q2. Difference between Capital Expenditure v/s Revenue Expenditure

❄❄❄❄❄❄❄

3

DEPRECIATION ACCOUNTING & TRIAL BALANCE

Unit Structure :

3.1 Definition of Depreciation,,its Causes & its Need

3.2 Methods of Depreciation

3.3. Examples -Sums on Depreciation

3.4 Preparation of Trial Balance-Its meaning, Characteristics, Objectives, How to prepare Trial Balance, its Format, Practice sum

OBJECTIVE

After Studying the module student would be able to:-

- Understand What is Depreciation, why it is charged
- Understand different methods of Depreciation
- Know the format of Trial Balance and its format

3.1 DEFINITION

"Depreciation means decline in the price or value of an asset. It means gradual diminution in the value of an asset on account of its use.

The following are the causes of Depreciation :-

1. **Physical Wear & Tear**

   The most important cause of depreciation of an asset is the physical wear and tear of the asset on account of its use. As the asset is used the physical qualities of the asset diminish as a result of which the value of the asset is reduced.

2. **Passage of Time**

   Apart from use, the physical qualities of an asset deteriorate due to passage of time. This causes reduction in value of asset.

3. **Obsolescence**

   Depreciation may be caused on account of obsolescence. Due to technological development new types of machineries may be invented due to which existing machine may be rendered outdated.

4. **Exhaustion**

   Certain assets like mines, quarries etc. get exhausted over a period of time which causes depreciation of these assets.

3.1.1. Objects \Necessity of providing Depreciation

1. **To find correct profit & loss**

   Depreciation is a non cash expenditure. Depreciation should be provided in the books of accounts to find the correct profits. If depreciation is not provided in the accounts the profits would be overstated.

2 **To provide Funds for Replacement of Assets**

   The most important reason for providing depreciation is to keep the funds in the business which can be used for replacement of the asset at the end of the life of asset. When depreciation is provided, the profits are reduced and lesser amount is distributed among the owners of the business, so the amount of funds equivalent to the depreciation remains in the business which can be used to buy new assets.

3. **To present "True Financial Position"**

   If depreciation is not provided, the result will be that the asset will be shown at higher value in the Balance sheet i.e. it will be over valued in the balance sheet. If depreciation is not provided the balance sheet will not disclose true financial position.

4. **Section 205 of the Companies Act.**

   According to this section for all limited companies, it is provided that the company cannot distribute dividend without providing depreciation. Therefore for companies declaring dividends, it is compulsory to provide depreciation.

3.2 THE DIFFERENT METHODS OF DEPRECIATION ARE

1. **Fixed Installment or Straight Line Method or Original Cost system.**

   Under this method a fixed proportion of the original cost of the asset is written off each year, the asset being reduced to nil or break up value at the end of its life. This method is very simple and easy to understand. The calculation of depreciation is not very complicated. This method is suitable for those assets, the working life of which can be easily estimated, e.g. a Lease, a patent etc. This method is not suitable for those assets whose life cannot be estimated as it depends upon its use. If the machinery is used for 3 shifts the wear and tear will be more, than in the case where it is used for 1 shift only. Again, in the case of machinery, difficulty is felt as during the course of the year, additions to the plant &machinery is made and thus calculations will be difficult.

The other defect of this system is that the charge to profit & loss A\c consisting of depreciation and repairs expenditure relating to the asset over the life of the asset will be inequitable considering the charge for repairs along with depreciation for the maintenance of the assets.

2. Reducing Balance Method or Diminishing Balance Method or Written down Value method.

Under this method, depreciation is calculated as a certain percentage of Book value of the asset. This method is commonly adopted for the depreciation of assets which have some residual value, e.g. Plant & machinery Motor Cars, Furniture etc. This system has one important advantage that the charge to the profit & loss A\c. over the life of the asset remains equal, considering the charge for repairs and renewals. The amount of depreciation gradually diminishes whereas the charge for repairs gradually increases as the assets gets older and older.

The defect of this system is that it takes a very long time to write down the asset to a reasonable break up value.

If the value of an asset is to be bought to a certain value which is about its scrap value the rate of depreciation is to be fixed at a very high level. But if this is done the charge for depreciation in initial years becomes reasonably heavy with a high percentage and if it is lowered to a reasonable level, there is always the danger of inadequate provision. The other drawbacks are that the system does not consider the question of interest charge on the capital outlay involved nor does it make provision for a smooth replacement of the asset when it ceases to be useful.

3. Depreciation Fund method or Sinking Fund Method.

Under this system a fixed amount is charged for depreciation to profit & loss A\c. each year, and credited to depreciation Fund A\c. An equal amount of money is invested in securities outside the business at the end of each year. Interest received on such investments is reinvested. At the end of the life of the asset, the investments are sold and the money realised from sale of investment is used to replace the asset.

This method is employed where it is desired to make provision for the replacement of a costly asset. e.g. the acquisition of a New Lease.

The advantage of this system is that when the asset has to be replaced funds are available by selling the securities. Another advantage is that one can know at any time the original value of the asset as it is always shown in the balance sheet at this price.

The disadvantage of this method is that the investment when realised may not give the requisite amount for replacement of the assets because investment may be sold at discount.

4. Annuity Method

Under this method the total cost incurred in holding the asset is considered as depreciation. The total cost of holding the asset is decline in the value of asset plus the notional interest lost on funds blocked in the asset. The total depreciation to be provided during the life of the asset is equal to cost of the asset plus interest lost on the funds blocked in the asset.

When the asset is purchased, asset account is debited with the cost of the asset and at the end of the year notional interest is calculated and debited to asset account and credited to interest amount. This increases the book value of the asset. Depreciation is provided on such an increased book value. This is done every year till the useful life of the asset comes to an end.

5. Insurance Policy Method

According to this system, an Endowment Insurance policy is purchased from the Insurance company, so that at the end of a definite period the insurance company will pay the assured sum with the help of which the asset can be replaced.

The advantage under the system is that the company is sure about the requisite amount for replacement of the asset. Under Depreciation Fund, investment may be sold at a discount, thus sufficient money may not be available from investment. In the case of Insurance policy system, however, the Insurance Co. will pay the stipulated amount to replace the asset. This method is not suitable for those assets to which many additions are made during the year and the life of which cannot be estimated with any precision. It is suitable for leases, where the life of the asset is definitely known.

6. Depletion or Output Method

In the case of wasting Assets such as Mines & Quarries, which have to be replaced, Depreciation is provided on the basis of depletion of the asset caused due to generation of output. Under this method total cost of the asset is compared with the estimated total contents of the mine. and depreciation per unit of out put is calculated. Thus if a mine estimated to contain 1,00,000 tons of Coal is acquired for Rs. 50,0000 the amount of depreciation to be provided will be 50 paise per ton of coal raised. If the output in a particular year is 20,000 tonnes, depreciation will be 20,000 x .5 i.e Rs 10,000.

7. Revaluation Method

Under this method, the asset, is revalued each year and the resulting depreciation is charged to profit & Loss A\c. It is suitable for assets which constantly change and whose life is uncertain, e.g. Live stock, Loose tools etc.

3.3 EXAMPLES- SUMS

Question No.1 Calculate the Rate of Depreciation under Straight Line Method (SLM) from the following:

Purchased a second-hand machine for ₹ 96,000, spent ₹ 24,000 on its cartage, repairs and installation, estimated useful life of machine 4 years. Estimated residual value ₹ 72,000.

ANSWER:

Amount of Depreciation=Cost of Machine−Scrap Value of Machine Life i n Years =1,20,000−72,000/4=Rs 12,000

Rate of Depreciation=Amount of Depreciation/Cost of Machine×100 =12,000/1,20,000×100=10%p.a.

Question No.2 On 1st April, 2015, X Ltd. purchased a machine costing ₹ 4,00,000 and spent ₹ 50,000 on its installation. The estimated life of the machinery is 10 years, after which its residual value will be ₹ 50,000 only. Find the amount of annual depreciation according to the Fixed Instalment Method and prepare Machinery Account for t he first three years. The books are closed on 31st March every year.

ANSWER:

Book of X Ltd.
Machinery Account
Dr. **Cr.**

Date	Particulars	J.F.	Amount (Rs)	Date	Particulars	J.F.	Amount (Rs)
2015 April 01	Bank		4,00,000	2016 Mar.31	Depreciation		40,000
April 01	Bank (Erection Expense)		50,000		Balance c/d		4,10,000
			4,50,000				4,50,000
2016 April 01	Balance b/d		4,10,000	2017 Mar.31	Depreciation		40,000
					Balance c/d		3,70,000
			4,10,000				4,10,000
2017 April 01	Balance b/d		3,70,000	2018 Mar.31	Depreciation		40,000
					Balance c/d		3,30,000
			3,70,000				3,70,000

Calculation of Depreciation:

Depreciation p.a.=4,00,000+50,000−50,000(Scrap Value)10 years
=Rs 40,000 p.a.

Question 3:

On 1st April, 2014, furniture costing ₹ 55,000 was purchased. It is estimated that its life is 10 years at the end of which it will be sold for ₹ 5,000. Additions are made on 1st April 2015 and 1st October, 2017 to the value of ₹ 9,500 and ₹ 8,400 (Residual values ₹ 500 and ₹ 400 respectively). Show the Furniture Account for the first four years, if Depreciation is written off according to the Straight Line Method.

ANSWER:

Furniture Account

Dr. **Cr.**

Date	Particulars	J.F.	Amount (Rs)	Date	Particulars	J.F.	Amount (Rs)
2014				2015			
April 01	Bank (F1)		55,000	March 31	Depreciation (F1)		5,000
				March 31	Balance c/d (F1)		50,000
			55,000				55,000
2015				2016			
April 01	Balance b/d (F1)		50,000	March 31	Depreciation		
April 01	Bank (F2)		9,500		F1 5,000		
					F2 900		5,900
				March 31	Balance c/d		
					F1 45,000		
					F2 8,600		53,600
			59,500				59,500
2016				2017			
April 01	Balance b/d			March 31	Depreciation		
	F1 45,000				F1 5,000		
	F2 8,600		53,600		F2 900		5,900
				March 31	Balance c/d		
					F1 40,000		
					F2 7,700		47,700
			53,600				53,600
2017				2018			

April 01	Balance b/d			March 31	Depreciation		
	F1 40,000				F1 5,000		
	F2 7,700		47,700		F2 900		
Oct. 01	Bank (F3)		8,400		F3 400		6,300
				March 31	Balance c/d		
					F1 35,000		
					F2 6,800		
					F3 8,000		49,800
			56,100				56,100

Working Notes:

$$\text{Depreciation on F1} = \frac{55,000 - 5,000\,(\text{Scrap Value})}{10\text{ years}} = \text{Rs}\,5,000\text{ p.a.}$$

$$\text{Depreciation on F2} = \frac{9,500 - 500\,(\text{Scrap Value})}{10\text{ years}} = \text{Rs}\,900\text{ p.a.}$$

$$\text{Depreciation on F3} = \frac{8,400 - 400\,(\text{Scrap Value})}{10\text{ years}} = \text{Rs}\,800\text{ p.a.}$$

$$\therefore \text{ Depreciation on F3 (for Six Months)} = 800 \times \frac{6}{12} = \text{Rs}\,400$$

Question 4:

On 1st April, 2014, *A* Ltd. purchased a machine for ₹ 2,40,000 and spent ₹ 10,000 on its erection. On 1st October, 2014 an additional machinery costing ₹ 1,00,000 was purchased. On 1st October, 2016, the machine purchased on 1st April, 2014 was sold for ₹ 1,43,000 and on the same date, a new machine was purchased ata cost of ₹ 2,00,000.

ANSWER:

Machinery Account

Dr. **Cr.**

Date	**Particulars**	**J.F.**	**Amount (Rs)**	**Date**	**Particulars**		**J.F.**	**Amount (Rs)**
2014				2015				
April 01	Bank (M1)		2,50,000	March 31	Depreciation			
Oct. 01	Bank (M2)		1,00,000		M1	12,500		
					M2 (6 Months)	2,500		15,000
				March 31	Balance c/d			
					M1	2,37,500		
					M2	97,500		3,35,000

Date	Particulars	Amount (Rs)	Date	Particulars	Amount (Rs)
		3,50,000			3,50,000
2015 April 01	Balance b/d M1 2,37,500 M2 97,500	3,35,000	2016 March 31	Depreciation M1 12,500 M2 5,000	17,500
			March 31	Balance c/d M1 2,25,000 M2 92,500	3,17,500
		3,35,000			3,35,000
2016 April 01	Balance b/d M1 2,25,000 M2 92,500	3,17,500	2016 Oct. 01	Depreciation (for 6 months)	6,250
			Oct. 01	Bank (M1 sold)	1,43,000
			Oct. 01	Profit and Loss (loss on sale)	75,750
July 01	Bank (M3)	2,00,000	2017 March 31	Depreciation M2 5,000 M3 (for 6 months) 5,000	10,000
			March 31	Balance c/d M2 87,500 M3 1,95,000	2,82,500
		5,17,500			5,17,500
2017 April 01	Balance b/d M2 87,500 M3 1,95,000	2,82,500	2018 March 31	Depreciation M2 5,000 M3 10,000	15,000
			March 31	Balance c/d M2 82,500 M3 1,85,000	2,67,500
		2,82,500			2,82,500

Working Notes:

1. Calculation of Deprecation

Machine 1 $2,50,000 \times \frac{5}{100} = \text{Rs}12,500 \text{ p.a}$

Machine 2 $1,00,000 \times \frac{5}{100} = \text{Rs}5,000 \text{ p.a}$

Machine 3 $2,00,000 \times \frac{4}{100} = \text{Rs}10,000 \text{ p.a}$

2. Calculation of profit or loss on sale of Machine 1

Particulars	**Amount (Rs)**
Book Value on April 01, 2016 *Less*: Deprecation for six month	2,25,000 (6,250)
Book Value on Oct. 01, 2016 *Less*: Sale Proceeds	2,18,750 (1,43,000)
Loss on Sale of Machine	75,750

Question 5:

From the following transactions of a concern, prepare the Machinery Account for the year ended 31st March, 2018:

1st April, 2017	:	Purchased a second-hand machinery for ₹ 40,000
1st April, 2017	:	Spent ₹ 10,000 on repairs for making it serviceable.
30th September, 2017	:	Purchased additional new machinery for ₹ 20,000.
31st December, 2017	:	Repairs and renewals of machinery ₹ 3,000.
31st March, 2018	:	Depreciate the machinery at 10% p.a.

ANSWER:

Machinery Account

Dr. **Cr.**

Date	Particulars	J.F.	Amount (Rs)	Date	Particular	J.F.	Amount (Rs)
2017				2018			
Apr.01	Bank (M1)		50,000	Mar.31	Depreciation		
Sept 30	Bank (M2)		20,000		M1 5,000		
					M2 (6 months) 1,000		6,000
				Mar.31	Balance c/d		
					M1 45,000		
					M2 (6 months) 19,000		64,000
			70,000				70,000

Note: Repair and renewal made on December 31, 2017 will not be recorded in Machinery Account because, this repair was made after putting the Machinery into use.

Question 6:

An asset was purchased for ₹ 10,500 on 1st April, 2011. The scrap value was estimated to to be ₹ 500 at the end of asset's 10 years' life. Straight Line Method of depreciation was used. The accounting year ends on 31st March every year. The asset was sold for ₹ 600 on 31st March, 2018. Calculate the following.

(i) The Depreciation expense for the year ended 31st March, 2012.

(ii) The net book value of the asset on 31st March, 2016.

(iii) The grain or loss on sale of the asset on 31st March, 2018.

ANSWER:

Asset Account

Dr. **Cr.**

Date	Particulars	J.F.	Amount (Rs)	Date	Particulars	J.F.	Amount (Rs)
2011				2012			
April 01	Bank		10,500	Mar.31	Depreciation		1,000
				Mar.31	Balance c/d		9,500
			10,500				10,500
2012				2013			
April 01	Balance b/d		9,500	Mar.31	Depreciation		1,000
				Mar.31	Balance c/d		8,500
			9,500				9,500
2013				2014			
April 01	Balance b/d		8,500	Mar.31	Depreciation		1,000
				Mar.31	Balance c/d		7,500
			8,500				8,500
2014				2015			
April 01	Balance b/d		7,500	Mar.31	Depreciation		1,000
				Mar.31	Balance c/d		6,500
			7,500				7,500
2015				2016			
April 01	Balance b/d		6,500	Mar.31	Depreciation		1,000
				Mar.31	Balance c/d		5,500
			6,500				6,500
2016				2017			
April 01	Balance b/d		5,500	Mar.31	Depreciation		1,000
				Mar.31	Balance c/d		4,500
			5,500				5,500
2017				2018			
April 01	Balance b/d		4,500	Mar.31	Depreciation		1,000
				Mar.31	Bank		600
				Mar.31	Profit and Loss (Loss)		2,900
			4,500				4,500

(i) Depreciation Expense for the year ended March 31, 2012 is Rs 1000

(ii) The Net Book Value of the asset on March 31, 2016 is Rs 5,500

(iii) Loss on Sale of the asset on March 31, 2018 is Rs 2,900

Question 7:

A Van was purchased on 1st April, 2015 for ₹ 60,000 and ₹ 5,000 was spent on its repair and registration. On 1st October, 2016 another van was purchased for ₹ 70,000. On 1st April, 2017, the first van purchased on 1st April, 2015 was sold for ₹ 45,000 and a new van costing ₹ 1,70,000 was purchased on the same date. Show the Van Account from 2015-16 to 2017-18 on the basis of Straight Line Method, if the rate of Depreciation charged is 10% p.a. Assume that books are closed on 31st March every year.

