

SYLLABUS - 2016

FUNDAMENTALS OF ACCOUNTING

FOUNDATION

STUDY NOTES



The Institute of Cost Accountants of India

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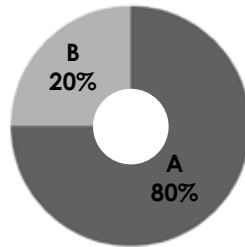
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Syllabus - 2016

PAPER 2: FUNDAMENTALS OF ACCOUNTING (FOA)

Syllabus Structure

A	Fundamentals of Financial Accounting	80%
B	Fundamentals of Cost Accounting	20%



ASSESSMENT STRATEGY

There will be written examination paper of three hours

OBJECTIVES

To gain comprehensive understanding of all aspects relating to financial statements, principles, procedures of accounting and their application to different practical situations

Learning Aims

The syllabus aims to test the student's ability to:

- Understand and explain the conceptual framework of Accounting
- Prepare Accounting for various entities under different situations
- Acquire basic concepts of Cost & Management Accounting relevant for managerial decision making

Skill set required

Level A: Requiring the skill levels of knowledge, comprehension,

Section A : Fundamentals of Financial Accounting	
1. Accounting Fundamentals	35%
2. Accounting for Special Transactions	20%
3. Preparation of Final Accounts	25%
Section B: Fundamentals of Cost Accounting	
4. Fundamentals of Cost Accounting	20%

SECTION A : Fundamentals of Financial Accounting [80 MARKS]

1. Accounting Basics
2. Accounting for Special Transactions
3. Preparation of Final Accounts

SECTION B: Fundamentals of Cost & Management Accounting [20 MARKS]

4. Fundamentals of Cost Accounting

Section A : Fundamentals of Financial Accounting [80 marks]

1. Accounting Process

- (a) Accounting Principles, Concepts and Conventions
- (b) Capital and Revenue transactions - capital and revenue expenditures, capital and revenue receipts
- (c) Double entry system, Books of prime entry, Subsidiary Books, Cash Book
- (d) Journal, Ledger, Trial Balance
- (e) Depreciation - Methods (Straight Line and Diminishing Balance methods only)
- (f) Rectification of Errors
- (g) Opening entries, Transfer entries, Adjustment entries, Closing entries
- (h) Bank Reconciliation Statements

2. Accounting for Special Transactions

- (a) Bills of Exchange (excluding accommodation bill, insolvency)
- (b) Consignment (cost price, invoice price, commission & valuation of stock)
- (c) Joint Venture

3. Preparation of Final Accounts

(a) Of a Profit making concern (for sole proprietorship concern only)

- (i) Accounting treatment of bad debts, reserve for bad and doubtful debts, provision for discount on debtors and provision for discount on creditors.
- (ii) Preparation of Trading Account, Profit & Loss Account and Balance Sheet.

(b) Of a Not-for- Profit making concern

- (i) Preparation of Receipts and Payments Account
- (ii) Preparation of Income and Expenditure Account

SECTION B: Fundamentals of Cost Accounting [20 MARKS]

4. Fundamentals of Cost Accounting

- (a) Meaning, Definition, Significance of Cost Accounting, its relationship with Financial Accounting & Management Accounting.
- (b) Classification of Costs
- (c) Format of Cost Sheet

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STUDY NOTE : 1

ACCOUNTING BASICS

THIS STUDY NOTE INCLUDES:

- 1.1 Accounting Principles, Concepts and Conventions
- 1.2 Capital and Revenue transactions - capital and revenue expenditures, capital and revenue receipts
- 1.3 Double entry system, Books of prime entry, Subsidiary Books, Cash Book, Journal, Ledger, Trial Balance
- 1.4 Depreciation - Methods (Straight Line and Diminishing Balance methods)
- 1.5 Rectification of Errors
- 1.6 Opening entries, Transfer entries, Adjustment entries, Closing entries
- 1.7 Bank Reconciliation Statements

1.1 ACCOUNTING PRINCIPLES, CONCEPTS AND CONVENTIONS

Introduction to Financial Accounting

Business is an economic activity undertaken with the motive of earning profits and to maximize the wealth for the owners. Business cannot run in isolation. Largely, the business activity is carried out by people coming together with a purpose to serve a common cause. This team is often referred to as an organization, which could be in different forms such as sole proprietorship, partnership, body corporate etc. The rules of business are based on general principles of trade, social values, and statutory framework encompassing national or international boundaries. While these variables could be different for different businesses, different countries etc., the basic purpose is to add value to a product or service to satisfy customer demand.

The business activities require resources (which are limited & have multiple uses) primarily in terms of material, labour, machineries, factories and other services. The success of business depends on how efficiently and effectively these resources are managed. Therefore, there is a need to ensure the businessman tracks the use of these resources. The resources are not free and thus one must be careful to keep an eye on cost of acquiring them as well. As the basic purpose of business is to make profit, one must keep an ongoing track of the activities undertaken in course of business. Two basic questions would have to be answered:

- (a) What is the result of business operations? This will be answered by finding out whether it has made profit or loss.
- (b) What is the position of the resources acquired and used for business purpose? How are these resources financed? Where the funds come from?

The answers to these questions are to be found continuously and the best way to find them is to record all the business activities. Recording of business activities has to be done in a scientific manner so that they reveal correct outcome. The science of book-keeping and accounting provides an effective solution. It is a branch of social science. This study material aims at giving a platform to the students to understand basic principles and concepts, which can be applied to accurately measure performance of business. After studying the various chapters included herein, the student should be able to apply the principles, rules, conventions and practices to different business situations like trading, manufacturing or service.

DEFINITIONS

Definition of Accounting

Definition by the American Institute of Certified Public Accountants (Year 1961):

"Accounting is the art of recording, classifying and summarizing in a significant manner and in terms of money, transactions and events which are, in part at least, of a financial character, and interpreting the result thereof"

Definition by the American Accounting Association (Year 1966):

"The process of identifying, measuring and communicating economic information to permit informed judgments and decisions by the users of accounting".

Objectives of Accounting**(i) Providing Information to the Users for Rational Decision-making**

The primary objective of accounting is to provide useful information for decision-making to stakeholders such as owners, management, creditors, investors, etc. Various outcomes of business activities such as costs, prices, sales volume, value under ownership, return of investment, etc. are measured in the accounting process. All these accounting measurements are used by stakeholders (owners, investors, creditors/bankers, etc.) in course of business operation. Hence, accounting is identified as 'language of business'.