ANSWER:

Van Account

Dr. **Cr.**

Date	**Particulars**	**J.F.**	**Amount (Rs)**	**Date**	**Particulars**	**J.F.**	**Amount (Rs)**
2015				2016			
April 01	Bank (I)		65,000	March 31	Depreciation (I)		6,500
				March 31	Balance c/d (I)		58,500
			65,000				65,000
2016				2017			
April 01	Balance b/d (I)		58,500	March 31	Depreciation		
Oct. 01	Bank (II)		70,000		(I) 6,500		
					(II) 3,500 (*for 6 month*)		10,000
				March 31	Balance c/d		
					(I) 52,000		
					(II) 66,500		1,18,500
			1,28,500				1,28,500
2017				2017			
April 01	Balance b/d			April 01	Bank (I)		45,000
	(I) 52,000			April 01	Profit and Loss (*Loss on Sale*)		7,000
				2018			
	(II) 66,500		1,18,500	March 31	Depreciation		
April 01	Bank (III)		1,70,000		(II) 7,000		
					(III) 17,000		24,000
				March 31	Balance c/d		
					(II) 59,500		
					(III) 1,53,000		2,12,500
			2,88,500				2,88,500

Working Notes

1. Calculation of Annual Depreciation

Maruti Van (I)= 65,000*10%=Rs.6,500

Maruti Van (II)= 70,000*10%=Rs.7,000

Maruti Van (III)= 1,70,000*10%=Rs.17,000

2. Calculation of profit or loss on sale of Van (I)

Particulars	Amount (Rs)
Book Value on Apr. 01, 2017 *Less*: Sale of Van	52,000 (45,000)
Loss on Sale of Van	7,000

Question 8:

A company whose accounting year is a financial year, purchased on 1st July, 2014 machinery costing ₹ 30,000.

It purchased further machinery on 1st January, 2015 costing ₹ 20,000 and on 1st October, 2015 costing ₹ 10,000.

On 1st April, 2016, one-third of the machinery installed on 1st July, 2014 became obsolete and was sold for ₹ 3,000.

Show how Machinery Account would appear in the books of the company. It being given that machinery was depreciated by Fixed Instalment Method at 10% p.a. What would be the value of Machinery Account on 1st April, 2017?

ANSWER:

Machinery Account

Dr. **Cr.**

Date	Particulars	J.F.	Amount (Rs)	Date	Particulars		J.F.	Amount (Rs)
2014				2015				
July 01	Bank (I)		30,000	March 31	Depreciation			
2015								
Jan. 01	Bank (II)		20,000		I (*for 9 months*)	2,250		
					II	500		2,750
				March 31	Balanced c/d			
					I	27,750		
					II	19,500		47,250
			50,000					50,000
2015				2016				

April 01	Balance b/d			March 31	Depreciation		
	I 27,750				I 3,000		
	II 19,500		47,250		II 2,000		
					III 500		5,500
Oct. 01	Bank (III)		10,000	March 31	Balance c/d		
					I 24,750		
					II 17,500		
					III 9,500		51,750
			57,250				57,250
2016				2016			
April 01	Balance b/d			April 01	Bank I(1/3rd portion)		3,000
	I 24,750			April 01	Profit and Loss (Loss on Sale of I)		5,250
				2017			
	II 17,500			March 31	Depreciation		
	III 9,500		51,750		I (on 2/3rd portion) 2,000		
					II 2,000		
					III 1,000		5,000
				March 31	Balance c/d		
					I (on 2/3rd portion) 14,500		
					II 15,500		
					III 8,500		38,500
			51,750				51,750

Working Notes

1. Calculation of Depreciation

$$\text{Machine I} = 30,000 \times \frac{10}{100} = \text{Rs}\,3,000 \text{ p.a}$$

$$\text{and Depreciation of } 2/3^{rd} \text{ Portion } = 3,000 \times \frac{2}{3} = \text{Rs}\,2,000$$

$$\text{Machine II} = 20,000 \times \frac{10}{100} = \text{Rs}\,2,000 \text{ p.a}$$

$$\text{Machine III} = 10,000 \times \frac{10}{100} = \text{Rs}\,1,000 \text{ p.a}$$

Calculation of profit or loss on sale of 1/3rd Portion of Machine I

Particulars	**Amount (Rs)**
Book Value of 1/3rd portion of Machine I on April 01, 2016 (24,750 × 1/3)	8,250
Less: Sale Value	(3,000)
Loss on sale	5,250

3.4 TRIAL BALANCE

Meaning : A trial balance is **a bookkeeping worksheet in which the balance of all ledgers are compiled into debit and credit account column totals that are equal**. A company prepares a trial balance periodically, usually at the end of every reporting period.

The famous writer R.N. Carter says;

A trial balance is a schedule or a list of balances both debit and credit extracted from the accounts in the ledger and including the cash and bank balances from the cash book.

According to J.R. Batliboi,

A trial balance may be defined as a statement of debit and credit balances extracted from the ledger with a view to testing the arithmetical accuracy of the books.

3.4.1 Characteristics of Trial Balance

It appears from the definitions of trial balance that the trial balance contains the following features;

1. The trial balance is neither an account nor a part of it. It is a statement containing all balances of ledger accounts.
2. It is not recorded in any book of account. The trial balance is prepared in a separate sheet or paper.
3. The trial balance is prepared with the balances of accounts at the end of a particular accounting period. A trial balance is prepared before the preparation of financial statements at the end of the accounting period.
4. The statement contains all kinds of accounts, irrespective of their classifications, such as assets liabilities, income-expenses etc. It helps to test the arithmetical accuracy of accounts.

3.4.2. Objects of Trial Balance

Although trial balance is not an account, it is prepared to fulfill the following objects;

- The main object of the trial balance is to proof the arithmetical accuracy of accounts.
- It is prepared to check whether the debit and credit accounts of each transaction have been recorded properly.
- For the convenient preparation of financial statements, the trial balance is prepared to bring debit and credit ledger balances together.
- To proof accurate balancing of a ledger account.
- To detect mistakes in the process of accounts, if any.
- To provide information to the proper authority in time.
- To compare the balances of various ledger accounts of the current year with those of previous year.

3.4.3. How to Prepare a Trial Balance

Business transactions are first recorded in the journal and thereafter these are posted in the ledger under different heads of accounts.

It may be mentioned that transactions may directly be posted in the ledger accounts without recording them in the journal.

At the end of a particular accounting period, a trial balance is prepared in a separate sheet of prescribed form recording debit ledger balance, in debit column and credit ledger balances in credit money column.

Besides ledger balances, cash balance and bank balance of cash book of that particular date are also included in the trial balance.

Thereafter total of debit and credit money columns of a trial balance is calculated. Agreement of trial balance is the conclusive evidence of the accuracy of the ledger and trial balance.

3.4.5. The format for Preparing Trial Balance

A short description of the format of the trial balance is given below:

1. **Titles:** In the middle of the format name of the company, the trial balance and date of preparation are written.
2. **Accounts serial number:** In this column, the serial numbers of ledger accounts are written.

3. **Account Titles:** The serial number of that account of the ledger which has been written in the first column, the full title of that account is written in this column. For example, Capital account, Furniture account, Cash account etc.

4. **Ledger Folio:** The number of the ledger page from where ledger balances are brought is written in this column.

5. **Debit balance:** All debit balances of ledger accounts are written in this column.

6. **Credit balance:** All credit balances of ledger accounts are written in this column.

3.4.6. Important to remember:

1. Opening cash and bank balance is not shown in the trial balance as these are included in closing cash and bank balances.

2. Closing stock is not shown in the trial balance because this remains included with opening stock and purchase of the accounting year. But if opening stock and purchase remain absent in trial balance and adjusted purchase is shown in the trial balance, in that case, the closing stock is shown in the debit money column of the trial balance.

Sum- Example

Q1. From the following balances extracted by M/s Mohanlal & Co. You are required to prepare their trial balance. these balances are as on 31.3.2019

	Rupees		***Rupees***
Capital a/c of Mohanlal	45,000	Sundry Creditors	27,000
Drawings a/c of Mohanlal	9,000	Bills payable	18,000
Sales	60,000	Bad debts	1,500
Purchases	24,000	Advertisements	1,500
Salaries	1,500	Building	30,000
Wages	4,500	Machinery	43,500
Sales returns	3,000	Interest Received	1,500
Purchase returns	1,500	Sundry receipts	3,000
Rates and taxes	3,000	Furniture and Fixtures	30,000
Sundry expenses	1,500	Cash on hand	3,000
Sundry debtors	15,000	Overdraft with Dena Bank	15,000

Soln: **Trial Balance as on 31/3/2019 for M/S.Mohanlal & Co**

Particulars	Dr. Rs.	Cr. Rs.
Capital a/c of Mohanlal		45000
Drawings a/c of Mohanlal	9000	
Sales		60,000
Purchases	24000	
Salaries	1500	
Wages	4500	
Sales returns	3000	
Purchase returns		1500
Rates and taxes	3000	
S.Exp	1500	
S. Debtors	15,000	
S. Credtiors		27000
Bills payable		18000
Bad debts	1500	
Advertisements	1500	
Building	30,000	
Machinery	43,500	
Interest received		1500
S. Receipts (various income)		3000
Furniture & Fix	30,000	
Cash on Hand	3000	
Overdraft with dena bank		15000
Total	**171000**	**171000**

Review Questions:

1. Difference between Ledger V/S Trial Balance
2. Difference between WDV Method and SLM.

❄❄❄❄❄❄❄

4

INTRODUCTION TO FINAL ACCOUNTS OF A SOLE PROPRIETOR

Unit Structure:

LEARNING OBJECTIVES

After studying this unit, you will be able to:

- Make out various accounts, which are the parts of final accounts
- Understand the various items of Manufacturing Account, Trading Account, Profit & Loss Account and Balance Sheet
- Form and Layout of Final Accounts
- Adjusting and Closing entries

4.01 INTRODUCTION

Meaning of a Sole Trader

A sole trader, also known as a sole proprietorship, is a simple business structure in which one individual runs and owns the entire business. A sole trader is entitled to keep all profits after taxes have been deducted but is also liable for all losses the business incurs. Sole-trading business is carried on by one person with his own funds and according to his managerial capabilities. The sole trader carries on business by himself and for himself. He is the proprietor, manager and controller of business

Meaning of Final Accounts

Initially, the transactions are recorded in the Journal of the company, which is then reflected in the individual **ledgers** maintained for the relative transaction type & party. The closing balance of this ledger is maintained in the **Trial Balance**, which shows equal debit and credit side for the period. Then for providing the status & performance of the business organization for the specified period (i.e., a year, half-year, quarter, etc.), Final accounts are prepared which includes Trading Account for **calculation of Gross profit** (now generally inclusive with the statement of profit & loss), Statement of Profit & Loss for net profit earned during the period and Balance Sheet which provide the **Assets & Liabilities** of the entity at the period end.

Features of Final Accounts

1. The final account is legally required for the entities. The **financial accounting** and preparation of Financial statements are obligatory for the entities and getting those accounts audited.

2. These accounts are prepared to present and provide the entity's financial performance and status to the stakeholders, users, investors, promoters, etc.

3. The presentation of comparable figures for the current period from the previous period increases the utility of the statements of accounts.

4. It presents an accurate & fair view of the organization's financial performance by providing accurate & full information regarding the business with proper notes and disclosures of the real facts.

Objectives of Final Accounts

1. They are prepared to calculate Gross profit & net profit earned by the organization for the relevant period by presenting the **Statement of Profit & Loss**.

2. The Balance sheet is prepared to provide the company's correct financial position as of the date.

3. These accounts use the bifurcation of **direct expenses** to obtain the gross profit & loss and bifurcation in **indirect expenses** to ascertain the organization's net profit & loss.

4. Through the Balance sheet, these accounts bifurcate the assets & liabilities as per the holding & usage periods of the same.

Overview of the Final Accounts of sole proprietor can be explained with the help of the following chart

Sole Proprietor

Non Manufacturing Business Units | **Manufacturing Business Units**

Final Accounts | **Final Accounts**

Non Manufacturing Business Units	Manufacturing Business Units
Final Accounts	**Final Accounts**
- Trading A/c	**- Manufacturing A/c**
- Profit & Loss A/c	**- Trading A/c**
- Balance Sheet	**- Profit & Loss A/c**
	- Balance Sheet

Let us discuss the meaning and format of above accounts in detail.

4.02 MANUFACTURING ACCOUNT

Manufacturing Account is prepared by manufacturing firms to ascertain the "Cost of Goods" manufactured during an accounting period. It is closed by transferring its balance to the debit side of Trading Account. The manufacturing account gives information on all the expenses and costs incurred in the preparation of the goods to be sold. This includes the expenses that are met in the path of preparing the goods but not the finished goods. Any type of expenses including the cost of raw materials, the cost of machines and their maintenance, the salaries and wages of both skilled and unskilled workers which are considered as the direct expenses of the manufacturing. Even the depreciation of the assets like costly machines and plants are also included under this account.

Manufacturing A/c for the year ended ....

Particulars	Amt	Amt	Particulars	Amt	Amt
To Work in Progress (Opening)		xx	**By Work in Progress (Closing)**		xx
To Raw Materials Consumed			**By Sale of Scrap**		xx
Opening Stock	xx				
Add: Purchases	xx		**By Cost of Production trf. To Trading Account**		xx
Add: Purchase Expenses					
- Carriage Inward	xx				
- Octroi Duty	xx				
- Customs Duties	xx				
Less: Purchase Returns	(xx)				
Less: Closing Stock	(xx)	xx			
To Direct Wages		xx			
To Direct Mfg. Expenses					
- Hire of Machinery	xx				
- Royalty related to Mfg.	xx				
- Design Expenses	xx	xx			
To Direct Factory Expneses					
- Stores, Oil, Grease	xx				
- Power & Fuel	xx				
- Repairs to Factory Assets	xx				
- Rent, lighting of Factory bldg	xx	xx			
		xxx			xxx

The purpose of preparing the Manufacturing Account is to ascertain the cost of goods manufactured. Therefore, it should include all the expenses relating to manufacture of goods such as purchase of raw materials, carriage and freight on purchase of materials and other expenses incurred in the production process i.e. conversion of raw materials in to finished goods.

Major Manufacturing expenses are as follows.

1. **Direct Materials** – These are the raw materials from which finished goods are manufactured. Raw Materials consumed is arrived as follows.

Opening Stock of Raw Materials	xx
Add – Purchase of Raw Materials	Xx
Less – Purchase Returns	Xx
Less – Closing Stock of Raw Materials	Xx
	xxx

2. **Work in Progress / Semi Finished Goods** – The value of opening WIP appears on Dr side and value of closing WIP appears on Cr side of manufacturing account. This represents materials put in to process.

3. **Direct Labor** – It is the amount of wages paid to the workers who are employed in the production process

4. **Manufacturing Expenses/Factory or Production Overheads** – These are expenses incurred in the factory like rent, rates, taxes, electricity, salaries, insurance, depreciation of factory building, plant and machinery, amortization of patents, water, heat, light and parts used in the factory, power & fuel, factory stores & spares, factory supervision etc.

5. **Sale of Scrap** – In a production process there may be certain scrap which may or may not have a sale value. Amount of scrap is credited in manufacturing account.

6. **Cost of Production** – It is the cost of manufacturing the goods. It is the excess of debit side total of manufacturing account over its credit side total. It is the balance in the manufacturing account which is transferred to Trading Account.

4.03 TRADING ACCOUNT

It shows the result of buying & selling of goods and/or services during an accounting period. The main purpose is to ascertain the gross profit or gross loss. Gross Profit or Gross Loss is the difference between Sales Value and Cost of Goods Sold. Trading Account records trading transactions of a businessman.

Trading and manufacturing business firms deal in sales and purchases of goods. Therefore, only manufacturing and trading entities prepare the trading account. Trading account gives details of total sales, total purchases and direct expenses relating to purchase and sales. It shows gross profit of business activities during a specific period.

In case of trading concern or where manufacturing account is not prepared, Trading account will also include other expenses for receipt or manufacture of goods.