(ii) Systematic Recording of Transactions

To ensure reliability and precision for the accounting measurements, it is necessary to keep a systematic record of all financial transactions of a business enterprise which is ensured by bookkeeping. These financial records are classified, summarized and reposted in the form of accounting measurements to the users of accounting information i.e., stakeholder.

(iii) Ascertainment of Results of above Transactions

'Profit/loss' is a core accounting measurement. It is measured by preparing profit and loss account for a particular period. Various other accounting measurements such as different types of revenue expenses and revenue incomes are considered for preparing this profit and loss account. Difference between these revenue incomes and revenue expenses is known as result of business transactions identified as profit/loss. As this measure is used very frequently by stockholders for rational decision making, it has become the objective of accounting. For example, Income Tax Act requires that every business should have an accounting system that can measure taxable income of business and also explain nature and source of every item reported in Income Tax Return.

(iv) Ascertain the Financial Position of Business

'Financial position' is another core accounting measurement. Financial position is identified by preparing a statement of ownership i.e., Assets and Owings i.e., liabilities of the business as on a certain date. This statement is popularly known as balance sheet. Various other accounting measurements such as different types of assets and different types of liabilities as existed at a particular date are considered for preparing the balance sheet. This statement may be used by various stakeholders for financing and investment decision.

(v) To Know the Solvency Position

Balance sheet and profit and loss account prepared as above give useful information to stockholders regarding concerns potential to meet its obligations in the short run as well as in the long run.



Providing Information to the Users for Rational Decision-making
Systematic Recording of Transactions
Ascertainment of Results of above Transactions
Ascertain the Financial Position of Business
To Know the Solvency Position

Function of Accounting

The main functions of accounting are as follows:

- (a) Measurement:** Accounting measures past performance of the business entity and depicts its current financial position
- (b) Forecasting:** Accounting helps in forecasting future performance and financial position of the enterprise using past data.
- (c) Decision-making:** Accounting provides relevant information to the users of accounts to aid rational decision-making.
- (d) Comparison & Evaluation:** Accounting assesses performance achieved in relation to targets and discloses information regarding accounting policies and contingent liabilities which play an important role in predicting, comparing and evaluating the financial results.
- (e) Control:** Accounting also identifies weaknesses of the operational system and provides feedbacks regarding effectiveness of measures adopted to check such weaknesses.
- (f) Government Regulation and Taxation:** Accounting provides necessary information to the government to exercise control on the entity as well as in collection of tax revenues.

BOOK-KEEPING

As defined by Carter, 'Book-keeping is a science and art of correctly recording in books-of accounts all those business transactions that result in transfer of money or money's worth'.

Book-keeping is an activity concerned with recording and classifying financial data related to business operation in order of its occurrence.

Book-keeping is a mechanical task which involves:

- Collection of basic financial information.
- Identification of events and transactions with financial character i.e., economic transactions.
- Measurement of economic transactions in terms of money.
- Recording financial effects of economic transactions in order of its occurrence.
- Classifying effects of economic transactions.
- Preparing organized statement known as trial balance.

The distinction between book-keeping and accounting is given below:

Distinction between Book-keeping and Accounting

Distinction between Book-keeping and Accounting

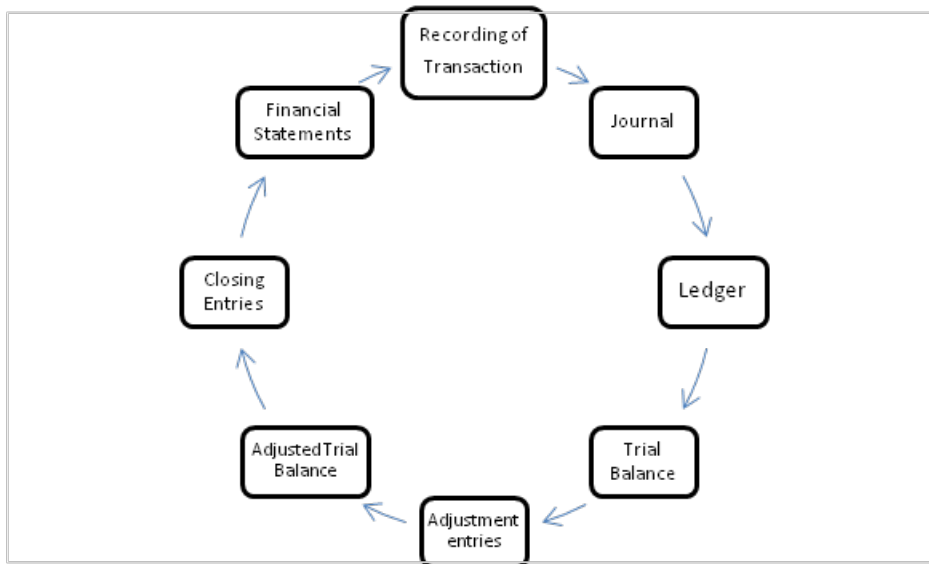
Book-Keeping	Accounting
1. Output of book-keeping is an input for accounting.	1. Output of accounting permit informed judgments and decisions by the user of accounting information.
2. Purpose of book-keeping is to keep systematic record of transactions and events of financial character in order of its occurrence.	2. Purpose of accounting is to find results of operating activity of business and to report financial strength of business.
3. Book-keeping is a foundation of accounting.	3. Accounting is considered as a language of business.
4. Book-keeping is carried out by junior staff.	4. Accounting is done by senior staff with skill of analysis and interpretation.
5. Objects of book-keeping is to summarize the cumulative effect of all economic transactions of business for a given period by maintaining permanent record of each business transaction with its evidence and financial effects on accounting variable.	5. Object of accounting is not only bookkeeping but also analyzing and interpreting reported financial information for informed decisions.

ACCOUNTING CYCLE

When complete sequence of accounting procedure is done which happens frequently and repeated in same directions during an accounting period, the same is called an accounting cycle.

Steps/Phases of Accounting Cycle

The steps or phases of accounting cycle can be developed as under:



ACCOUNTING CYCLE

- (i) **Recording of Transaction:** As soon as a transaction happens it is at first recorded in subsidiary book.
- (ii) **Journal:** The transactions are recorded in Journal chronologically.
- (iii) **Ledger:** All journals are posted into ledger chronologically and in a classified manner.
- (iv) **Trial Balance:** After taking all the ledger account closing balances, a Trial Balance is prepared at the end of the period for the preparations of financial statements.
- (v) **Adjustment Entries:** All the adjustments entries are to be recorded properly and adjusted accordingly before preparing financial statements.
- (vi) **Adjusted Trial Balance:** An adjusted Trail Balance may also be prepared.
- (vii) **Closing Entries:** All the nominal accounts are to be closed by the transferring to Trading Account and Profit and Loss Account.
- (viii) **Financial Statements:** Financial statement can now be easily prepared which will exhibit the true financial position and operating results.

ACCOUNTING – CLASSIFICATION

The various sub-fields of the accounting are:



1.	Financial Accounting	Determining the financial results for the period and the state of affairs on the last day the accounting period.	Stewardship Accounting
2.	Cost Accounting	Information generation for Controlling operations with a view to maximizing efficiency and profit.	Control Accounting
3.	Management Accounting	Accounting to assist management in planning and decision making.	Decision Accounting

(a) Financial Accounting

It is commonly termed as Accounting. The American Institute of Certified Public Accountants defines Accounting as "an art of recoding, classifying and summarizing in a significant manner and in terms of money, transactions and events which are in part at least of a financial character, and interpreting the results thereof."

(b) Cost Accounting

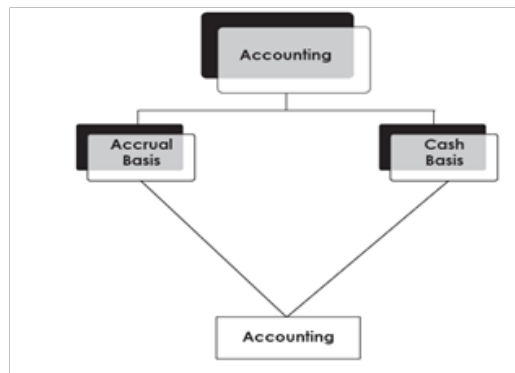
According to the Chartered Institute of Management Accountants (CIMA), Cost Accountancy is defined as "application of costing and cost accounting principles, methods and techniques to the science, art and practice of cost control and the ascertainment of profitability as well as the presentation of information for the purpose of managerial decision-making."

(c) Management Accounting

Management Accounting is concerned with the use of Financial and Cost Accounting information to managers within organizations, to provide them with the basis in making informed business decisions that would allow them to be better equipped in their management and control functions.

BASIS OF ACCOUNTING

ACCRUAL BASIS AND CASH BASIS OF ACCOUNTING



(I) Accrual Basis of Accounting

Accrual Basis of Accounting is a method of recording transactions by which revenue, costs, assets and liabilities are reflected in the accounts for the period in which they accrue. This basis includes consideration relating to deferrals, allocations, depreciation and amortization. This basis is also referred to as mercantile basis of accounting.

(I) Cash Basis of Accounting

Cash Basis of Accounting is a method of recording transactions by which revenues, costs, assets and liabilities are reflected in the accounts for the period in which actual receipts or actual payments are made.

Distinction between Accrual Basis of Accounting and Cash Basis of Accounting

Basis of Distinction	Accrual Basis of Accounting	Cash Basis of Accounting
1. Prepaid/Outstanding Expenses / accrued/ unaccrued Income in Balance Sheet.	Under this, there may be prepaid/ outstanding expenses and accrued/ unaccrued incomes in the Balance Sheet.	Under this, there is no prepaid / outstanding expenses or accrued / unaccrued incomes.
2. Higher/lower Income in case of prepaid expenses and accrued income	Income Statement will show a relatively higher income	Income Statement will show lower income.
3. Higher/lower income in case of outstanding expenses and unaccrued income	Income Statement will show a relatively lower income.	Income Statement will show higher income.
4. Availability of options to an accountant to manipulate the accounts by way of choosing the most suitable method out of several alternative methods of accounting e.g. FIFO/LIFO/SLM/WDV	Under this, an accountant has options.	Under this an accountant has no option to make a choice as such.

Hybrid or Mixed Basis

Under the hybrid system of accounting, incomes are recognised as in Cash Basis Accounting i.e. when they are received in cash and expenses are recognised on accrual basis i.e. during the accounting period in which they arise irrespective of when they are paid.



BASIC ACCOUNTING TERMS

In order to understand the subject matter clearly, one must grasp the following common expressions always used in business accounting. The aim here is to enable the student to understand with these often used concepts before we embark on accounting procedures and rules. You may note that these terms can be applied to any business activity with the same connotation.

- (i) **Transaction:** It means an event or a business activity which involves exchange of money or money's worth between parties. The event can be measured in terms of money and changes the financial position of a person e.g. purchase of goods would involve receiving material and making payment or creating an obligation to pay to the supplier at a future date. Transaction could be a cash transaction or credit transaction. When the parties settle the transaction immediately by making payment in cash or by cheque, it is called a cash transaction. In credit transaction, the payment is settled at a future date as per agreement between the parties.
- (ii) **Goods/Services:** These are tangible article or commodity in which a business deals. These articles or commodities are either bought and sold or produced and sold. At times, what may be classified as 'goods' to one business firm may not be 'goods' to the other firm. e.g. for a machine manufacturing company, the machines are 'goods' as they are frequently made and sold. But for the buying firm, it is not 'goods' as the intention is to use it as a long term resource and not sell it. Services are intangible in nature which are rendered with or without the object of earning profits.
- (iii) **Profit:** The excess of Revenue Income over expense is called profit. It could be calculated for each transaction or for business as a whole.
- (iv) **Loss:** The excess of expense over income is called loss. It could be calculated for each transaction or for business as a whole.
- (v) **Asset:** Asset is a resource owned by the business with the purpose of using it for generating future profits. Assets can be Tangible and Intangible. Tangible Assets are the Capital assets which have some physical existence. They can, therefore, be seen, touched and felt, e.g. Plant and Machinery, Furniture and Fittings, Land and Buildings, Books, Computers, Vehicles, etc. The capital assets which have no physical existence and whose value is limited by the rights and anticipated benefits that possession confers upon the owner are known as Intangible Assets. They cannot be seen or felt although they help to generate revenue in future, e.g. Goodwill, Patents, Trade-marks, Copyrights, Brand Equity, Designs, Intellectual Property, etc.