Trading A/c for the year ended					
Particulars	**Amt**	**Amt**	**Particulars**	**Amt**	**Amt**
To Opening Stock		xx	By Sales	xx	
To Purchases	xx		Less: Sales Returns	xx	
Less: Purchase Returns	xx	xx	By Goods lost / destroyed		xx
To Direct Purchase Exp.		xx	By Goods taken by Proprietor		xx
To Manufacturing A/c		xx	By Goods given as free samples		xx
(Cost of Production trf.)			By Closing Stock		xx
To Gross Profit B/f		xx	By Gross Loss C/f		xx
		xxx			**xxx**

Trading Account contains the following details

- Opening stock details of Finished Goods and in case where manufacturing account is not prepared then it also includes opening stock details of Raw Material, Semi-Finished Goods (WIP)
- Closing stock details of Finished Goods, raw material and semi-finished goods
- Total purchases of goods less Purchase Returns.
- Total sales of goods less Sales Returns.
- All direct expenses related to purchases or sales or manufacturing of goods.

Items of Income (Cr.) side

- Total sales of goods fewer Sales returns
- Closing stock of goods.
- Drawings in the form of goods, goods issued as samples or goods lost by accidents

Items of Expenditure (Dr.) Side

- Opening stock of goods
- Total purchases of goods Less purchase returns
- All direct expenses like Carriage inward & Freight expenses, rent for go-down or factory, Electricity and Power expenses, wages of workers and supervisors, Packing expenses, etc.

Balancing of Trading Account

After recording all the expenses and incomes as mentioned above to trading account, it is closed by transferring the balance – Gross Profit or Gross Loss – to Profit & Loss Account. If Cr side > Dr Side = it's Gross Profit and Dr side > Cr side = it's Gross Loss.

4.04 PROFIT & LOSS ACCOUNT

It is a part of financial statement, which shows the result of business operations conducted during the year. The purpose is to find out net profit earned or net loss incurred during the year. It contains all indirect expenses and losses (other than those shown on debit side of trading account) which are shown on its debit side and all indirect incomes and gains (other than those shown on credit side of trading account) which are shown on its credit side.

All indirect expenses and losses (other than those shown on debit side of Trading A/c) are shown on debit side of P&L A/c, whereas all indirect resource incomes and gains (other than those shown on credit side of Trading A/c) are shown on credit side of Profit & Loss A/c

Profit & Loss A/c may be prepared showing separately the expenses as under:

1. Administration Exp., 2. Selling Exp., 3. Distribution Exp., 4. Finance Charges

Explanation of Indirect or Other Expenses and Gains

- All indirect expenses are transferred to debit side of Profit & Loss A/c. Any loss occurred by fire or accident is also debited to Profit & Loss Account
- Discount allowed to customers (Debtors) is a loss and should be debited to P&L A/c and Discount earned from suppliers (Creditors) is a gain and should be credited to P&L A/c
- Commission on sales to agents and salesmen paid is expenditure and should be debited to P&L A/c and commission received being gain, to be credited to P&L A/c
- Interest paid on capital or loans taken, being expense should be debited to P&L A/c and Interest received on loans given, being gain, to be credited to P&L A/c
- Bad Debts are the debts or dues from customers, which are not recoverable. It is a loss to the business, therefore, debited to P&L A/c
- Salaries and wages – sometimes only one account is kept for both salaries and wages. When the amount of wages is small such combined account is opened. In such case full amount to be debited to P&L A/c. But if the item is Wages and Salaries, it is transferred to

Trading A/c on the assumption that wages is a major part of this expenditure

- Trade Expenses also known as sundry expenses or miscellaneous expenses or petty expenses are charged to P&L A/c debit side
- Income Tax is a tax in income. It should not be treated as expenses of the business. Therefore, it is not debited to P&L A/c. In case of sole trader, it is debited to Capital Account or added to Drawings

Balancing of Profit & Loss A/c

After transferring all expenses and losses of the business to Debit, and all incomes and gains of the business to Credit side of P&L A/c, it is balanced.

If Credit Side > Debit Side then difference is Net Profit

If Debit Side > Credit Side then difference is Net Loss

in case of sole proprietor and partnership business, net profit is added to the Capital and net loss is deducted from the capital.

Profit & Loss A/c for the year ended					
Particulars	**Amt**	**Amt**	**Particulars**	**Amt**	**Amt**
To Gross Loss B/d		xx	By Gross Profit B/d		xx
To Administrative Expenses			**By Other Income or Gains**		
- Rent, Insurance, Repairs	xx		- Commission recd	xx	
- Office Salaries	xx		- Discount recd	xx	
- Postage, teleph & telex	xx		- Dividend recd	xx	
- Printing & Stationery	xx		- Interest recd	xx	
- Fees (legal/audit)	xx		- Profit on sale of assets	xx	
- General Expenses	xx	xx			
To Selling & Distribution Exp.					
- Salesman's salaries, commission	xx				
- Travelling	xx				
- Carriage, freight, duties	xx				
- Warehousing charges	xx				
- Packing expense	xx				
- Advtg & sales promotion	xx				
- Goods given as free samples	xx	xx			
To Financial Expenses					
- Interest & bank charges	xx				
- Bad debts & prov for bad debts	xx				
- Discounts given	xx	xx			
To Depreciation					
- on Machinery, Computers	xx				
- on Furniture & Fixtures	xx				
- Building, Office Equipments	xx	xx			
To Unusual Exp or losses					
- Goods lost/destroyed	xx				
- Loss on sale of fixed assets	xx	xx			
To Appropriations					
- Income tax	xx				
- Reserves	xx	xx			
To Net Profit trf to Capital A/c		xx			
		xxx			**xxx**

4.05 BALANCE SHEET

A Balance Sheet is a statement (not an account) of the total assets and liabilities of an organization at a particular date- usually the last date of an accounting period. Objective is to ascertain the financial position of a concern. It shows the nature and value of assets and the nature and value of liabilities and the position of capital. It is always prepared on a certain date and not for a particular period. It is divided in to two sides. The left hand side is "**Liabilities**" and right hand side is **"Assets"**. It is a summary of balances of those ledger accounts, which have not been closed by transfer to Trading and Profit & Loss A/c. It shows financial position of the business.

Balance Sheet As at …….					
LIABILITIES	**Amt**	**Amt**	**ASSETS**	**Amt**	**Amt**
Capital Account			**Fixed Assets**		
Opening Balance	xx		Goodwill /Land		xx
Add: New Capital brought in	xx		Plant & Machinery	xx	
Add: Net profit during the year	xx		**Less - Depreciation**	xx	xx
Less: Drawings	xx		Premises/Building / Vehicles	xx	
Less: Net loss during the year	xx	xx	**Less - Depreciation**	xx	xx
			Furniture & Fittings	xx	
			Less - Depreciation	xx	xx
Reserves & Surplus			**Investments**		
General Reserve		xx	Investments in shares & bonds		xx
Loans (Secured/Unsecured)			**Current Assets, Loans & Advances**		
Loans from Bank		xx	Closing Stock		xx
Bank Overdraft		xx	Debtors		xx
			Loans & Advances given		xx
Current Liabilities & Provisions			Bills receivable		xx
Creditors		xx	Prepaid Expense		xx
Bills Payables		xx	Cash at Bank		xx
Outstanding expenses		xx	Cash in Hand		xx
Income received in advance		xx			
			Fictitious Assets		
			Deferred Expense not w/off		xx
			Capital A/c Debit balance		xx
		xxx			**xxx**

Form and Layout

The Balance Sheet is generally prepared in T Form having two sides, one to show the assets and the other liabilities. The left-hand side is generally called as the Liabilities side and the right-hand side is called the Asset side. This is called the Traditional Form. Now a days the Balance Sheet is also prepared in the vertical of T form in a way a layman can understand.

4.06 CLASSIFICATION OF ASSETS

Assets are classified in to (1) Fixed Assets, (2) Floating or Current Assets and (3) Fictitious Assets

Fixed Assets – are the assets of a permanent nature, which are used in business as long as they are held and useful. These assets are not meant for resale. Business is carried on with the help of these assets. Examples are Machinery, Building, Office Equipment, Plant, Patent Rights etc.

Types of Fixed Assets

1. **Tangible Fixed Assets** – Have physical existence and can be seen by eyes. E.g. Land, Building, Machinery, Furniture etc.

2. **Intangible Fixed Assets** – Have no physical existence and which cannot be seen. E.g. Goodwill, Patents, Copyrights etc.

Floating/Current Assets/Circulating Assets – Assets which are held temporarily and which are meant for resale or consumption in business. They change from time to time. E.g. Cash and Bank, Sundry Debtors, Bills Receivables, Stock etc.

Fictitious Assets – These are those assets which are not represented by anything concrete. There is no tangible property or asset representing it. They cannot be converted into cash. E.g. preliminary expenses, discount on issue of shares and debentures etc.

4.07 CLASSIFICATION OF LIABILITIES

Liabilities can be classified into (1) Fixed (2) Current and (3) Contingent Liabilities

Fixed Liabilities – Liabilities which are redeemed or repaid after a long period of time. E.g. are Long term loans and capital.

Current Liabilities – Liabilities which are to be paid or discharged in the near future, usually within a year. E.g. Creditors, Bank Overdraft, Outstanding Expenses, Bills Payable etc.

Contingent Liabilities – These are not actual liabilities, but they may become actual liability on happening of certain events. If expected event does not occur, no liability or loss will arise. E.g. suit filed against the business for a claim, not admitted by the business. The liability will arise if Court decides against the concern and in favour of the claimant, otherwise there will be no liability. Other examples would be liability on partly paid shares and debentures held as investment, liability of bill discounted etc.

Arrangements of Assets and Liabilities

Balance sheet is generally prepared in "T" form having two sides, one to show the assets and the other liabilities. Left hand side is generally called as Liabilities side and the right-hand side is called the Assets side. For sole proprietorship and partnership organizations there is no prescribed form of Balance Sheet. A sole trader may arrange the assets and properties in the order of liquidity or in the order of permanency.

4.08 ADJUSTMENT / CLOSING ENTRIES

1	**Every Adjustment has two effects, one in B/S & other is in either Trading A/c or in P/L A/c**	
2	**Normally adjustments are related to the following items**	
a	**Closing stock (to be valued at cost price or market price which ever is less)**	
	Closing Stock A/c ... Dr	(shown on Asset Side)
	To Trading A/c .....Cr	(Shown on Trading A/c Cr Side)
b	**Depreciation**	
	Entry for Charging Depreciation	
	Depreciation A/c....... Dr	(Shown in profit & loss A/c Dr. Side)
	To Assets A/c........Cr	(shown as deduction from Asset)
	Entry for Transferring depreciation to profit & loss A/c	
	P/L A/c...................Dr	
	To Deprn A/c ....Cr	
c	**Outstanding Expenses (Expenses Payable)**	
	Expenses A/c.............Dr	(Shown in profit & loss A/c Dr. Side)
		or add in the concerned expenses)
	To O/s Expenses A/c...Cr	(Shown as Liability in B/S)
d	**Prepaid Expenses (expense paid in advance)**	
	Prepaid Expenses A/c......Dr	(Shown as Asset in B/S)
	To Expenses A/c.......Cr	(Shown in Profit & Loss A/c Cr. Side)
		or reduce from the concerned expense
e	**Goods distributed as free samples /Loss by fire/Loss by theft etc.**	
	Goods (Free Samples) A/c ....Dr	(Show as expense in P/L A/c)
	To Trading A/c....Cr	(show in Trading A.c Cr. Side)
f	**Bad debts written off**	
	Bad Debts A/c .....Dr.	(shown in P/L A/c Dr. side)
	To Debtors A/c...Cr	(Deduct from Debtors in B/S)
g	**Provision for doubtful debts**	
	Doubtful Debts A/c ...... Dr.	(shown in P/L A/c Dr. side)
	To Prov. for Doubtful Debts a/c	(Shown in liability side)
h	**Outstanding Income**	
	Outstanding Income A/c....Dr	(Show as Assets in B/S)
	To Income A/c .... Cr	(show in P/L A/c Cr.Side)
i	**Prepaid Income**	
	Income A/c ....Dr	(Deduct from the income in P/L A/c)
	To Prepaid Income A/c..Cr	(Show as liability)
j	**Interest on Capital**	
	Interest on Capital A/c.....Dr	(Show as expense in P/L A/c)
	To Proprietor's Capital A/c	(Add to Capital on liability side)
k	**Interest on Drawings**	
	Proprietor's Capital A/c.....Dr	(Deduct from capital A/c in B/S)
	To Interest on Drawings A/c	(show as income in P/L A/c)
l	**Other Rectificatory Entries**	

4.09 TREATMENT OF SOME ITEMS OF ADJUSTMENT IN TRIAL BALANCE

Sr. No.	Items Given in Trial Balance	Treatment in Trading and Profit & Loss A/c	Treatment in Balance Sheet
1	Closing Stock		Show on Asset side as a current asset
2	Outstanding Expenses		Show on Liabilities side as a current liability
3	Prepaid Expenses		Show on Asset side as a current asset
4	Accrued income/Income Due		Show on Asset side as a current asset
5	Income Received in Advance		Show on Liabilities side as a current liability
6	Depreciation	Show on Dr side of P&L A/c	
7	Bad Debts (If no RDD is given)	Show on Dr side of P&L A/c as a separate item	
8	Bad Debts (If RDD is given)	Show on Dr side of RDD A/c	
9	Discount Allowed (If no provision for Discount on debtors appears)	Show on Dr side of P&L A/c	
10	Discount Allowed (If provision for Discount on Debtors appears)	Show on Dr side of provision for discount in debtors	
11	Discount Received (If no reserve for discount is given)	Show on Cr side of P&L A/c	
12	Discount Received (if reserve for discount is given)	Show on Cr side of reserve for discount A/c	
13	Interest on Capital	Show on Dr side of P&L A/c	
14	Interest on Drawings	Show on Cr side of P&L A/c	

4.10 TREATMENT OF SOME ITEMS IN THE ABSENCE OF ANY SPECIFIC INFORMATION

Item	**If the item appears on Dr side of Trial Balance**	**If the item appears on Cr side of Trial Balance**	**If nothing is given about Debit or Credit**
Returns	It is a sales return which should be deducted from sales	It is a purchase return which should be deducted from purchases	Necessary assumption should be taken about the return (either sales return or purchase return)
Carriage / Freight	It is assumed as carriage/Freight on purchases which should be debited to Trading A/c		It is assumed as carriage/Freight on purchases
Wages & Salaries	Shown on Debit side of Trading A/c		
Salaries & wages	Shown on Debit side of Profit & Loss A/c		
Discount	Shown on Debit side of P&L A/c as Discount Allowed	Shown on Credit side of P&L A/c as Discount Received	It is assumed as Discount Allowed
Commission	Shown on Debit side of P&L A/c as Commission Allowed	Shown on Credit side of P&L A/c as Commission Received	It may be assumed as commission allowed
Interest	Shown on Debit side of P&L A/c	Shown on Credit side of P&L A/c	It is assumed as interest on loan taken and shown on debit side of P&L A/c
Rent	Shown on Debit side of P&L A/c	Shown on Credit side of P&L A/c	It is assumed as rent paid
Premium	Shown on Debit side of P&L A/c as premium paid	Shown on Credit side of P&L A/c as premium received	It is assumed as premium paid

4.11 PROCEDURE FOR PREPARING FINAL ACCOUNTS

1. First open the various accounts like Manufacturing A/c, Trading A/c, Profit & Loss A/c and Balance Sheet leaving appropriate space/lines
2. Post the items given in the Trial Balance or in the sum in the abovementioned accounts and /or statements.
3. Identify and/or classify the particular item as Assets, Liabilities, Incomes, Expense and accordingly post them in to the respective accounts as follows
4. Assets = Debit Balance (Record in B/S on Asset Side)
5. Expenses = Debit Balance (Record either in Trading A/c or P&L A/c on Debit Side)
6. Liabilities = Credit Balance (Record in B/S on Liability Side)
7. Incomes = Credit Balance (Record either in Trading A/c or P&L A/c on Credit Side)
8. Personal Accounts having Debit Balance to be recorded on Asset Side and
9. Personal Accounts having credit balance to be recorded on Liability Side
10. Information outside the trial balance should be considered and two effects should be given
11. Personal expenses of the owner are to be treated as drawings and deducted from capital
12. First close the Manufacturing A/c and transfer the balance to Trading A/c.
13. Then close the Trading A/c and transfer the balance to P&L A/c
14. Then close the Profit & Loss A/c and transfer the balance to Balance Sheet
15. Finally balance sheet should match.

4.12 SOLVED ILLUSTRATIONS

Illustration 1

From the following particulars of Lal Traders, you are required to prepare Trading A/c for the year ended 31st March XXXX

Particulars	**Rs.**	**Particulars**	**Rs.**
Opening Stock	30000	Carriage inwards	11000
Purchases	305000	Carriage outwards	8500
Purchase Returns	5000	Power & Fuel	7500
Sales	380000	Bad Debts	1500
Sales Returns	12800	Closing Stock	75000
Wages	54000		

Additional Information

1. Purchase of Rs.5000 from Mr. M and Sales of goods worth Rs.7000 of Mr. C were not recorded in the books
2. Goods worth Rs.1000 were distributed as free sample
3. Goods of the estimated value of Rs.500 were received as free samples and were included in the closing stock at that value
4. Goods costing Rs.1500 were taken by Mr. Lal for his personal use
5. Goods costing Rs.5000 were lost in fire

Solution

M/s Lal Traders					
Trading Account for the year ended 31st March XXX					
Dr.					**Cr.**
Particulars	**Amt**	**Amt**	**Particualrs**	**Amt**	**Amt**
To Opening Stock	0	30000	By Sales	380000	
To Purchases	305000		Add - Unrecorded Sales	7000	
Add - Unrecorded Purchases	5000		Less - Returns	12800	374200
Less - Returns	5000				
Less - Withdrawn for Personal use	1500	303500	By Goods lost by fire		5000
			By Free Samples		1000
To Wages		54000	By Closing Stock	75000	
To Carriage Inward		11000	Less - Free Samples Received		
To Power & Fuel		7500	wrongly included in stock	500	74500
To Gross Profit trf to P&L A/c		48700			
		454700			**454700**

Illustration 2

From the following balances of a Manufacturer prepare Manufacturing A/c for the year ended 31st December XXX

Particulars	**Amt**	**Particulars**	**Amt**
Opening Stock of		Wages	6400
Raw Materials	17000	Factory rent	3800
W.I.P.	8000	Factory Insurance	900
Finished Goods	12000	Coal	1600
Purchases		Mfg. Packing Expenses	500
Raw Materials	50000	Repairs to Machinery	750
Finished Goods	25000	Royalty	1000
Carriage		**Consumables**	
Raw Materials	700	Stores	200
Finished Goods	300	Sales	120000
Railway Freight		Sales Return	1100
Raw Materials	1400	**Closing Stock**	
Finished Goods	600	Raw Materials	8000
Purchase Returns		W.I.P.	5200
Raw Materials	700	Finished Goods	25000
Finished Goods	800		

Solution

Manufacturing A/c for the year ended 31st December XXX					
Dr.					**Cr.**
Particulars	**Amt**	**Amt**	**Particualrs**	**Amt**	**Amt**
To Opening Stock			By Closing Stock		
W.I.P.		8000	WIP		5200
To Materials Consumed					
Opn stock of R/M	17000		By Cost of Production		
Add - Purchase of R/M	50000		Trf to Trading A/c		78350
Less - Purchase Returns of R/M	700				
Less - Closing Stock of R/M	8000	58300			
To Carriage of R/M		700			
To Railway Freight - R/M		1400			
To Wages		6400			
To Factory rent		3800			
To Factory Insurance		900			
To Coal		1600			
To Mfg. Packing Expenses		500			
To Repairs to Machinery		750			
To Royalty		1000			
To Consumable Stores		200			
		83550			**83550**

Trading Account for the year ended 31st December XXX					
Dr.					**Cr.**
Particulars	**Amt**	**Amt**	**Particualrs**	**Amt**	**Amt**
To Opn Stock - F/G		12000	By Sales	120000	
To Purchases - F/G	25000		Less - Returns	1100	118900
Less - Purchase Returns - F/G	800	24200			
			By Closing Stock - F/G		25000
To Carriage of F/G		300			
To Railway Freight - F/G		600			
To Cost of Production		78350			
To Gross Profit		28450			
		143900			**143900**

Illustration 3

Prepare Profit & Loss Account for the year ended 31st March XXX

Particulars	**Amt**	**Particulars**	**Amt**
Gross Profit	15000	Sales Salaries	2600
Salaries	5000	Packing expenses	200
Advertising	400	Rates & Taxes	900
Postage	250	Insurance	750
Printing & Stationery	180	Commission Received	1800
Rent	2500	Dividend on Investment	1700
Interest on loan	400	Donation	350
Discount (Dr.)	600	Carriage Outward	480
Discount (Cr)	750	Apprentice Premium	160
Interest om Bank overdraft	250		

Solution

Profit & Loss A/c for the year ended 31st March XXX

Dr.		Cr.	
Particulars	**Amt**	**Particualrs**	**Amt**
To Salaries	5000	By Gross Profit	15000
To Advertising	400	By Discount Received	750
To Postage	250	By Commission Received	1800
To Printing & Stationery	180	By Dividend on Investment	1700
To Rent	2500		
To Interest on Loan	400		
To Discount Allowed	600		
To Interest on Bank Overdraft	250		
To Sales Salaries	2600		
To Packing Expenses	200		
To Rates & Taxes	900		
To Insurance	750		
To Donation	350		
To Carriage outward	480		
To Apprentice Premium Paid	160		
To Net Profit	**4230**		
	19250		**19250**

Illustration No.4

Following are the balances of Ms. Roselin, as on 31.03.2022. You are requested to prepare the Final Accounts, after giving effects to the adjustments.

Particulars	Amt	Particulars	Amt	Particulars	Amt
Sundry Creditors	94500	Patents	112500	Fuel & Power	70950
Sundry Debtors	217500	Machinery	300000	Wages	157200
Capital Account	1065000	Freehold Land	150000	Returns Outwards	7500
Drawings	78675	Building	450000	Returns Inwards	10200
Insurance	9000	Stock 1.4.21	86400	Sales	1481700
General Expenses	45000	Carriage on Purchase	30600	Purchases	610125
Salaries	225000	Carriage on Sales	48000	Cash at Bank	39450
				Cash in Hand	8100

1. Stock as on 31.03.2022 was valued at Rs.102000/-
2. Provision for Doubtful Debts is to be created @5% on Sundry Debtors
3. Depreciate Machinery by 10%, Patents by 20%
4. Wages include a sum of Rs.30000/- spent on erection of a Cycle shed for employees & customers
5. Salaries for the month of March 2022 were unpaid at Rs.22500/-
6. Insurance include a premium of Rs.2520 on a policy, expiring on 30.09.2022

Illustration No.5

Following is the Trial Balance of Ms. Prachi as on 31.03.2022. Prepare Trading A/c & P&L A/c for the year ended 31.03.2022 & Balance Sheet after making necessary adjustments

Particulars	Amt	Particulars	Amt	Particulars	Amt
Debtors	450000	Motor Car	216000	Rates & Taxes	22500
Creditors	180000	Printing & Stationery	13500	Drawings	18000
O/s Liab. for Exp	49500	Furniture & Fittings	99000	Capital Account	1298700
Wages	90000	Advertisements	76500	Purchases	1494000
Carriage outwards	99000	Insurance	40500	Sales	1788750
Carriage inwards	45000	Salesmen's Commission	78750	Stock on 1.4.22	225000
General Expense	63000	Postage & Telegram	51750	Cash at Bank	54000
Discount allowed	18000	Salaries	144000	Cash in Hand	9450
Bad Debts	9000				

1. Closing stock was valued at Rs.652500/-
2. Provision for Doubtful Debts is to be created @5% on Sundry Debtors
3. Depreciate Furniture & Fittings by 10%, Motor Car by 20%
4. Prachi had withdrawn goods worth Rs.22500/- during the year
5. Sales include goods worth Rs.67500 sent out to Prabhat & Company on approval and remaining unsold on 31.03.2022. The cost of goods was Rs.45000/-
6. Salesmen are entitled to a commission of 5% on total sales
7. Debtors include Rs.22500/- bad debts
8. Purchase include purchase of furniture worth Rs.45000/-

Solution for Illustration No.4

DR.	Trading A/c for the year ended 31.03.2022				CR.
Particulars	**Amt**	**Amt**	**Particulars**	**Amt**	**Amt**
To Opening Stock		86400	By Sales	1481700	
To Purchases	610125		Less - Returns Inward	10200	1471500
Add - Carriage on Purchases	30600				
Less - Returns Outward	7500	633225	By Closing Stock		102000
To Fuel & Power		70950			
To Wages	157200				
Less - Cycle Shed Charges	30000	127200			
To Gross Profit c/d		655725			
		1573500			**1573500**

DR.	Profit & Loss A/c for the year ended 31.03.2022				CR.
Particulars	**Amt**	**Amt**	**Particulars**	**Amt**	**Amt**
To Insurance	9000		By Gross Profit b/d		655725
Less - Prepaid Insurance (2520/12*6)	1260	7740			
To General Expenses		45000			
To Salaries	225000				
Add - Unpaid Salaries	22500	247500			
To Carriage on Sales		48000			
To Provision for Doubtful Debts		10875			
To Depreciation on Patents		22500			
To Depreciation on Machinery		30000			
To Net Profit c/d		244110			
		655725			**655725**

DR.	Balance Sheet as on 31.03.2022				CR.
Liabilities	**Amt**	**Amt**	**Assets**	**Amt**	**Amt**
Capital Account	1065000		Patents	112500	
Less - Drawings	78675		Less - Depreciation @20%	22500	90000
Add - Net Profit	244110	1230435	Machinery	300000	
			Less - Depreciation @10%	30000	270000
			Freehold Land		150000
Sundry Creditors		94500	Building		450000
Unpaid Salaries		22500	Cycle Shed		30000
			Sundry Debtors	217500	
			Less - Prov for Doubtful Debts @5%	10875	206625
			Cash at Bank		39450
			Cash in Hand		8100
			Closing Stock		102000
			Prepaid Insurance		1260
		1347435			**1347435**

Solution for Illustration 5

DR.	Trading A/c for the year ended 31.03.2022				CR.
Particulars	**Amt**	**Amt**	**Particulars**	**Amt**	**Amt**
To Opn Stock		225000	By Sales	1788750	
To Purchases	1494000		Less - Goods sold on approval basis		
Less - Furniture	45000	1449000	but remaining unsold as on 31.3.22	67500	1721250
To Carriage Inwards		45000			
To Wages		90000	By Goods Withdrawn by Proprietor		22500
			By Closing Stock	652500	
			Add : Cost of Goods sold on approval		
			basis but remaining unsold	45000	697500
To Gross Profit c/d		632250			
		2441250			**2441250**

DR.	Profit & Loss A/c for the year ended 31.03.2022				CR.
Particulars	**Amt**	**Amt**	**Particulars**	**Amt**	**Amt**
			By Gross Profit B/d		632250
To Carriage Outwards		99000			
To General Expenses		63000			
To Discount Allowed		18000			
To Bad Debts	9000				
Add - Further Bad Debts	22500				
Add - Provision for Doubtful Debts @5%	18000	49500			
To Printing & Stationery		13500			
To Advertisements		76500			
To Insurance		40500			
To Salesmen's Commission	78750				
Add- Outstanding Commission	7313	86063			
(5/100*(1788750-67500)=86063					
To Postage & Telegram		51750			
To Salaries		144000			
To Rates & Taxes		22500			
To Depreciation on Motor Car		43200			
To Depreciation on Furniture & Fittings		14400	By Net Loss		89663
		721913			**721913**

DR.	Balance Sheet as on 31.03.2022				CR.
Liabilities	**Amt**	**Amt**	**Assets**	**Amt**	**Amt**
Capital Account	1298700		Motor Car	216000	
Less - Drawings	18000		Less - Depreciation @20%	43200	172800
Less - Further Drawings (Goods Withdrawn)	22500		Furniture & Fittings	99000	
Less - Loss during the year	89663	1168537	Add - Furniture	45000	
			Less - Depreciation @10%	14400	129600
Creditors		180000			
Outstanding Liabilities for Expenses		49500	Debtors	450000	
Outstanding Salesmen commission		7313	Less - Sales on Approval basis but		
			but remaining unsold as on 31.3.22	67500	
			Less - Bad Debts	22500	
			Less - Provision for Doubtful Debts @5%	18000	342000
			(5/100*(450000-67500-22500)		
			Cash at Bank		54000
			Cash in Hand		9450
			Closing Stock	652500	
			Add : Cost of Goods sold on approval		
			basis but remaining unsold	45000	697500
		1405350			**1405350**

Illustration 6

Following is the Trial Balance of Ms. Manu, Proprietor of Chinu Enterprises for the year ended 31.3.20xx

Particulars	**Dr**	**Cr**	**Particulars**	**Dr**	**Cr**
Opening Stock – R/M	250000		Printing & Stationary	5200	
- WIP	80000		Bank Charges	2500	
- F/G	220000		Travelling Expenses	10000	
Purchases	215000		Discount	3300	
Buildings	150000		Sales Return	11000	
Plant & Machinery	360000		Advertisement	5500	
Furniture	40000		Sales		780000
Trade Mark	30000		Capital		850000
Wages	83000		Sundry Creditors		52000
Factory Taxes	4000		Sundry Debtors	82500	
Motive Power	9000		Discount		2500
Factory Insurance	5000		Mis Expenses	5500	
Salary to Office Staff	11000		Bills Payable		34000
Office Rent	10500		Bills Receivable	16000	
Carriage Inward	2500		Corporation Bank	98000	
			Cash on Hand	9000	
				1718500	**1718500**

Adjustments

1. Closing stock of R/M – Rs.85000/-, WIP – Rs.30000/- and F/G – Rs.205000/-
2. Factory taxes Prepaid Rs.2000/-
3. Depreciate Furniture @10%, P&M @15%, Trade Mark @20% and Building @5%
4. Prepare Manufacturing A/c, Trading A/c and Profit & Loss A/c for the year 31.3.xx

Illustration 7

Amar Chemicals has the following Ledger Balances as on 31.03.xx

Particulars	**Dr**	**Cr**	**Particulars**	**Dr**	**Cr**
Goodwill	50000		Net Sales		1100000
Factory Shed	20000		Misc. Income		4000
Machinery	130000		Bad Debts Reserve		5000
Furniture	8000		Purchase of Materials	860000	
Investments	10000		Freight on Materials	50000	
Capital		195000	Factory Power	15000	
Bank Loan		300000	Salaries & wages – Factory	150000	
Creditors		150000	Salaries & wages – Office	65000	
Debtors	135000		Repairs and Renewals	2500	
Stock on 1.4.xx			Rent & Taxes	16500	
Materials	130000		Insurance	3900	
Work in Progress	7500		General Expenses	18100	
Finished Goods	82500			**1754000**	**1754000**

Adjustments

1. Closing stock: Materials Rs.210000/-, WIP Rs.12500 and Finished Goods Rs.207500/-
2. Depreciation to be charged @2.5% on factory shed, 10% on Machinery and 15% on Furniture
3. Repairs and Rent and Taxes to be apportioned between factory and office in 3:2 ratio
4. Reserve for bad and doubtful debts to be provided at 4% on debtors
5. Insurance premium covers a period of one month in advance.