Assets can also be classified into Current Assets and Non-Current Assets.

Current Assets – An asset shall be classified as Current when it satisfies any of the following:

- (a) It is expected to be realised in, or is intended for sale or consumption in the Company's normal Operating Cycle,
- (b) It is held primarily for the purpose of being traded,
- (c) It is due to be realised within 12 months after the Reporting Date, or
- (d) It is Cash or Cash Equivalent unless it is restricted from being exchanged or used to settle a Liability for at least 12 months after the Reporting Date.

Non-Current Assets – All other Assets shall be classified as Non-Current Assets. e.g. Machinery held for long term etc.

(vi) **Liability:** It is an obligation of financial nature to be settled at a future date. It represents amount of money that the business owes to the other parties. E.g. when goods are bought on credit, the firm will create an obligation to pay to the supplier the price of goods on an agreed future date or when a loan is taken from bank, an obligation to pay interest and principal amount is created.

Depending upon the period of holding, these obligations could be further classified into Long Term or non-current liabilities and Short Term or current liabilities.

Current Liabilities – A liability shall be classified as Current when it satisfies any of the following:

- (a) It is expected to be settled in the Company's normal Operating Cycle,
- (b) It is held primarily for the purpose of being traded,
- (c) It is due to be settled within 12 months after the Reporting Date, or
- (d) The Company does not have an unconditional right to defer settlement of the liability for at least 12 months after the reporting date (Terms of a Liability that could, at the option of the counterparty, result in its settlement by the issue of Equity Instruments do not affect its classification)

Non-Current Liabilities – All other Liabilities shall be classified as Non-Current Liabilities. E.g. Loan taken for 5 years, Debentures issued etc.

(vii) **Internal Liability:** These represent proprietor's equity, i.e. all those amount which are entitled to the proprietor, e.g., Capital, Reserves, Undistributed Profits, etc.

(viii) **Working Capital:** In order to maintain flows of revenue from operation, every firm needs certain amount of current assets. For example, cash is required either to pay for expenses or to meet obligation for service received or goods purchased, etc. by a firm. On identical reason, inventories are required to provide the link between production and sale. Similarly, Accounts Receivable generate when goods are sold on credit. Cash, Bank, Debtors, Bills Receivable, Closing Stock, Prepayments etc. represent current assets of firm. The whole of these current assets from the working capital of a firm which is termed as Gross Working Capital.

$$\begin{aligned} \text{Gross Working capital} &= \text{Total Current Assets} \\ &= \text{Long term internal liabilities} + \text{long term debts} + \text{The current liabilities} - \\ &\quad \text{The amount blocked in the fixed assets.} \end{aligned}$$

There is another concept of working capital. Working capital is the excess of current assets over current liabilities. That is the amount of current assets that remain in a firm if all its current liabilities are paid. This concept of working capital is known as Net Working Capital which is a more realistic concept.

$$\text{Working Capital (Net)} = \text{Current Assets} - \text{Currents Liabilities.}$$

(ix) **Contingent Liability:** It represents a potential obligation that could be created depending on the outcome of an event. E.g. if supplier of the business files a legal suit, it will not be treated as a liability because no obligation is created immediately. If the verdict of the case is given in favour of the supplier then only the obligation is created. Till that it is treated as a contingent liability. Please note that contingent liability is not recorded in books of account, but disclosed by way of a note to the financial statements.

(x) **Capital:** It is amount invested in the business by its owners. It may be in the form of cash, goods, or any other asset which the proprietor or partners of business invest in the business activity. From business point of view, capital of owners is a liability which is to be settled only in the event of closure or transfer of the business. Hence, it is not classified as a normal liability. For corporate bodies, capital is normally represented as share capital.



- (xi) **Drawings:** It represents an amount of cash, goods or any other assets which the owner withdraws from business for his or her personal use. e.g. if the life insurance premium of proprietor or a partner of business is paid from the business cash, it is called drawings. Drawings will result in reduction in the owners' capital. The concept of drawing is not applicable to the corporate bodies like limited companies.
- (xii) **Net worth:** It represents excess of total assets over total liabilities of the business. Technically, this amount is available to be distributed to owners in the event of closure of the business after payment of all liabilities. That is why it is also termed as Owner's equity. A profit making business will result in increase in the owner's equity whereas losses will reduce it.
- (xiii) **Non-current Investments:** Non-current Investments are investments which are held beyond the current period as to sale or disposal. e. g. Fixed Deposit for 5 years.
- (xiv) **Current Investments:** Current investments are investments that are by their nature readily realizable and are intended to be held for not more than one year from the date on which such investment is made. e. g. 11 months Commercial Paper.
- (xv) **Debtor:** The sum total or aggregate of the amounts which the customer owe to the business for purchasing goods on credit or services rendered or in respect of other contractual obligations, is known as Sundry Debtors or Trade Debtors, or Trade Payable, or Book-Debts or Debtors. In other words, Debtors are those persons from whom a business has to recover money on account of goods sold or service rendered on credit.

These debtors may again be classified as under:

- (a) Good debts: The debts which are sure to be realized are called good debts.
(b) Doubtful Debts: The debts which may or may not be realized are called doubtful debts.
(c) Bad debts: The debts which cannot be realized at all are called bad debts.

It must be remembered that while ascertaining the debtors balance at the end of the period certain adjustments may have to be made e.g. Bad Debts, Discount Allowed, Returns Inwards, etc.

- (xvi) **Creditor:** A creditor is a person to whom the business owes money or money's worth. e.g. money payable to supplier of goods or provider of service. Creditors are generally classified as Current Liabilities.
- (xvii) **Capital Expenditure:** This represents expenditure incurred for the purpose of acquiring a fixed asset which is intended to be used over long term for earning profits there from. e. g. amount paid to buy a computer for office use is a capital expenditure. At times expenditure may be incurred for enhancing the production capacity of the machine. This also will be a capital expenditure. Capital expenditure forms part of the Balance Sheet.
- (xviii) **Revenue expenditure:** This represents expenditure incurred to earn revenue of the current period. The benefits of revenue expenses get exhausted in the year of the incurrence. e.g. repairs, insurance, salary & wages to employees, travel etc. The revenue expenditure results in reduction in profit or surplus. It forms part of the Income statement.
- (xix) **Balance Sheet:** It is the statement of financial position of the business entity on a particular date. It lists all assets, liabilities and capital. It is important to note that this statement exhibits the state of affairs of the business as on a particular date only. It describes what the business owns and what the business owes to outsiders (this denotes liabilities) and to the owners (this denotes capital). It is prepared after incorporating the resulting profit/losses of Income statement.

(xx) **Profit and Loss Account or Income Statement:** This account shows the revenue earned by the business and the expenses incurred by the business to earn that revenue. This is prepared usually for a particular accounting period, which could be a month, quarter, a half year or a year. The net result of the Profit and Loss Account will show profit earned or loss suffered by the business entity.

(xxi) **Trade Discount:** It is the discount usually allowed by the wholesaler to the retailer computed on the list price or invoice price. e.g. the list price of a TV set could be ₹ 15000. The wholesaler may allow 20% discount thereof to the retailer. This means the retailer will get it for ₹ 12000 and is expected to sale it to final customer at the list price. Thus the trade discount enables the retailer to make profit by selling at the list price. Trade discount is not recorded in the books of accounts. The transactions are recorded at net values only. In above example, the transaction will be recorded at ₹ 12000 only.

(xxii) **Cash Discount:** This is allowed to encourage prompt payment by the debtor. This has to be recorded in the books of accounts. This is calculated after deducting the trade discount. e.g. if list price is ₹ 15000 on which a trade discount of 20% and cash discount of 2% apply, then first trade discount of ₹ 3000 (20% of ₹ 15000) will be deducted and the cash discount of 2% will be calculated on ₹ 12000 (₹ 15000 – ₹ 3000). Hence the cash discount will be ₹ 240 (2% of ₹ 12000) and net payment will be ₹ 11,760 (₹ 12,000 - ₹ 240)

ACCOUNTING PRINCIPLES

GENERALLY ACCEPTED ACCOUNTING PRINCIPLES

A widely accepted set of rules, conventions, standards, and procedures for reporting financial information, as established by the Financial Accounting Standards Board are called Generally Accepted Accounting Principles (GAAP). These are the common set of accounting principles, standards and procedures that companies use to compile their financial statements. GAAP are a combination of standards (set by policy boards) and simply the commonly accepted ways of recording and reporting accounting information.

GAAP is to be followed by companies so that investors have a optimum level of consistency in the financial statements they use when analyzing companies for investment purposes. GAAP cover such aspects like revenue recognition, balance sheet item classification and outstanding share measurements.

ACCOUNTING CONCEPTS AND CONVENTIONS

As seen earlier, the accounting information is published in the form of financial statements. The three basic financial statements are

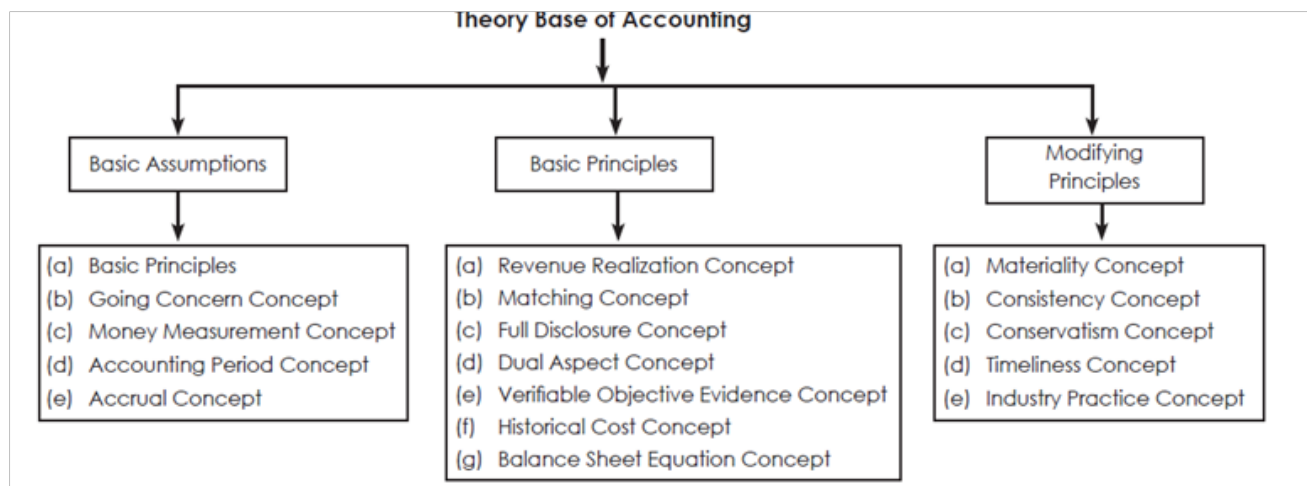
- (i) The Profit & Loss Account that shows net business result i.e. profit or loss for a certain periods
- (ii) The Balance Sheet that exhibits the financial strength of the business as on a particular dates
- (iii) The Cash Flow Statement that describes the movement of cash from one date to the other.

As these statements are meant to be used by different stakeholders, it is necessary that the information contained therein is based on definite principles, concrete concepts and well accepted convention.

Accounting principles are basic guidelines that provide standards for scientific accounting practices and procedures. They guide us to how the transactions are to be recorded and reported. They assure uniformity and understandability. Accounting concepts lay down the foundation for accounting principles. They are ideas essentially at mental level and are self-evident. These concepts ensure recording of financial facts on sound bases and logical considerations. Accounting conventions are methods or procedures that are widely accepted. When

transactions are recorded or interpreted, they follow the conventions. Many times, however, the terms-principles, concepts and conventions are used interchangeably.

Professional Accounting Bodies have published statements of these concepts. Over years, many of these concepts are being challenged as outdated. Yet, no major deviations have been made as yet. Path breaking ideas have emerged and the accounting standards of modern days do require companies to record and report transactions which may not be necessarily based on concepts that are in vogue for long. It is essential to study accounting from the basic levels and understand these concepts in entirety.



A. BASIC ASSUMPTIONS

(a) Business Entity Concept

This concept explains that the business is distinct from the proprietor. Thus, the transactions of business only are to be recorded in the books of business.

(b) Going Concern Concept

This concept assumes that the business has a perpetual succession or continued existence.

(c) Money Measurement Concept

According to this concept only those transactions which are expressed in money terms are to be recorded in accounting books.