Prepare Manufacturing, Trading and Profit & Loss A/c for the year ended 31.3.xx

Solution for Illustration 6

DR.	Manufacturing A/c for the year ended 31.3.xx				CR.
Particulars	**Amt**	**Amt**	**Particulars**	**Amt**	**Amt**
To Opn Stock - Raw Materials		250000	By Closing Stock - Raw Materials		85000
- Work in Progress		80000	- Work in Progress		30000
To Purchases		215000			
To Wages		83000			
To Factory Taxes	4000				
Less - Prepaid Factory Taxes	2000	2000			
To Motive Power		9000			
To Factory Insurance		5000	By Cost of Production		531500
To Carriage Inward		2500			
		646500			**646500**

DR.	Trading A/c for the year ended 31.3.xx				CR.
Particulars	**Amt**	**Amt**	**Particulars**	**Amt**	**Amt**
To Opn Stock - Finished Goods		220000	By Sales	780000	
To Cost of Production		531500	Less - Returns	11000	769000
			By Closing Stock - Finished Goods		205000
To Gross Profit		222500			
		974000			**974000**

DR.	Profit & Loss A/c for the year ended 31.03.xx				CR.
Particulars	**Amt**	**Amt**	**Particulars**	**Amt**	**Amt**
			By Gross Profit b/d		222500
To Salary to office Staff		11000	By Discount		2500
To Office Rent		10500			
To Printing & Stationery		5200			
To Bank charges		2500			
To Travelling Expenses		10000			
To Discount		3300			
To Advertisement		5500			
To Mis. Expenses		5500			
To Depreciation on - Building		7500			
- P&M		54000			
- Furniture		4000			
- Trade Mark		6000			
To Net Profit		100000			
		225000			**225000**

DR.	Balance Sheet as on 31.3.xx				CR.
Liabilities	**Amt**	**Amt**	**Assets**	**Amt**	**Amt**
Capital	850000		Buildings	150000	
Add - Net Profit	100000	950000	Less - Depreciation @5%	7500	142500
			Plant & Machinery	360000	
Sundry Creditors		52000	Less - Depreciation @15%	54000	306000
Bills Payable		34000			
			Furniture	40000	
			Less - Depreciation @10%	4000	36000
			Trade Mark	30000	
			Less - Depreciation @20%	6000	24000
			Sundry Debtors		82500
			Bills Receivable		16000
			Corporation Bank		98000
			Cash on Hand		9000
			Closing Stock - Raw Materials		85000
			- Work in Progress		30000
			- Finished Goods		205000
			Prepaid Factory Taxes		2000
		1036000			**1036000**

Solution for Illustration 7

DR.	Manufacturing A/c for the year ended 31.3.xx				CR.
Particulars	Amt	Amt	Particulars	Amt	Amt
To Opn Stock - Raw Materials	130000		By Closing Stock - Raw Materials	210000	
- Work in Progress	7500	137500	- WIP	12500	222500
To Purchase of Materials		860000			
To Freight on Materials		50000			
To Factory Power		15000			
To Salaries & Wages - Factory		150000			
To Repairs & Renewals - Factory (3:2)		1500			
To Rent & Taxes - Factory (3:2)		9900			
To Depreciation - Factory Shed		500			
To Depreciation - Machinery		13000	By Cost of Production		1014900
		1237400			1237400

DR.	Trading A/c for the year ended 31.3.xx				CR.
Particulars	Amt	Amt	Particulars	Amt	Amt
To Opn Stock - Finished Goods		82500	By Net Sales		1100000
To Cost of Production		1014900	By Closing Stock - Finished Goods		207500
To Gross Profit		210100			
		1307500			1307500

DR.	Profit & Loss A/c for the year ended 31.03.xx				CR.
Particulars	Amt	Amt	Particulars	Amt	Amt
To Salaries & Wages - Office		65000	By Gross Profit b/d		210100
To Repairs & Renewals - Office (3:2)		1000	By Mis. Income		4000
To Rent & Taxes - Office (3:2)		6600			
To Insurance	3900				
Less-Advance for 1 month (3900/13*1)	300	3600			
To General Expenses		18100			
To Reserve for Bad & Doubtful Debts		5400			
To Depreciation - Furniture		1200			
To Net Profit		113200			
		214100			214100

	Balance Sheet as on 31.3.xx				
Liabilities	Amt	Amt	Assets	Amt	Amt
Capital	195000		Goodwill		50000
Add - Net Profit	113200	308200			
			Factory Shed	20000	
			Less - Depreciation @2.5%	500	19500
Bank Loan		300000			
			Machinery	130000	
Creditors		150000	Less - Depreciation @10%	13000	117000
			Furniture	8000	
			Less - Depreciation @15%	1200	6800
			Investments		10000
			Debtors	135000	
			Less - Bad Debts Reserve (Old)	5000	
			Less - RBD@4% (New)	5400	124600
			Closing Stock - Raw Materials	210000	
			- WIP	12500	
			- Finished Goods	207500	430000
			Prepaid Insurance		300
		758200			758200

4.13 EXERCISES

I. MULTIPLE CHOICE QUESTIONS

1. Return outwards in Trial Balance are deducted from
   - a. Sales
   - **b. Purchase**
   - c. Stock
   - d. C5
   - e. apital
2. Trade Mark is ---
   - a. Current Asset
   - b. Fictitious Asset
   - c. Tangible Asset
   - **d. Intangible Asset**
3. For a plastic company plastic is
   - **a. Raw Material**
   - b. WIP
   - c. Finished Goods
   - d. All of the above
4. Manufacturing account shows…
   - **a. Cost of Production**
   - b. Gross Profit
   - c. Net Profit
   - d. None of the above
5. Income Tax paid by a Sole Trader on his business income should be
   - a. Debited to Trading A/c
   - b. Debited to P&L A/c
   - **c. Deducted from Capital A/c in the Balance Sheet**
   - d. All of the above

II. STATE WHETHER THE FOLLOWING STATEMENTS ARE TRUE OR FALSE

1. Sale of machinery for cash will increase the asset and decrease the asset – T
2. A capital account is a real account – F
3. Depreciation is a loss – T
4. Sales are equal to Cost of Goods sold + Profit – T
5. Productive wages are debited to Profit & Loss Account – F

III. FILL IN THE BLANKS

1. A list of balances of all the accounts in the ledger is called ---
2. Net sales is the difference between gross sales and …..
3. Liabilities + Capital at the end gives = ….
4. …. Is a statement of assets and liabilities of a business on a particular date.
5. Assets minus liabilities is ------

Ans: 1-Trial Balance, 2 – Sales Return, 3 – Total Assets, 4 – Balance Sheet, 5 – Capital

IV. MATCH THE FOLLOWING

	Group X		Group Y
1	Depreciation	a	Deducted from Assets
2	Drawings	b	Deducted from Capital
3	Unrecorded Sales	c	Add to sales
4	Unrecorded Purchases	d	Add to purchases
5	New Reserve	e	Deducted from Debtors
6	Unsold goods	f	Closing Stock
7	Work in Progress	g	Semi-Finished goods
8	Tax charged by Govt.	h	Excise Duty
9	Profit & Loss Account	I	Nominal Account

(Ans: 1-a, 2-b, 3-c, 4-d, 5-e, 6-f, 7-g, 8-h, 9-I)

Practical Exercises

Exercise 1

From the following trial balance of Bhargav as on 31.3.xx you are required to prepare Trading and Profit & Loss A/c and Balance Sheet

Debit	**Rs.**	**Credit**	**Rs.**
Purchases	80000	Capital less drawings of Rs.4000	10250
Sales return	2100	Outstanding wages	1000
Sundry Debtors	20000	Dividend on Investments	400
Opneing stock	13000	Sales	135000
Wages	10250	Purchase Return	1500
Salaries	4450	Provision for Doubtful Debts	1000
Furniture	3500	Sundry Creditors	14000
Postage	2500		
Insurance	650		
Rent, rates and taxes	2750		
Bad Debts	250		
Loan to Suresh @5% given on 1.10.xx	2500		
Investments	6250		
Cash on Hand	2950		
Bills Receivable	12000		
	163150		**163150**

Adjustments

(a) Closing stock was valued at cost at Rs.10000 (Market price Rs.12000)

(b) Goods worth Rs.1000 were destroyed by fire but insurance company admitted a claim of Rs.800 only

(c) Depreciate furniture @10% p.a.

(d) Goods costing Rs.100 supplied to Bhargav were included as debtors

(e) Salaries include Rs.400 paid to an employee as advance

(f) Write off Rs.400 as further bad debts

Exercise 2		
Prepare Manufacturing, trading and Profit & Loss A/c and Balance Sheet from the following trial balance as on 31.03.2022		
Particulars	**Debit Rs**	**Credit Rs**
Baburao's Capital		77000
Baburao's Drawings	73500	
Plant at Cost	100000	
Plant depreciation up to 31.3.2021		27500
Office equipment at cost	4000	
Office equipment depreciation up to 31.3.2021		3000
Delivery vans cost	60000	
Delivery Vans depreciation up to 31.03.2021		28800
Stock of Raw Material on 1.4.2021	34500	
Stock of finished goods on 1.4.2021	18000	
Wages - factory	210420	
Salaries - office	120700	
Purchases of raw material	117350	
Power	15800	
Insurance	22500	
Sundry expenses	33600	
Delivery van expenses	5450	
Advertising	54700	
Discount	5750	
Sales		700000
Debtors and Creditors	47530	12000
Cash at Bank	1020	
Bills Payable		76520
	924820	**924820**
Adjustments		
1. On 31.3.2022 stock of R/M was Rs.33550/0 and finished goods cost Rs.16500		
2. Outstanding expenses were - Power Rs.5200, sundry Expenses Rs.900 and Delivery Van Expenses Rs.1250		
3. Prepaid expenses were insurance Rs.2500, Delivery van expenses Rs.400, Advertising Rs.2600		
4. Provision for depreciation to be made on reducing balance method 10% p.a. on plant and office equipment and 25% p.a. on vehicles		
5. Debtors of Rs.4280 to be written off		
6. Expenses are to be allocated as follows	**Factory**	**Office**
Power	98%	2%
Insurance	95%	5%
Sundry expenses	70%	30%

Exercise 3

Prepare Trading and Profit & Loss A/c and Balance Sheet from the following trial balance as on 31.03.xx

Particulars	**Debit Rs**	**Credit Rs**
Purchases & Sales	155000	207500
Stock	25000	
Cash in Hand	750	
bank of Maharashtra	6300	
Drawings and Capital	2000	144300
Rates & Taxes	2500	
Salaries	16000	
Postage	5750	
Salesmen's commission	17500	
Insurance	4500	
Advertisement	8500	
Furniture	11000	
Stationary & Printing	1500	
Car	24000	
Bad debts	1000	
Cash discounts	2000	
General expenses	7000	
Cariage inward	5000	
Carriage outward	11000	
Wages	10000	
Outstanding liability for expenses	5500	
Sundry Debtors and creditors	50000	20000
	371800	**371800**

Adjustments

1. Stock at the end Rs.72500 (at cost), Market Value Rs.75000
2. Goods withdrawn for personal use Rs.2500. No entry is passed for the same
3. Stationary and Printing expenses for the earlier year ending 31.3.2021 and not provided for in that year amounting to Rs.5500 were paid during the year by debiting "Outstanding Liability for expenses account"
4. Purchases include Furnitur worth Rs.3000 and Furniture for Residence Rs.2000
5. Debtors include Rs.2500 now considered bad and should be written off. Provision for doubtful debts is to be created @5% fo sundry debtors
6. Salesmen are entitled to a commission of 10% on total sales
7. Creditors include Rs.2000 to the credit of Mr.X. It was decided to pay Rs.1000 full and final settlement
8. Sales include goods worth Rs.7500 sent to Mr. P on approval and remaining unsold till the end of the year. Cost of these goods was Rs.5000
9. Depreciate furniture @10% and car by 20% under RBM. Original cost of furniture is Rs.20000, Cars Rs.40000

❄❄❄❄❄❄❄

5

RECTIFICATION OF ERRORS

Unit Structure:

LEARNING OBJECTIVES

- Errors and their classification
- Rectification of Errors

4.1 MEANING

Errors are the mistakes committed in recording the transactions in the books of accounts. These errors affect the accuracy of books of accounts.

4.2 TYPES OF ERRORS

Errors of Principles – These are the errors arising from not observing the accounting principles correctly, e.g. wrong capitalization of revenue items such as purchase of new tyres for car debited to Motor car account. This type of error does not disturb the trial balance, i.e. Trial balance will tally every after existence of such errors.

Errors of Omission – This is an error of omission of recording a transaction in the books of accounts. An omission may either be complete or partial. There is said to be a complete omission when the transaction is not recorded at all in the books of accounts, e.g. A purchase transaction not recorded at all.

Complete omission does not affect the agreement of trial balance and only with proper care and caution, can such errors be detected by the auditor. When the transactions are partly omitted i.e. one aspect is recorded and the other is omitted, it is a partial omission, which affects the Trial Balance. Such errors are comparatively easier to detect.

Errors of Commission – This is an error of recording a transaction wrongly in the books. These are errors in posting casting, carry forward or taking out balances etc. Posting errors may be of wrong account, wrong amount or wrong side. E.g. Amount received from X credited to Y's Account, Purchase of Rs.360 from A posted in his account as Rs.630 or sales returns from M posted as the debit or his account etc. The first type of error will not affect the Trial balance, however, the other two will affect the agreement of trial balance.

Casting errors are the errors committed while taking the totals. Such errors affect the trial balance. Errors in carrying forward and errors in taking out the balances also affect the trial balance.

4.3 CLASSIFICATION OF ERRORS

I. ERRORS RELATING TO AGREEMENT OF TRIAL BALACNE

Errors NOT affecting the Trial Balance

1. Complete omission of a Transaction
2. Recording of wrong amounts on both sides
3. Posting to wrong heads of accounts
4. Compensating errors
5. A wrong entry in the original record

Errors affecting Trial Balance

1. Partial Omission of Transaction
2. Posting of the wrong amount
3. Posting on the wrong side of an account
4. Wrong totaling or balancing

II. GENERAL CLASSIFICATION OF ERRORS

A. Clerical or Technical Errors
   - Partial Omission
   - Errors of Duplication
   - Errors of Commission
   - Compensating errors

B. Errors of Principle

III. ON THE BASIS OF RECTIFICATION

A. Errors affecting one account

B. Errors affecting two or more accounts

4.4 PROCEDURE

1. Pass Correct Entry
2. Pass Wrong Entry
3. Pass Reverse Entry of Wrong Entry

4. Pass Rectification Entry (Compare correct entry and reverse entry of wrong entry)

4.5 SOLVED ILLUSTRATIONS

Illustration I

Rectify the following errors

1. Purchases from Padma Rs.191 posted to her account as Rs.119
2. Purchases from Lata Rs.171 credit to her account as Rs.117
3. Salaries Rs.400 posted to Salaries Account as Rs.300
4. A cash sale of Rs.430 to Rita posted as Rs.43

Solution

	Correct Entry	Amt	Wrong Entry	Amt	Reverse of Wrong Entry	Amt	Rectification Entry	Amt
1	**There is an error of posting a wrong amount. Padma's account is credited by Rs.119 instead of Rs.191.**							
	The rectification can be done by passing following journal entries.							
	Purchase A/c…Dr	191	Purchase A/c..Dr	191	Padma A/c…Dr	119	Suspense A/c…Dr	72
	To Padma A/c	191	To Padma A/c	119	Suspense A/c..Dr	72	To Padma A/c	72
			To Suspense A/c	72	To Purchase A/c	191		
2	**Lata's account is credit by Rs.117 instead of Rs.171. The error can be rectified by passing following journal entries**							
	Purchase A/c…Dr	171	Purchase A/c…Dr	171	Lata A/c…Dr	117	Suspense A/c…Dr	54
	To Lata A/c	171	To Lata A/c	117	Suspense A/c..Dr	54	To Lata A/c	54
			To Suspense A/c	54	To Purchase A/c	171		
3	**Salary account is posted as Rs.300 instead of Rs.400. Error can be rectified by passing following journal entries**							
	Salaries A/c…. Dr	400	Salaries A/c….Dr	300	Cash A/c….Dr	400	Salaries A/c…Dr	100
	To Cash A/c	400	Suspense A/c…Dr	100	To Salaries A/c	300	To Suspense A/c	100
			To Cash A/c	400	To Suspense A/c	100		
4	**Cash sale is recorded correctly but the sales account is wrongly credited as Rs.43 instead of Rs.430/-**							
	This can be rectified by passing following entries							
	Cash A/c..Dr	430	Cash A/c..Dr	430	Sales A/c….Dr	43	Suspense A/c…Dr	387
	To Sales A/c	430	To Sales A/c	43	Suspense A/c…Dr	387	To Sales A/c	387
			To Suspense A/c	387	To Cash A/c	430		

Illustration 2

Following errors were found in the books of Ram Stores. Rectify them.