(d) The Accounting Period Concept

Businesses are living, continuous organisms. The splitting of the continuous stream of business events into time periods is thus somewhat arbitrary. There is no significant change just because one accounting period ends and a new one begins. This results into the most difficult problem of accounting of how to measure the net income for an accounting period. One has to be careful in recognizing revenue and expenses for a particular accounting period. Subsequent section on accounting procedures will explain how one goes about it in practice.

(e) The Accrual Concept

The accrual concept is based on recognition of both cash and credit transactions. In case of a cash transaction, owner's equity is instantly affected as cash either is received or paid. In a credit transaction, however, a mere obligation towards or by the business is created. When credit transactions exist (which is generally the case), revenues are not the same as cash receipts and expenses are not same as cash paid during the period.

Today's accounting systems based on accrual concept are called as Accrual system or mercantile system of accounting.

B. BASIC PRINCIPLES

(a) Realization Concept

This concept speaks about recording of only those transactions which are actually realized. For example Sale or Profit on sales will be taken into account only when money is realized i.e. either cash is received or legal ownership is transferred.

(b) Matching Concept

It is referred to as matching of expenses against incomes. It means that all incomes and expenses relating to the financial period to which the accounts relate should be taken in to account without regard to the date of receipts or payment.

(c) Full Disclosure Concept

As per this concept, all significant information must be disclosed. Accounting data should properly be clarified, summarized, aggregated and explained for the purpose of presenting the financial statements which are useful for the users of accounting information. Practically, this principle emphasizes on the materiality, objectivity and consistency of accounting data which should disclose the true and fair view of the state of affairs of a firm.

(d) Duality Concept

According to this concept every transaction has two aspects i.e. the benefit receiving aspect and benefit giving aspect. These two aspects are to be recorded in the books of accounts.

(e) Verifiable Objective Evidence Concept

Under this principle, accounting data must be verified. In other words, documentary evidence of transactions must be made which are capable of verification by an independent respect. In the absence of such verification, the data which will be available will neither be reliable nor be dependable, i.e., these should be biased data. Verifiability and objectivity express dependability, reliability and trustworthiness that are very useful for the purpose of displaying the accounting data and information to the users.

(f) Historical Cost Concept

Business transactions are always recorded at the actual cost at which they are actually undertaken. The basic advantage is that it avoids an arbitrary value being attached to the transactions. Whenever an asset is bought, it is recorded at its actual cost and the same is used as the basis for all subsequent accounting purposes such as charging depreciation on the use of asset, e.g. if a production equipment is bought for ` 1.50 crores, the asset will be shown at the same value in all future periods when disclosing the original cost. It will obviously be reduced by the amount of depreciation, which will be calculated with reference to the actual cost. The actual value of the equipment may rise or fall subsequent to the purchase, but that is considered irrelevant for accounting purpose as per the historical cost concept. The limitation of this concept is that the balance sheet does not show the market value of the assets owned by the business and accordingly the owner's equity will not reflect the real value. However, on an ongoing basis, the assets are shown at their historical costs as reduced by depreciation.

(g) Balance Sheet Equation Concept

Under this principle, all which has been received by us must be equal to that has been given by us and needless to say that receipts are clarified as debits and giving is clarified as credits. The basic equation, appears as :-

Debit = Credit

Naturally every debit must have a corresponding credit and vice-e-versa. So, we can write the above in the following form –

Expenses + Losses + Assets = Revenues + Gains + Liabilities



And if expenses and losses, and incomes and gains are set off, the equation takes the following form
– Asset = Liabilities or, Asset = Equity + External Liabilities
i.e., the Accounting Equation.

C. MODIFYING PRINCIPLES

(a) The Concept of Materiality

The materiality could be related to information, amount, procedure and nature. Error in description of an asset or wrong classification between capital and revenue would lead to materiality of information. Say, If postal stamps of ` 500 remain unused at the end of accounting period, the same may not be considered for recognizing as inventory on account of materiality of amount. Certain accounting treatments depend upon procedures laid down by accounting standards. Some transactions are by nature material irrespective of the amount involved. e.g., audit fees, loan to directors.

(b) Consistency Concept

This Concept says that the Accounting practices should not change or must remain unchanged over a period of several years.

(c) Conservatism Concept

Conservatism concept states that when alternative valuations are possible, one should select the alternative which fairly represents economic substance of transactions but when such choice is not clear select the alternative that is least likely to overstate net assets and net income. It provides for all known expenses and losses by best estimates if amount is not known with certainty, but does not recognizes revenues and gains on the basis of anticipation.

(d) Timeliness Concept

Under this principle, every transaction must be recorded in proper time. Normally, when the transaction is made, the same must be recorded in the proper books of accounts. In short, transaction should be recorded date-wise in the books. Delay in recording such transaction may lead to manipulation, misplacement of vouchers, misappropriation etc. of cash and goods. This principle is followed particularly while verifying day to day cash balance. Principle of timeliness is also followed by banks, i.e. every bank verifies the cash balance with their cash book and within the day, the same must be completed.

(e) Industry Practice

As that are different types of industries, each industry has its own characteristics and features. There may be seasonal industries also. Every industry follows the principles and assumption of accounting to perform their own activities. Some of them follow the principles, concepts and conventions in a modified way. The accounting practice which has always prevailed in the industry is followed by it. e.g., Electric supply companies, Insurance companies maintain their accounts in a specific manner. Insurance companies prepare Revenue Account just to ascertain the profit/loss of the company and not Profit and Loss Account. Similarly, non trading organizations prepare Income and Expenditure Account to find out Surplus or Deficit.