1. Rs.500/- paid for the purchase of office furniture charged to office expenses account
2. Rs.200/- received from Madanlal has been wrongly entered in Mohanlal's account
3. Goods worth Rs.187/- purchased from Chandan Stores but whose account was actually debited by Rs.178
4. Repairs paid were debited to Building Account for Rs.150/-
5. The total of the discount column on the credit side of the cash book was undercast by Rs.15
6. An amount of Rs.300 withdrawn by the proprietor for his personal use was debited to the Trade Expenses Account
7. Total of the sales book is short by Rs.500

8. An amount of Rs.130 received on account of interest was credited to Commission Account

Solution

	Correct Entry	Amt	Wrong Entry	Amt	Reverse of Wrong Entry	Amt	Rectification Entry	Amt
1	Furniture A/c…Dr	500	Office Exp. A/c..Dr	500	Cash A/c…Dr	500	Furniture A/c…Dr	500
	To Cash A/c	500	To Cash A/c	500	To Office Exp A/c	500	To Office Exp A/c	500
2	Cash A/c….Dr	200	Cash A/c….Dr	200	Mohanlal A/c…Dr	200	Mohanlal A/c…Dr	200
	To Madanlal A/c	200	To Mohanlal A/c	200	To Cash A/c	200	To Madanlal A/c	200
3	Goods A/c…Dr	187	Chandan Stores A/c..Dr	178	Suspense A/c…Dr	365	Suspense A/c…Dr	365
	To Chandan Stores A/c	187	Goods A/c…Dr	187	To Chandan Stores	178	To Chandan Stores	365
			To Suspense A/c	365	To Goods A/c	187		
4	Repairs A/c…Dr	150	Building A/c…Dr	150	Cash A/c….Dr.	150	Repairs A/c…Dr	150
	To Cash A/c	150	To Cash A/c	150	To Building A/c	150	To Building A/c	150
5	No Entry. Total of the discount column on credit side of the cash book should be corrected.							
6	Drawings A/c…Dr	300	Trade Exp A/c….Dr	300	Cash A/c…Dr	300	Drawings A/c…Dr	300
	To Cash A/c	300	To Cash A/c	300	To Trade Exp A/c	300	To Trade Exp A/c	300
7	No Entry. Total of sale book is to be corrected.							
8	Cash A/c….Dr	130	Cash A/c….Dr	130	Commission A/c…Dr	130	Commission A/c..Dr	130
	To Interest A/c	130	To Commission A/c	130	To Cash A/c	130	To Interest A/c	130

Illustration 3

Rectify the following errors

1. Rs.3000 paid for purchase of typewriter charged to stationary account
2. Wages paid Rs.1800 for erection of new machinery were posted to Wages A/c
3. Paid Rs.150 for the purchase of a table fan posted to purchase A/c
4. 100 shares of Oswal Oil Limited purchased @Rs.50 each not recorded in the books
5. An amount of Rs.500 withdrawn by the proprietor for his personal use was debited to sundry expenses account
6. Sold old furniture on credit for Rs.250 passed through the Day (Sales) Book

Solution

	Correct Entry	Amt	Wrong Entry	Amt	Reverse of Wrong Entry	Amt	Rectification Entry	Amt
1	Typewriter A/c..Dr	3000	Stationary A/c….Dr	3000	Cash A/c…Dr	3000	Typewriter A/c..Dr	3000
	To Cash A/c	3000	To Cash A/c	3000	To Stationery A/c	3000	To Stationery A/c	3000
2	Machinery A/c….Dr	1800	Wages A/c….Dr	1800	Cash A/c….Dr	1800	Machinery A/c…Dr	1800
	To Cash A/c	1800	To Cash a/c	1800	To Wages A/c	1800	To Wages A/c	1800
3	Furniture A/c…Dr	150	Purchase A/c…Dr	150	Cash A/c…Dr	150	Furniture A/c…Dr	150
	To Cash A/c	150	To Cash A/c	150	To Purchase A/c	150	To Purchase A/c	150
4	Investment in Shares A/c	5000	NOT Applicable		NOT Applicable		Investment in Shares A/c	5000
	To Bank A/c	5000					To Bank A/c	5000
5	Drawings A/c….Dr	500	Sundry Expenses A/c..Dr	500	Cash A/c….Dr	500	Drawings A/c….Dr	500
	To Cash A/c	500	To Cash A/c	500	To Sundry Expenses A/c	500	To Sundry Expenses A/c	500
6	Customer A/c…Dr	250	Customer A/c…Dr	250	Sales A/c….Dr	250	Sales A/c…Dr	250
	To Furniture A/c	250	To Sales A/c	250	To Customer A/c	250	To Furniture A/c	250

Illustration 1

Rectify the following errors

1. A sale of old furniture of Rs.4000 has been credited to sale account
2. Purchase of furniture for Rs.4000 has been debited to purchase account
3. Rs.3000 paid to Jeevan has been debited to Jeevan Ram
4. Rent of Rs.10000 paid to landlord has been debited to landlord account
5. An amount of Rs.8000 withdrawn by the proprietor has been debited to general expense account
6. Rs.15000 spent for repairs to machinery has been posted to machinery account
7. Salary of Rs.8000 paid to the Draftsman Sachin has been debited to his personal account
8. Goods worth Rs.4000 purchased from Ravi have been omitted to be recorded in the books
9. Paid for purchase of furniture Rs.6000 has been debited to computer account.

4.6 EXERCISES

I. MULTIPLE CHOICE QUESTIONS

1. What is the type of error in which wrong casting is done?

   a. Error of Commission,

   b. Error of Omission

   c. Error of Principle

   d. Compensating Error

2. In which error the effect of one mistake is nullified by another opposite mistake for the similar account?

   a. Compensating Error

   b. Error of commission

   c. Error of principle

   d. Compensating error

3. In which error wrong accounting principles are followed by an accountant in passing a journal entry?
   a. Error of principle
   b. Error of omission
   c. Compensating error
   d. Error of commission

4. The error disclosed by Trial Balance is
   a. Error of omission
   b. Error of commission
   c. Error of principle
   d. None of the above

5. Suspense Account in the Trial Balance is entered in
   a. Trading A/c
   b. Balance sheet
   c. Profit & Loss A/c
   d. Manufacturing A/c

II. STATE WHETHER THE FOLLOWING STATEMENTS ARE TRUE OR FALSE

1. Single sided errors affect only one side of the Trial Balance – True
2. A Trial balance can agree in-spite of some errors – True
3. All errors are rectified by means of Journal entries - False
4. If the amount is wrongly debited instead of credit then errors would be equal to double amount – True
5. Wrong balancing will not affect the trial balance – False

III. FILL IN THE BLANKS

1. Difference in trial balance may be transferred to ….. Account (Suspense)
2. Mistakes involving wrong posting are called as errors of ….. (Posting)
3. In an error of principle, the debit and credit are …. (Equal)
4. Rectification entries are passed in the ….. (Journal Proper)
5. Double side errors cannot be disclosed through ….. (Trial Balance)

IV. MATCH THE FOLLOWING

	Group X		Group Y
1	Compensating Errors	A	Recording the transaction wrongly
2	Error of Omission	B	Error affecting one account

3	Error of Duplication	C	One error removes the effect of another error
4	Error of Commission	D	Failure to record transaction in the Account book
5	One Sided Error	E	Errors affecting totaling the account
6	Error of Casting	F	Recording same transaction two times

Answers:

(1 – C, 2 – D, 3 – F, 4 – A, 5 – B, 6 – E)

V. Illustration 1

Rectify the following errors

1. A sale of old furniture of Rs.4000 has been credited to sale account
2. Purchase of furniture for Rs.4000 has been debited to purchase account
3. Rs.3000 paid to Jeevan has been debited to Jeevan Ram
4. Rent of Rs.10000 paid to landlord has been debited to landlord account
5. An amount of Rs.8000 withdrawn by the proprietor has been debited to general expense account
6. Rs.15000 spent for repairs to machinery has been posted to machinery account
7. Salary of Rs.8000 paid to the Draftsman Sachin has been debited to his personal account
8. Goods worth Rs.4000 purchased from Ravi have been omitted to be recorded in the books
9. Paid for purchase of furniture Rs.6000 has been debited to computer account.

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6

MANUFACTURING A/C, TRADING A/C, PROFIT & LOSS A/C AND BALANCE SHEET

Unit Structure:

LEARNING OBJECTIVES

After studying this unit, you will be able to:

- Make out various accounts, which are the part of final accounts
- Understand the various items of Manufacturing Account, Trading Account, Profit & Loss Account and Balance Sheet
- Form and Layout of Manufacturing, Trading and Profit & Loss A/c and Balance Sheet

4.1 MANUFACTURING ACCOUNT

Manufacturing Account is prepared by manufacturing firms to ascertain the "Cost of Goods" manufactured during an accounting period. It is closed by transferring its balance to the debit side of Trading Account. The manufacturing account gives information on all the expenses and costs incurred in the preparation of the goods to be sold. This includes the expenses that are met in the path of preparing the goods but not the finished goods. Any type of expenses including the cost of raw materials, the cost of machines and their maintenance, the salaries and wages of both skilled and unskilled workers which are considered as the direct expenses of the manufacturing. Even the depreciation of the assets like costly machines and plants are also included under this account.

Manufacturing A/c for the year ended …….					
Particulars	**Amt**	**Amt**	**Particulars**	**Amt**	**Amt**
To Work in Progress (Opening)		xx	**By Work in Progress (Closing)**		xx
To Raw Materials Consumed			**By Sale of Scrap**		xx
Opening Stock	xx				
Add: Purchases	xx		**By Cost of Production trf. To Trading Account**		xx
Add: Purchase Expenses					
- Carriage Inward	xx				
- Octroi Duty	xx				
- Customs Duties	xx				
Less: Purchase Returns	(xx)				
Less: Closing Stock	(xx)	xx			
To Direct Wages		xx			
To Direct Mfg. Expenses					
- Hire of Machinery	xx				
- Royalty related to Mfg.	xx				
- Design Expenses	xx	xx			
To Direct Factory Expneses					
- Stores, Oil, Grease	xx				
- Power & Fuel	xx				
- Repairs to Factory Assets	xx				
- Rent, lighting of Factory bldg	xx	xx			
		xxx			**xxx**

The purpose of preparing the Manufacturing Account is to ascertain the cost of goods manufactured. Therefore, it should include all the expenses relating to manufacture of goods such as purchase of raw materials, carriage and freight on purchase of materials and other expenses incurred in the production process i.e. conversion of raw materials in to finished goods.

Major Manufacturing expenses are as follows.

1. **Direct Materials** – These are the raw materials from which finished goods are manufactured. Raw Materials consumed is arrived as follows.

Opening Stock of Raw Materials	xx
Add – Purchase of Raw Materials	Xx
Less – Purchase Returns	Xx
Less – Closing Stock of Raw Materials	Xx
	xxx

2. **Work in Progress / Semi Finished Goods** – The value of opening WIP appears on Dr side and value of closing WIP appears on Cr side of manufacturing account. This represents materials put in to process.

3. **Direct Labor** – It is the amount of wages paid to the workers who are employed in the production process

4. **Manufacturing Expenses/Factory or Production Overheads** – These are expenses incurred in the factory like rent, rates, taxes, electricity, salaries, insurance, depreciation of factory building, plant and machinery, amortization of patents, water, heat, light and parts used in the factory, power & fuel, factory stores & spares, factory supervision etc.

5. **Sale of Scrap** – In a production process there may be certain scrap which may or may not have a sale value. Amount of scrap is credited in manufacturing account.

6. **Cost of Production** – It is the cost of manufacturing the goods. It is the excess of debit side total of manufacturing account over its credit side total. It is the balance in the manufacturing account which is transferred to Trading Account.

4.2 TRADING ACCOUNT

It shows the result of buying & selling of goods and/or services during an accounting period. The main purpose is to ascertain the gross profit or gross loss. Gross Profit or Gross Loss is the difference between Sales Value and Cost of Goods Sold. Trading Account records trading transactions of a businessman.

Trading A/c for the year ended ....

Particulars	Amt	Amt	Particulars	Amt	Amt
To Opening Stock		xx	By Sales	xx	
To Purchases	xx		Less: Sales Returns	xx	
Less: Purchase Returns	xx	xx	By Goods lost / destroyed		xx
To Direct Purchase Exp.		xx	By Goods taken by Proprietor		xx
To Manufacturing A/c		xx	By Goods given as free samples		xx
(Cost of Production trf.)			By Closing Stock		xx
To Gross Profit B/f		xx	By Gross Loss C/f		xx
		xxx			xxx

Trading and manufacturing business firms deal in sales and purchases of goods. Therefore, only manufacturing and trading entities prepare the trading account. Trading account gives details of total sales, total purchases and direct expenses relating to purchase and sales. It shows gross profit of business activities during a specific period.

In case of trading concern or where manufacturing account is not prepared, Trading account will also include other expenses for receipt or manufacture of goods.

Trading Account contains the following details

- Opening stock details of Finished Goods and in case where manufacturing account is not prepared then it also includes opening stock details of Raw Material, Semi-Finished Goods (WIP)
- Closing stock details of Finished Goods, raw material and semi-finished goods
- Total purchases of goods less Purchase Returns.
- Total sales of goods less Sales Returns.
- All direct expenses related to purchases or sales or manufacturing of goods.

Items of Income (Cr.) side

- Total sales of goods fewer Sales returns
- Closing stock of goods.
- Drawings in the form of goods, goods issued as samples or goods lost by accidents

Items of Expenditure (Dr.) Side

- Opening stock of goods
- Total purchases of goods Less purchase returns
- All direct expenses like Carriage inward & Freight expenses, rent for go-down or factory, Electricity and Power expenses, wages of workers and supervisors, Packing expenses, etc.

Balancing of Trading Account

After recording all the expenses and incomes as mentioned above to trading account, it is closed by transferring the balance – Gross Profit or Gross Loss – to Profit & Loss Account. If Cr side > Dr Side = it's Gross Profit and Dr side > Cr side = it's Gross Loss.

4.3 PROFIT & LOSS ACCOUNT

It is a part of financial statement, which shows the result of business operations conducted during the year. The purpose is to find out net profit earned or net loss incurred during the year. It contains all indirect expenses and losses (other than those shown on debit side of trading account) which are shown on its debit side and all indirect incomes and gains (other than those shown on credit side of trading account) which are shown on its credit side.

All indirect expenses and losses (other than those shown on debit side of Trading A/c) are shown on debit side of P&L A/c, whereas all indirect resource incomes and gains (other than those shown on credit side of Trading A/c) are shown on credit side of Profit & Loss A/c

Profit & Loss A/c may be prepared showing separately the expenses as under:

1. Administration Expenses
2. Selling Expenses
3. Distribution Expenses
4. Finance Charges and others

Profit & Loss A/c for the year ended ………					
Particulars	**Amt**	**Amt**	**Particulars**	**Amt**	**Amt**
To Gross Loss B/d		xx	By Gross Profit B/d		xx
To Administrative Expenses			**By Other Income or Gains**		
- Rent, Insurance, Repairs	xx		- Commission recd	xx	
- Office Salaries	xx		- Discount recd	xx	
- Postage, teleph & telex	xx		- Dividend recd	xx	
- Printing & Stationery	xx		- Interest recd	xx	
- Fees (legal/audit)	xx		- Profit on sale of assets	xx	
- General Expenses	xx	xx			
To Selling & Distribution Exp.					
- Salesman's salaries, commission	xx				
- Travelling	xx				
- Carriage, freight, duties	xx				
- Warehousing charges	xx				
- Packing expense	xx				
- Advtg & sales promotion	xx				
- Goods given as free samples	xx	xx			
To Financial Expenses					
- Interest & bank charges	xx				
- Bad debts & prov for bad debts	xx				
- Discounts given	xx	xx			
To Depreciation					
- on Machinery, Computers	xx				
- on Furniture & Fixtures	xx				
- Building, Office Equipments	xx	xx			
To Unusual Exp or losses					
- Goods lost/destroyed	xx				
- Loss on sale of fixed assets	xx	xx			
To Appropriations					
- Income tax	xx				
- Reserves	xx	xx			
To Net Profit trf to Capital A/c		xx			
		xxx			**xxx**

Explanation of Indirect or Other Expenses and Gains

- All indirect expenses are transferred to debit side of Profit & Loss A/c. Any loss occurred by fire or accident is also debited to Profit & Loss Account
- Discount allowed to customers (Debtors) is a loss and should be debited to P&L A/c and Discount earned from suppliers (Creditors) is a gain and should be credited to P&L A/c
- Commission on sales to agents and salesmen paid is expenditure and should be debited to P&L A/c and commission received being gain, to be credited to P&L A/c
- Interest paid on capital or loans taken, being expense should be debited to P&L A/c and Interest received on loans given, being gain, to be credited to P&L A/c
- Bad Debts are the debts or dues from customers, which are not recoverable. It is a loss to the business, therefore, debited to P&L A/c

- Salaries and wages – sometimes only one account is kept for both salaries and wages. When the amount of wages is small such combined account is opened. In such case full amount to be debited to P&L A/c. But if the item is Wages and Salaries, it is transferred to Trading A/c on the assumption that wages is a major part of this expenditure

- Trade Expenses also known as sundry expenses or miscellaneous expenses or petty expenses are charged to P&L A/c debit side

- Income Tax is a tax in income. It should not be treated as expenses of the business. Therefore, it is not debited to P&L A/c. In case of sole trader, it is debited to Capital Account or added to Drawings

Balancing of Profit & Loss A/c

After transferring all expenses and losses of the business to Debit, and all incomes and gains of the business to Credit side of P&L A/c, it is balanced.

If Credit Side > Debit Side then difference is Net Profit

If Debit Side > Credit Side then difference is Net Loss

in case of sole proprietor and partnership business, net profit is added to the Capital and net loss is deducted from the capital.

4.4 BALANCE SHEET

A Balance Sheet is a statement (not an account) of the total assets and liabilities of an organization at a particular date- usually the last date of an accounting period. Objective is to ascertain the financial position of a concern. It shows the nature and value of assets and the nature and value of liabilities and the position of capital. It is always prepared on a certain date and not for a particular period. It is divided in to two sides. The left-hand side is "**Liabilities**" and right-hand side is **"Assets**". It is a summary of balances of those ledger accounts, which have not been closed by transfer to Trading and Profit & Loss A/c. It shows financial position of the business.

Balance Sheet As at …….					
LIABILITIES	**Amt**	**Amt**	**ASSETS**	**Amt**	**Amt**
Capital Account			**Fixed Assets**		
Opening Balance	xx		Goodwill /Land		xx
Add: New Capital brought in	xx		Plant & Machinery	xx	
Add: Net profit during the year	xx		**Less - Depreciation**	xx	xx
Less: Drawings	xx		Premises/Building / Vehicles	xx	
Less: Net loss during the year	xx	xx	**Less - Depreciation**	xx	xx
			Furniture & Fittings	xx	
			Less - Depreciation	xx	xx
Reserves & Surplus			**Investments**		
General Reserve		xx	Investments in shares & bonds		xx
Loans (Secured/Unsecured)			**Current Assets, Loans & Advances**		
Loans from Bank		xx	Closing Stock		xx
Bank Overdraft		xx	Debtors		xx
			Loans & Advances given		xx
Current Liabilities & Provisions			Bills receivable		xx
Creditors		xx	Prepaid Expense		xx
Bills Payables		xx	Cash at Bank		xx
Outstanding expenses		xx	Cash in Hand		xx
Income received in advance		xx			
			Fictitious Assets		
			Deferred Expense not w/off		xx
			Capital A/c Debit balance		xx
		xxx			**xxx**

Form and Layout

The Balance Sheet is generally prepared in T Form having two sides, one to show the assets and the other liabilities. The left-hand side is generally called as the Liabilities side and the right-hand side is called the Asset side. This is called the Traditional Form. Now a days the Balance Sheet is also prepared in the vertical of T form in a way a layman can understand.