Multiple Choice Questions:

1. According to the money measurement, currency transactions & events are recorded in books of accounts
 - (a) In the ruling currency of the country in which transaction takes place.
 - (b) In the ruling currency of the country in which books of accounts are prepared.
 - (c) In the currency set by ministry of finance
 - (d) In the currency set by government.
2. The determination of expenses for an accounting period is based on the concept of
 - (a) Objectivity
 - (b) Materiality
 - (c) Matching
 - (d) periodicity
3. Decrease in the amount of creditors results in

- a) Increase in cash (b) decrease in cash (c) increase in assets (d) no change in assets
4. Ram purchased a car ₹10,000 paid ₹3000 as cash and balance amount will be paid in three equal installments due to this
a) Total assets increase by ₹10,000 (b) Total liabilities increase by ₹3000 (c) Assets will increase by ₹7000 with corresponding increase in liability by ₹7000 (d) Both (b) and (c)
 5. Accounting does not record non-financial transactions because of
a) Entity concept (b) Accrual Concept (c) Cost Concept (d) Money Measurement Concept
 6. Provision for bad debt is made as per the
a) Entity concept (b) Conservatism Concept (c) Cost Concept (d) Going Concern Concept
 7. Fixed Assets and Current Assets are categorized as per concept of
a) Separate Entity (b) Going Concern (c) consistency (d) Time period
 8. Omission of paise and showing the round figures in financial statements is based on
a) Conservatism Concept b) Consistency concept (c) Materiality Concept (d) Realization Concept
 9. Income tax of the sale trader paid is shown
(a) Debited to P&L Account (b) Debited to Trading Account
(c) Debited to his Capital Account (d) none
 10. Payment of salary is recorded by
(a) Dr. Salary, Cr. Cash Account (b) Dr. Cash Account, Cr. Salary Account
(c) Dr. Employee Account, Cr. Cash Account (d) Dr. employee Account, Cr. Salary Account
 11. Purchase of furniture for cash would
(a) Increase fixed assets & reduce current assets
(b) Reduce fixed assets & increase current assets (c) Increase total assets (d) both (a) & (b)
 12. Narration are given at the end of
(a) Final accounts (b) trial balance each ledger account (c) each ledger accounts
(d) Each journal entry
 13. Which of the following is an example of Personal Account?
a) Machinery b) Rent (c) Cash (d) Creditor
 14. P & L Account is prepared for period of one year by following
(a) Consistency Concept b) Conservatism concept
(c) Accounting Period Concept d) Cost Concept
 15. Current Liabilities means
a) Liabilities which are payable within 12 months
b) Liabilities which are payable immediately
c) Liabilities which payable after one accounting year
d) Liabilities which are readable within 3 months

Ans: 1. b 2. c 3. b 4. c 5.d 6. b 7. b 8.c 9.c 10.a 11.a 12.d 13.d 14.c 15.a

Fill in the blanks:

1. Book keeping records only _____ transactions of business (financial)
2. It is generally assumed that the business will not liquidate in the near forcible future because of ____ (going concern concept)
3. The capital contributed by the proprietor is treated as a liability according to ____ (business entity concept)
4. GAAP's means ____ (Generally Accepted Accounting Principles)
5. Window dressing of accounts means ____ (showing more profits to attract investment)
6. The accounting standards are mandatory for ____ (companies)
7. In journal, transactions are recorded on _____ (chronological order)
8. The amount of debt which is not recoverable or realized is called ____ (bad debt)



9. The difference between the selling price and the cost price of the goods sold is called _____ (gross profit)
10. Live stock is treated as a/an ____ (asset)
11. Recording of a transaction in a journal is called _____ (entry)
12. Expenses Account will always have _____ (debit)
13. Brief explanation of a transaction is called _____ (narration)
14. Drawings will result in _____ in the owners capital. (Reduction)
15. A debtor is a person who _____ money to the business (Owes)

True or false:

1. Accounting is an art of recording keeping (TRUE)
2. Consistency is one of the accounting concepts (FALSE)
3. Accounting is concerned with both monetary and non-monetary transactions? (FALSE)
4. Joint venture follows the going concern concepts (FALSE)
5. Financial statements are part of Accounting (TRUE)
6. Double entry principle means writing twice the same entry (FALSE)
7. Credit means increase in liability and decrease in asset (TRUE)
8. Goodwill is a Fictitious Asset (FALSE)
9. Returns in words implies purchase returns (FALSE)
10. Capital Account is a liability of the business (TRUE)

Match the following:

1. Debtors	j	a) Goodwill
2. Asset	g	b) nominal account
3. Expenses	b	c) Debentures
4. An increase in asset	f	d) plant and machinery
5. An increase in liability	h	e) preliminary expenses
6. Fixed asset	d	f) Debit
7. Intangible asset	a	g) real account
8. Fictitious asset	e	h) Credit
9. Long term liabilities	c	i) casting
10. Totaling of amount	i	j) personal account

1.2 CAPITAL AND REVENUE TRANSACTIONS - CAPITAL AND REVENUE EXPENDITURES, CAPITAL AND REVENUE RECEIPTS

There are 2 types of Transaction

1. **Capital**
2. **Revenue**

The concepts of capital and revenue are of fundamental importance to the correct determination of accounting profit for a period and recognition of business assets at the end of that period.

- **Capital Transactions:**
Transactions having long-term effect are known as capital transactions.
- **Revenue Transactions:**
Transactions having short-term effect are known as revenue transactions.

- **Capital Expenditure**

Capital expenditure can be defined as expenditure incurred on the purchase, alteration or improvement of fixed assets. For example, the purchase of a car to be use to deliver goods is capital expenditure. Included in capital expenditure are such costs as:

- Delivery of fixed assets;
- Installation of fixed assets;
- Improvement (but not repair) of fixed assets;
- Legal costs of buying property;
- Demolition costs;
- Architects fees;

- **Revenue Expenditures**

Revenue expenditure is expenditure incurred in the running/management of the business. For example, the cost of petrol or diesel for cars is revenue expenditure. Other revenue expenditure:

- Maintenance of Fixed Assets;
- Administration of the business;
- Selling and distribution expenses.

Capitalized Expenditure

Expenditure connected with the purchase of fixed asset are called capitalized expenditure e.g. wages paid for the installation of machinery.

The Treatments of Capital and Revenue Expenditures

Capital expenditures are shown in the Balance Sheet Assets Side while Revenue Expenditures are shown in the Trading and Profit And Loss Account debit side.

Revenue Receipts

Amount received against revenue income are called revenue receipt.

Capital Receipts and Revenue Receipts:

Revenue Receipts:

The receipts or income which are received by the business organization in the course of normal activities are revenue receipts.

Capital Receipts:

Receipts which are not of revenue nature are capital receipts.
The Receipts which are not received now and then can be treated as capital receipt.

Capital and Revenue Receipts Examples:

Capital Receipts:

1. Capitals contributed by members.
2. Share capital contributed by the share holders/ members.
3. Loans raised
4. Proceeds from sale of fixed assets.
5. Life membership fees in the case of clubs and associations.
6. Legacies.
7. Government grants for specific purpose.
8. Donations for specific purpose.