4.5 CLASSIFICATION OF ASSETS

Assets are classified in to (1) Fixed Assets, (2) Floating or Current Assets and (3) Fictitious Assets

Fixed Assets – are the assets of a permanent nature, which are used in business as long as they are held and useful. These assets are not meant for resale. Business is carried on with the help of these assets. Examples are Machinery, Building, Office Equipment, Plant, Patent Rights etc.

Types of Fixed Assets

1. **Tangible Fixed Assets** – Have physical existence and can be seen by eyes. E.g. Land, Building, Machinery, Furniture etc.

2. **Intangible Fixed Assets** – Have no physical existence and which cannot be seen. E.g. Goodwill, Patents, Copyrights etc.

Floating/Current Assets/Circulating Assets – Assets which are held temporarily and which are meant for resale or consumption in business. They change from time to time. E.g. Cash and Bank, Sundry Debtors, Bills Receivables, Stock etc.

Fictitious Assets – These are those assets which are not represented by anything concrete. There is no tangible property or asset representing it. They cannot be converted into cash. E.g. preliminary expenses, discount on issue of shares and debentures etc.

4.6 CLASSIFICATION OF LIABILITIES

Liabilities can be classified into (1) Fixed (2) Current and (3) Contingent Liabilities

Fixed Liabilities – Liabilities which are redeemed or repaid after a long period of time. E.g. are Long term loans and capital.

Current Liabilities – Liabilities which are to be paid or discharged in the near future, usually within a year. E.g. Creditors, Bank Overdraft, Outstanding Expenses, Bills Payable etc.

Contingent Liabilities – These are not actual liabilities, but they may become actual liability on happening of certain events. If expected event does not occur, no liability or loss will arise. E.g. suit filed against the business for a claim, not admitted by the business. The liability will arise if Court decides against the concern and in favour of the claimant, otherwise there will be no liability. Other examples would be liability on partly paid shares and debentures held as investment, liability of bill discounted etc.

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7

PREPARATION OF FINAL ACCOUNTS IN HORIZONTAL & VERTICAL FORM

Unit Structure:

LEARNING OBJECTIVES

After studying this unit, you will be able to:

- Understand Horizontal and Vertical Format of Profit & Loss A/c and Balance Sheet

4.1 INTRODUCTION

At the end of the accounting year, a businessman prepares certain statements which present the results of the business operations for that period. These statements comprise of:

1. Balance Sheet and
2. Profit and Loss A/c

These statements taken together are known as final accounts / financial statements

4.2 FORMS OF BALANCE SHEET

1. **Conventional (Horizontal or T) form** – It shows the assets and properties and their values on the right-hand side of the sheet and the liabilities and capital and their values on the left-hand side.

2. **Columnar (Vertical) form** – Also known as the report format. Assets are shown in order of liquidity (i.e. how quickly it can be converted into cash). The least liquid asset appears first and the most liquid asset appears last. The liabilities appear in the order of due dates for repayment. The permanent liabilities appear first, followed by semi-permanent liabilities. Short term liabilities appear last.

4.3 FORMS OF PROFIT & LOSS A/C

1. **Customary or Conventional Form** – Also known as Horizontal Form or Account Form or T Form. It shows all income for the year on the credit side of the account and all expenditure on the debit side. Excess of income over expenditure denotes profit for the year whereas excess of expenditure over income denotes loss for the year.

2. **Vertical or Columnar or Analytical Form** – It is prepared in a statement format showing Gross Sales less Returns = Net Sales. From Net sales cost of goods sold is deducted and gross margin is arrived. And from Gross Margin, operating and non-operating expenses are deducted. It gives clarity and simplicity and facility of analysis of the various sections of profit & loss a/c. It is possible to compute the relationship between various items in the revenue statement when it is prepared in such vertical format.

4.4 VERTICAL FORMAT OF BALANCE SHEET

	BALANCE SHEET AS ON.......		
SOURCES OF FUNDS		Amt	Amt
I	**Shareholder's Funds**		
	Share Capital	xx	
	Capital Reserve	xx	
	General Reserve	xx	
	Securities Premium	xx	
	Forfeited Shares	xx	
	Profit & Loss A/c	xx	
Less:	**Accumulated Losses**		
	Preliminary Expenses	xx	
	Discount on issue of shares/debentures	xx	
	Underwritting commission	xx	xx
II	**Loan Funds**		
	Debentures	xx	
	Other Long Term Loans	xx	xx
	TOTAL SOURCES		xxx
APPLICATION OF FUNDS		Amt	Amt
I	**Fixed Assets**		
	Goodwill	xx	
	Land & Building	xx	
	Plant & Machinery	xx	
	Patents, Copyrights	xx	
	Furniture	xx	xx
II	**Investments**		xx
III	**Working Capital**		
	Current Assets		
	Cash	xx	
	Bank	xx	
	Debtors	xx	
	Bills Receivables	xx	
	Marketable Securities	xx	
	Stock of goods	xx	
	Prepaid expenses	xx	
Less	**Current Liabilities and Provisions**		
	Creditors	xx	
	Bills Payable	xx	
	Outstanding expenses	xx	
	Bank overdraft	xx	
	Provision for Taxation	xx	
	Provision for Dividend	xx	
	Other provisions	xx	
	Working capital	xx	xx
	TOTAL APPLICATIONS		xxx

4.5 HORIZONTAL FORMAT OF BALANCE SHEET

Horizontal Format of Balance Sheet			
Imaginary Company Name Balance Sheet as at..			
Liabilities	**Amt**	**Assets**	**Amt**
Shareholder's Funds		**Fixed Assets**	
Share Capital	x	Land and Building	x
Reserves and Surplus	x	Furniture	x
Long Term Liabilities		**Current Assets**	
Loans	x	Cash at bank	x
		Sundry debtors	x
Current Liabilities		B/R	x
Sundry creditors	x	Stock	x
B/P	x		
Outstanding expenses	x	**Investments**	x
Bank overdraft	x		
Provisions		**Misc. Expenditure**	
Provision for Bad Debts	x	Discount on issue of shares	x
Provision for Taxation	x		
Total		**Total**	

4.6 VERTICAL FORM OF P&L ACCOUNT

	PROFIT & LOSS STATEMENT AS ON …		
		Amt	Amt
	Gross Sales		
	Cash + Credit Sales	xx	
Less:	Sales Returns	xx	
	Sales Tax	xx	
	Net Sales	xx	
Less:	**Cost of Sales**		
	R/M Consumed	xx	
	Direct wages	xx	
	Manufacturing expenses	xx	
Add:	Opening Stock - F/G & WIP	xx	
Less:	Closing Stock - F/G & WIP	xx	
	GROSS PROFIT		xxx
Add:	**Operating Income**		
	Commission on purchase & sale	XX	
	Discount received	XX	
Less:	**Operating Expenses**		
	Administrative expenses	XX	
	Selling & Distribution expenses	XX	
	Finance Expenses	XX	
	NET OPERATING PROFIT BEFORE INTEREST AND TAX (NOPBIT)		XXX
Add:	**Non Operating Income**		
	Dividend & Interest Received	XX	
	Profit on sale of fixed assets	xx	
Less:	**Non operating expenses & losses**		
	Discount on issue of shares/debentures	xx	
	Loss on sale of fixed assets	xx	
	NET PROFIT BEFORE INTEREST & TAX (NPBIT)		XXX
Less:	Interet on Debentures		XX
	NET PROFIT AFTER INTEREST BUT BEFORE TAX (NPAIBT)		XXX
Less:	Tax		XX
	NET PROFIT AFTER TAX (NPAT)		**XXX**

4.7 HORIZONTAL FORMAT OF PROFIT & LOSS A/C

Profit & Loss A/c for the year ended ……..					
Particulars	**Amt**	**Amt**	**Particulars**	**Amt**	**Amt**
To Gross Loss B/d		xx	By Gross Profit B/d		xx
To Administrative Expenses			**By Other Income or Gains**		
- Rent, Insurance, Repairs	xx		- Commission recd	xx	
- Office Salaries	xx		- Discount recd	xx	
- Postage, teleph & telex	xx		- Dividend recd	xx	
- Printing & Stationery	xx		- Interest recd	xx	
- Fees (legal/audit)	xx		- Profit on sale of assets	xx	
- General Expenses	xx	xx			
To Selling & Distribution Exp.					
- Salesman's salaries, commissio	xx				
- Travelling	xx				
- Carriage, freight, duties	xx				
- Warehousing charges	xx				
- Packing expense	xx				
- Advtg & sales promotion	xx				
- Goods given as free samples	xx	xx			
To Financial Expenses					
- Interest & bank charges	xx				
- Bad debts & prov for bad debts	xx				
- Discounts given	xx	xx			
To Depreciation					
- on Machinery, Computers	xx				
- on Furniture & Fixtures	xx				
- Building, Office Equipments	xx	xx			
To Unusual Exp or losses					
- Goods lost/destroyed	xx				
- Loss on sale of fixed assets	xx	xx			
To Appropriations					
- Income tax	xx				
- Reserves	xx	xx			
To Net Profit trf to Capital A/c		xx			
		xxx			**xxx**

4.8 SOLVED ILLUSTRATIONS

Illustration:1

Convert the following Balance Sheet in vertical format.

Balance Sheet of X & Co. as on 31st March, 2XXX (Proprietor Mr.X)					
Liabilities	**Amt**	**Amt**	**Assets**	**Amt**	**Amt**
Proprietor's Funds			**Fixed Assets**		
Capital	700000		Land	100000	
Reserves	300000	1000000	Buillding	360000	
			Plant & Machinery	660000	1120000
Long Term Loans					
Secured	300000		**Investment**		30000
Unsecured	200000	500000			
			Current Assets		
Current Liabilities			**Stock in Trade**		
Creditors	100000		Raw Materials	50000	
Provision for Taxation	35000	135000	Stores & Spares	5000	
			Work in Process	5000	
			Finished Goods	100000	160000
			Debtors	300000	
			Prepaid Expense	20000	
			Cash & Bank Balance	5000	325000
		1635000			**1635000**

Illustration 2:

Convert the following Balance Sheet in Vertical Format

Balance Sheet of Venus Manufacturers as on 31st March, 2XXX					
Liabilities	**Amt**	**Amt**	**Assets**	**Amt**	**Amt**
Outstanding Expenses		11700	Cash on Hand		1000
Sundry Creditors		90000	Cash with Bank		16000
Bills Payable		60000	Sundry Debtors		418019
			Bills Receivable		20000
Capital Balance	440000		Closing Stock		20000
Less - Drawings	38000		Prepaid Expenses (Insurance)		1500
Add - Net Profit	94619	496619			
			Loose Tools	10000	
			Less - Depreciation	1000	9000
			Furniture	4000	
			Less - Depreciation	400	3600
			Plant & Machinery	100000	
			Less - Depreciation	10000	90000
			Building	50000	
			Add - Extension	12000	
			Less - Depreciation	2800	59200
			Land		20000
		658319			**658319**

Solution for Illustration 1

Balance Sheet of X & Co as on …..		
SOURCES OF FUNDS	**Amt**	**Amt**
Proprietor's Funds		
Capital	700000	
Reserves	300000	1000000
Long Term Loans		
Secured	300000	
Unsecured	200000	500000
	Total	**1500000**
APPLICATION OF FUNDS	**Amt**	**Amt**
Fixed Assets		
Land	100000	
Buillding	360000	
Plant & Machinery	660000	1120000
Working Capital		
Current Assets		
Stock in Trade		
Raw Materials	50000	
Stores & Spares	5000	
Work in Process	5000	
Finished Goods	100000	
Debtors	300000	
Prepaid Expense	20000	
Cash & Bank Balance	5000	
Marketable Investments	30000	515000
Less - Current Liabilities		
Creditors	100000	
Provision for Taxation	35000	135000
	Total	**1500000**

Solution for Illustration 2

	Balance Sheet of Venus Manufacturers as on …..		
	SOURCES OF FUNDS	**Amt**	**Amt**
	Proprietor's Funds		
	Capital Balance	440,000	
	Less - Drawings	38,000	
	Add - Net Profit	94,619	496,619
	Long Term Loans		-
		Total	**496,619**
	APPLICATION OF FUNDS	**Amt**	**Amt**
I	**Fixed Assets**		
	Loose Tools	10,000	
	Less - Depreciation	1,000	9,000
	Furniture	4,000	
	Less - Depreciation	400	3,600
	Plant & Machinery	100,000	
	Less - Depreciation	10,000	90,000
	Building	50,000	
	Add - Extension	12,000	
	Less - Depreciation	2,800	59,200
	Land		20,000
II	**Investments**		-
III	**Working Capital**		
	Current Assets		
	Cash on Hand	1,000	
	Cash with Bank	16,000	
	Sundry Debtors	418,019	
	Bills Receivable	20,000	
	Closing Stock	20,000	
	Prepaid Expenses (Insurance)	1,500	476,519
	Less - Current Liabilities		
	Outstanding Expenses	11,700	
	Sundry Creditors	90,000	
	Bills Payable	60,000	161,700
		Total	**496,619**

Illustration 3

Present the following

Manufacturing, Trading and Profit & Loss Account for the year ended …31.03.XX					
Particulars	**Amt**	**Amt**	**Particulars**	**Amt**	**Amt**
To Opn stock (R/M)		40000	By Closing Stock (R/M)		80000
To Purchases	205000		By Cost of Production C/d		242000
Less - Returns	5000	200000			
To Packing Materials		15000			
To Wages		55000			
To Carriage Inwards		9000			
To Depreciation - Plant		3000			
		322000			**322000**
To Opn Stock (F/G)		10000	By Sales	410000	
To Cost of Production b/d		242000	Less - Returns	10000	400000
To Gross Profit c/d		168000	By Closing Stock of F/G		20000
		420000			**420000**
To Salaries		22000	By Gross Profit b/d		168000
To Insurance		2500	By Miscellaneous Income		5000
To Rent		7000			
To Printing & Stationary		4000			
To Rates and Taxes		3000			
To Office Expenes		4000			
To Interest & Bank Charges		8000			
To Salesmen's Travel Exp		10000			
To General Exp		1000			
To Audit Fees		2000			
To Advertisements		6000			
To Legal Charges		36000			
To Interest on Loan		25000			
To Prov for doubtful debts		7000			
To Dep on furniture		1200			
To Net Profit c/d		34300			
		173000			**173000**

Solution for Illustration 3

PROFIT & LOSS STATEMETN IN VERTICAL FORM			
Particulars	**Amt**	**Amt**	**Amt**
Gross Sales		410000	
Less - Returns		10000	
Net Sales			400000
Less - Cost of Sales			
Opn Stock - R/M		40000	
Opn Stock - F/G		10000	
Add - Purchases	205000		
Less - Returns	5000	200000	
Add - Packing Materials		15000	
Add - Wages		55000	
Add - Carriage Inwards		9000	
Add - Depreciation - Plant		3000	
Less - Closing Stock - R/M		80000	
Less - Closing Stock - F/M		20000	232000
Gross Profit			168000
Less - Operating Expenses			
Administrative Expenses			
Salaries	22000		
Insurance	2500		
Rent	7000		
Printing & Stationery	4000		
Rent & Taxes	3000		
Office Expenses	4000		
General Expenses	1000		
Audit Fees	2000		
Legal Charges	36000		
Depreciation on Furniture	1200	82700	
Finance Expenses			
Interest & Bank charges	8000		
Interest on Loan	25000		
Provision for Doubtful Debts	7000	40000	
Selling & Distribution Expenses			
Travel expenses of salesmen	10000		
Advertisement	6000	16000	138700
Operating Net Profit			29300
Add - Non Operating Income			
Miscellaneous Income			5000
Less - Non Operating Expenses			0
Net Profit			**34300**

Illustration 4

Profit & Loss Account for the year ended …31.03.XX					
Particulars	**Amt**	**Amt**	**Particulars**	**Amt**	**Amt**
To Opn stock		40200	By Sales	1940000	
To Purchases less Returns		1650260	Less - Returns	4800	1935200
To Electricity Power		28100	By Closing Stock		24100
To Carriage Inward		5120			
To Wages		32212			
To Gross Profit c/d		203408			
		1959300			**1959300**
To Rates and Taxes		2500	By Gross Profit b/d		203408
To Salaries		38240	By Bad Debts Recovered		2000
To Lighting		6210			
To Office Rent		6000			
To Travel Exp of Salesmen		2220			
To Insurance		1000			
To Advertising		39550			
To Bad Debts		16050			
To Discount		5705			
To General Expenses		11265			
To Postage & Telegram		3000			
To Dep on Plant		3916			
To Dep on furniture		1560			
To Audit Fees		1200			
To Loss on Sale of Machinery		33250			
To Net Profit c/d		33742			
		205408			**205408**

Solution for Illustration 4

PROFIT & LOSS STATEMETN IN VERTICAL FORM			
Particulars	**Amt**	**Amt**	**Amt**
Gross Sales		1940000	
Less - Returns		4800	
Net Sales			1935200
Less - Cost of Sales			
Opening Stock		40200	
Add - Purchases		1650260	
Electricity Power		28100	
Carriage Inward		5120	
Wages		32212	
Deprn on Plant		3916	
		1759808	
Less - Closing Stock		24100	1735708
Gross Margin			199492
Less - Operating Expenses			
Administrative Expenses			
Rates & Taxes	2500		
Salaries	38240		
Lighting	6210		
Office Rent	6000		
Insurance	1000		
General Expenses	11265		
Postage & Telegram	3000		
Deprn on Furniture	1560		
Audit Fees	1200	70975	
Finance Expenses			
Bad Debts	16050		
Discount	5705	21755	
Sellign & Distribution Expenses			
Salesmen's Travel Expenses	2220		
Advertising	39550	41770	134500
Operating Net Profit			**64992**
Add - Non Operating Income			
Bad Debts Recovery			2000
Less - Non Operating Expenses			
Loss on Sale of Machinery			33250
Net Profit Before Tax			**33742**

❄❄❄❄❄❄❄

8

INTRODUCTION TO SCHEDULE VI OF COMPANIES ACT, 1956

(Now Schedule III of Companies Act, 2013, Amended by MCA Notification dated 24th March, 2021)

Unit Structure:

LEARNING OBJECTIVES

- After studying this unit, you will be able to understand:
- Schedule III of the Companies Act 2013
- Financial Statements as per Revised Schedule III

4.1 INTRODUCTION & MEANING

Financial Statements are historical documents which show summaries of detailed information about financial performance and financial position of an organization for the accounting period. There are two basic financial documents viz. Income Statement and Balance Sheet.

Income Statement

It is a statement of Revenue from operations, other incomes and expenses during a given accounting year. It indicates financial performance of an organization for an accounting year. It is also called as statement of profit & loss

Balance Sheet

It is a statement of assets and liabilities indicating financial position of an organization at a certain date. It is a statement of assets and equity. Assets include non-current assets and current assets and liabilities include shareholders fund, Non-current liabilities and current liabilities.

4.2 FORMAT OF BALANCE SHEET AND PROFIT & LOSS STATEMENT AS GIVEN IN THE SCHEDULE III OF THE COMPANIES ACT 2013 ARE GIVEN BELOW FOR REFERENCE WITH BRIEF EXPLANATION

			Part I - FORM OF BALANCE SHEET			
			Name of the Company			
			BALANCE SHEET			
			PARTICULARS	**Note No.**	**Current Year Amt Rs.**	**Previous Year Amt Rs.**
I			**EQUITY & LIABILITIES**			
	1		**EQUITY**			
		a	Share Capital			
		b	Other Equity - Reserves & Surplus			
		c	Money Received against Share Warrants			
	2		**Share Application Money Pending Allotment**			
	3		**NON CURRENT LIABILITIES**			
		a	Long Term Borrowing			
		b	Deferred Tax Liabilities (Net)			
		c	Other Long Term Liabilities			
		d	Long Term Provisions			
	4		**CURRENT LIABILIITES**			
		a	Short Term Borrowings			
		b	Trade Payables			
			- Total outstanding dues of Micro Enterprises & Small Enterprises			
			- Total outstanding dues of Creditors other than Micro Enterprises & Small Enterprises			
		c	Other Current Liabilities			
		d	Short Term Provisions			
			TOTAL			
II			**ASSETS**			
	1		**NON CURRENT ASSETS**			
		a	Property Pland & Equipment and Intangible Assets			
			i) Property, Plant and Equipment			
			ii) Intangible Assets			
			iii) Capital Work in Progress			
			iv) Intangible Assets under Development			
		b	Non Current Investments			
		c	Deferred Tax Assets (Net)			
		d	Long Term Loans & Advances			
		e	Other Non Current Assets			
	2		**CURRENT ASSETS**			
		a	Current Investments			
		b	Inventories			
		c	Trade Receivables			
		d	Cash & Cash Equivalents			
		e	Short Term Loans & Advances			
		f	Other Current Assets			
			TOTAL			

		Part II - FORM OF STATEMENT OF PROFIT & LOSS			
		Name of the Company			
		PROFIT & LOSS STATEMENT FOR THE YEAR ENDED			
		PARTICULARS	**Note No.**	**Current Year Amt Rs.**	**Previous Year Amt Rs.**
I		Revenue from Operations			
II		Other Income			
III		**Total Income**			
IV		**Expensese**			
	a	Cost of Materials Consumed			
	b	Purchases of Stock in Trade			
	c	Change in Inventories (of F/G, WIP & Stock in Trade)			
	d	Employee Benefit Expenses			
	e	Finance Cost			
	f	Depreciation & Amortization			
	g	Other Expenses			
		Total Expenses			
V		**Profit Before Exceptional and Extraordinary Items and Tax (III-IV)**			
VI		**Exceptional Items**			
VII		Profit Before Extraordinary Items and Tax (V-VI)			
VIII		Extraordinary Items			
IX		Profit Before Tax (VII-VIII)			
X		Tax Expenses			
		1. Current Tax			
		2. Deferred Tax			
XI		Profit or (Loss) for the period from continuing operations (VII-VIII)			
XII		Profit or (Loss) for the period from dis - continuing operations			
XIII		Tax expenses of discontinuing operations			
XIV		Profit / (Loss) from Discontinuing operations (after tax) (XII-XIII)			
XV		Profit or (loss) for the period (XI+XIV)			
XVI		Earnings per Equity Share			
		1. Basic (NPAT-Preference Dividend)/No. of issued equity shares			
		2. Diluted (NPAT-Preference Dividene)/ No. of issued Equity shares, Preference shares, Warrants, Debts, stock options etc.			

4.3 ITEMS APPEARING UNDER THE HEAD EQUITY AND LIABILITIES IN THE BALANCE SHEET

1) Shareholders Funds

(a) Share Capital:

Note: Equity Share Capital and Preference Share Capital are to be shown separately.

(b) Reserves and Surplus: The following items are shown under this head:

(i) Capital Reserves

(ii) Capital Redemption Reserve

(iii) Securities Premium

(iv) Debenture Redemption Reserve

(v) Revaluation Reserve (Accounting Treatment -Not to be evaluated)

(vi) Share options Outstanding Account (Accounting Treatment -Not to be evaluated);

(vii) Other reserves (restricted to General Reserve only);

(viii) Surplus i.e. balance in the Statement of Profit & Loss [Add Cr. Bal or Less Dr. balance]

The balance of 'Reserves and Surplus', after adjusting negative balance of surplus, if any, shall be shown under the head 'Reserves and Surplus' even if the resulting figure is in negative.

(c) Money received against share warrants

2) Share application money pending allotment

3) Non-current liabilities

(a) Long Term borrowing:

(Debentures / Bonds, Bank Loans, Long Term Loans, Mortgage Loans, Public Deposits etc.)

(b) Deferred Tax Liabilities: (Net)

(c) Other Long -Term Liabilities:

Intercompany Owings from associates, subsidiaries or other companies, long term trade payable.

(d) Long Term provisions:

(Provision for Employee Benevolent/Welfare Fund, Provident Fund, Gratuity Fund, Provision for Warranties, Provision for Pension Fund)

4) Current Liabilities

(a) Short-term Borrowings: Loans repayable on demand from banks and other parties, Bank Overdrafts, Cash credits.

(b) Trade Payables: Sundry Creditors, Bills Payable, Outstanding Expenses

(c) Other Current Liabilities: Unpaid dividends, Interest accrued and due or not due on borrowings, Income received in advance, Calls in advance, o/s Interest on calls in advance.

(d) Short-term Provisions: (Provision for tax and Proposed dividend)

4.4 ITEMS APPEARING UNDER THE HEAD ASSETS IN THE BALANCE SHEET.

1. Non-Current Assets

(a) Fixed Assets:

(i) **Tangible Assets:** (Land, Building, Plant and Equipment, Furniture & Fixture, Vehicles, Office Equipment, Live Stock, Railway sidings etc.)

(ii) **Intangible Assets:**

(a) Goodwill

(b) Brand / Trademarks

(c) Computer Software & Mining rights

(d) Masthead and Publishing titles.

(e) Copyrights, and patents and other intellectual property rights, services and operating rights.

(f) Recipes, formulae, models, designs and prototypes

(g) Licenses and franchise

(iii) Capital work in Progress:

(iv) Intangible Assets under Development: like patents, intellectual property rights, etc. which are being developed by the company.

(b) Non-Current Investments: Investments /Trade Investments and Non-trade investment (If it is a long term)

(c) Deferred Tax Assets (Net):

(d) Long-term Loans and Advances: – only Capital Advances and Security Deposits.

(e) Other non-current assets: Preliminary Expenses, Discount on Issue of shares/ debentures

Underwriting Commission, Deferred revenue expenses/ Discount on issue of shares/debenture/Share expenses

2. Current Assets

(a) Current Investments:

(Investments in Equity Instruments (Shares), Preference shares, Government Securities,

Debentures, and Mutual Funds etc.) (For **short duration**, i.e. meant for resale)

(b) Inventories: Inventories include the following:

(i) Raw Material

(ii) Work-in-progress

(iii) Finished Goods

(iv) Stock- in- trade (in respect of goods acquired for trading)

(v) Stores and Spares

(vi) Loose Tools

(c) Trade Receivables: Debtors and Bills receivables.

(d) Cash and cash equivalents:

(a) Balance with banks

(b) Cheques, drafts on hand.

(c) Cash in hand

(d) Deposit with Banks.

(e) Short-term Loans and Advances: (short term loans /advances given to employees)

(f) Other Current Assets: (Restricted to prepaid expenses, Accrued Incomes, Interest accrued on Investments, Advance Tax)

3. Contingent Liabilities and Capital Commitments

(a) Contingent Liabilities – Those liabilities which may or may not arise because they are dependent on a happening in future. It is not recorded in the books of accounts but is disclosed in the Notes to Accounts for the information of the users. (Claims against the company not acknowledged as debts, Guarantees, Other money for which the company is contingently liable).

(b) Capital commitments – A future liability for capital expenditure in respect of which contacts have been made. (Uncalled liability on shares and other investments partly paid etc.)

4.5 BRIEF EXPLANATION FOR PROFIT & LOSS STATEMENT

I **Revenue from operations** (Cash sales + Credit sales Less Sales returns Less Excise Duty)

II **Other Income** (All incomes other than sales)

III **Total Revenue (I + II)**

IV Expenses

a) **Cost of materials consumed** (is given specifically; No need to calculate if not given)

b) **Purchases of stock-in-trade** (purchases)

c) **Changes in inventories of finished goods, work-in-progress & stock-in-trade** (Opening stock less closing stock)

d) **Employees Benefits Expenses** (salaries, wages, canteen expenses, all their employee welfare expenses, PF contribution of the employer)

e) **Finance cost** (Interest on borrowings)

f) **Depreciation & Amortization expenses** (Dep. On fixed tangible assets & amortization of intangible asset)

g) **Other expenses** All other revenue expenses & losses + loss by theft/fire etc.

4.6 LEGAL REQUIREMENTS

1. Books of Accounts – Section 128(1) provides that every company must keep at its registered office books of accounts, relevant papers and financial statements for every financial year and explain the transaction effected both at the registered office and its branches.

2. Basis – Books of accounts must be kept on accrual basis and according to Double Entry System of Accounting

3. A Place Other than Registered Office – The books of accounts may be kept at such other place in India as the Board of Directors may decide. When such a decision is taken, the company must file with the registrar, within 7 days a notice giving full address of that place.

4. Electronic Mode – The company may keep such books of accounts or other relevant papers in electronic mode in such a manner as may be prescribed

5. Branch Books of Accounts – Where a company has a branch in India or outside India, the Provisions of the Act must be complied with. The branch must send the summarized return at its registered office or at such other place where accounts are kept

6. Inspection by Directors – The directors have the right to inspect the books of accounts at the registered office or at such a place where accounts are kept.

7. Preservation – The books of accounts of every company must be preserved for at least 8 financial years immediately preceding the financial year

8. Penalty – In case of contravention of section 128, MD, whole time director in charge of finance, chief financial officer shall be punishable with imprisonment for 1 year or with fine of Rs.50000 which may be extended to Rs.500000 or with both

9. Compliances with AS and Forms – The financial statements must comply with the accounting standard notifies under section 133 and must be in the form prescribed by schedule III (Section 129 (1))

10. Consolidated Financial Statements – In case a company has one or more subsidiaries, it prepares consolidated financial statements in addition to financial statements

11. Board Responsibility – The board is responsible to lay before Annual General meeting of a company the financial statements for the year.

12. Deviation – If there is a deviation from A.S. such deviations and the reasons there of must be disclosed in the financial statements for the year.

13. Signature – Financial statements must be approved by the board of directors before they are signed on behalf of the board by chairman or 2 directors, the Chief Financial Officer, Secretary of the company. Thereafter the financial statements should be submitted for audit (Section 134 (1))

14. Auditor's Report – The auditors report is to be attached to every financial statement (Section 134(2))

15. BOD Report – The report is to be attached to statements laid before the general meeting

16. Directors responsibility statement (Section 134(5) must state – compliance with accounting standards, Accounting policies, Accounting records, Internal Financial Control and Compliance with Law

17. Circulation – A signed copy of every financial statement including consolidated financial statement, must be issued,

circulated or published along with a copy of notes, auditors report and boards report

18. Penalty- If a company contravenes the provisions of section 134, the company shall be punishable with a fine of Rs.50000 which may extend to Rs.2500000 and every officer in default shall be punishable with imprisonment for a term which may extend to 3 years or with fine which shall be at least Rs.50000 and which may extend to Rs.500000 or with both.

19. Members Right (Section 136) – Every member has a right to receive copies of audited financial statements at least 21 days before the date of the annual general meeting (Section 136 (1))

20. File with the Registrar (Section 137)- A copy of financial statements including consolidated financial statements if any along with the documents to be attached to such financial statements, must be filed with the registrar of companies within 30 days of the date of annual general meeting

4.7 EXERCISES

I. MULTIPLE CHOICE QUESTIONS

1. The requirements for final account of companies are specified in Schedule…

   a. I

   b. III

   c. XIII

   d. XIV

2. Any amount payable within 12 months from date of Balance Sheet is called….

   a. Capital

   b. Loan

   c. Contingent

   d. Current Liabilities

3. Schedule III requires Profit & Loss Account to be prepared in ----

   a. Horizontal format

   b. Vertical Format

   c. Convenient Format

   d. Columnar Format

4. Which of the following is not an example of PPE?
   a. Plant & Machinery
   b. Buildings
   c. Royalty
   d. Patents

5. Following is not a secured loan
   a. Debentures
   b. Bank Loans
   c. Public Deposits
   d. None of the above

II. STATE WHETHER THE FOLLOWING STATEMENTS ARE TRUE OR FALSE

1. The companies final accounts should be prepared in the form prescribed under Companies Act, 2013 – True
2. Companies must prepare their financial statements in vertical format only – True
3. Immovable property is included in PPE – True
4. Goodwill is amortized – True
5. Authorized capital is disclosed only for information – True
6. Accounting policies adopted by a company should be disclosed as per AS-9 – False (it is AS-1)

III. FILL IN THE BLANKS

1. Accounting policies are prescribed by ….. (AS-1)
2. Machinery is shown under …. Assets. (PPE)
3. Profit & Loss Account of a company must be as per part … of schedule III of Companies Act, 2013 (II)
4. Fixed Deposits with bank should be shown as ----- (Bank Balance)
5. Immovable properties held for source of additional income is to be shown as --- (Investment)
6. The capital work in progress is added to …. In Balance Sheet (PPE)

IV. MATCH THE FOLLOWING

	Group X		Group Y
1	Proposed Dividend	A	Contingent Liability as a note
2	Discount on Issue of Shares	B	Other current assets
3	Disputed Tax Demand	C	Contingent Liability
4	Debentures	D	Long Term Borrowing
5	Live Stocks	E	PPE
6	Trade Marks	F	Intangible Assets
7	Issue of Bonus Shares	G	Capitalization of Reserve

Answers: (1-A), (2-B), (3-C), (4-D), (5-E), (6-F), (7-G)

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