Revenue Receipts:

1. Receipts from sale of goods or services.
2. Discounts, commissions received.
3. Interest on Bank Deposits.
4. Annual Subscriptions in the case of clubs and associations.
5. Donations which are general in nature.
6. Entrance fee.
7. Sale of old news papers.
8. Locker rent.

Sale of Tickets for Entertainment Programmes, Concerts etc.

Capital Profits

Capital profit which is earned on the sale of the fixed assets.

Revenue Profit

The profit which is earned during the ordinary course of business is called revenue profit.

Capital Loss

The loss suffered by a company on the sale of fixed assets.

Revenue Loss

The loss suffered by the business in the ordinary course of business is called revenue loss.

Rules for Determining Capital Expenditure

An expenditure can be recognized as capital if it is incurred for the following purposes:

- An expenditure incurred for the purpose of acquiring long term assets (useful life is at least more than one accounting period) for use in business to earn profits and not meant for resale, will be treated as a capital expenditure. For example, if a second hand motor car dealer buys a piece of furniture with a view to use it in business; it will be a capital expenditure. But if he buys second hand motor cars, for re-sale, then it will be a revenue expenditure because he deals in second hand motor cars.
- When an expenditure is incurred to improve the present condition of a machine or putting an old asset into working condition, it is recognised as a capital expenditure. The expenditure is capitalized and added to the cost of the asset. Likewise, any expenditure incurred to put an asset into working condition is also a capital expenditure.
- For example, if one buys a machine for ₹ 5,00,000 and pays ₹ 20,000 as transportation charges and ₹ 40,000 as installation charges, the total cost of the machine comes upto ₹ 5,60,000. Similarly, if a building is purchased for ₹ 1,00,000 and ₹ 5,000 is spent on registration and stamp duty, the capital expenditure on the building stands at ₹ 1,05,000.
- If an expenditure is incurred, to increase earning capacity of a business will be considered as of capital nature. For example, expenditure incurred for shifting 'the 'factory for easy supply of raw materials. Here, the cost of such shifting will be a capital expenditure.
- Preliminary expenses incurred before the commencement of business is considered capital expenditure. For example, legal charges paid for drafting the memorandum and articles of association of a company or brokerage paid to brokers, or commission paid to underwriters for raising capital.
- Thus, one useful way of recognising expenditure as capital is to see that the business will own something which qualifies as an asset at the end of the accounting period.

Some examples of capital expenditure:

(i) Purchase of land, building, machinery or furniture; (ii) Cost of leasehold land and building; (iii) Cost of purchased goodwill; (iv) Preliminary expenditures; (v) Cost of additions or extensions to existing assets; (vi) Cost of overhauling second-hand machines; (vii) Expenditure on putting an asset into working condition; and (viii) Cost incurred for increasing the earning capacity of a business.

Rules for Determining Revenue Expenditure

Any expenditure which cannot be recognised as capital expenditure can be termed as revenue expenditure. A revenue expenditure temporarily influences only the profit earning capacity of the business. An expenditure is recognised as revenue when it is incurred for the following purposes:

Expenditure for day-to-day conduct of the business, the benefits of which last less than one year. Examples are wages of workmen, interest on borrowed capital, rent, selling expenses, and so on.

Expenditure on consumable items, on goods and services for resale either in their original or improved form. Examples are purchases of raw materials, office stationery, and the like. At the end of the year, there may be some revenue items (stock, stationery, etc.) still in hand. These are generally passed over to the next year though they were acquired in the previous year.

Expenditures incurred for maintaining fixed assets in working order. For example, repairs, renewals and depreciation.

Some examples of revenue expenditure

- (i) Salaries and wages paid to the employees;
- (ii) Rent and rates for the factory or office premises;
- (iii) Depreciation on plant and machinery;
- (iv) Consumable stores;
- (v) Inventory of raw materials, work-in-progress and finished goods;
- (vi) Insurance premium;
- (vii) Taxes and legal expenses; and
- (viii) Miscellaneous expenses.

Deferred Revenue Expenditures

Deferred revenue expenditures represent certain types of assets whose usefulness does not expire in the year of their occurrence but generally expires in the near future. These type of expenditures are carried forward and are written off in future accounting periods. Sometimes, we make some revenue expenditure but it eventually becomes a capital asset (generally of an intangible nature). If one undertakes substantial repairs to the existing building, the deterioration of the premises may be avoided. We may engage our own employees to do that work and pay them at prevailing wage-rate, which is of a revenue nature. If this expenditure is treated as revenue expenditure and the current year's-profit is charged with these expenses, we are making the current year to absorb the entire expenses, though the benefit of which will be enjoyed for a number of accounting years. To overcome this difficulty, the entire expenditure is capitalised and is added to the asset account. Another example is an insurance policy. A business can pay insurance premium in advance, say, for a 3 year period. The right does not expire in the accounting period in which it is paid but will expire within a fairly short period of time (3 years). Only a portion of the total premium paid should be treated as a revenue expenditure (portion pertaining to the current period) and the balance should be carried forward as an asset to be written off in subsequent years.

Now, Preliminary Expenses are not shown in the balance Sheet as per para 56 of AS-26, it is a part of other expenses which is shown in the **Profit and Loss A/c** (Part I of Schedule III in case of a Company). It is a part of **revenue expenditure**, e.g., expenditure incurred on Scientific Research is recognized as an expense when it is incurred". In



short, the whole amount of expenditure is treated as expense for the current year only and will not proportionately be transferred as deferred charge.

Treatment of Revenue Expenditure as Capital Expenditure:

The following are some of the instances where an item of expenditure which is in the nature of revenue expenditure will be treated as capital expenditure.

1. **Repairs:** Repairs expenditure is revenue in nature, but huge amount incurred on a second hand machinery in order to bring it to working condition can be treated as capital expenditure and should be added to the cost of Machinery.
2. **Wages:** Normally, wages are revenue in nature. But wages paid to the workers for the construction or installation of fixed assets, will be treated as capital expenditure and added to the cost of that asset.
3. **Preliminary Expenses:** All the expenses paid in the process of formation of a company should be treated as capital expenditure and recorded in the balance sheet on asset side.
4. **Brokerage, Government Stamp Duty and Legal Expenses:** All the expenses paid on the purchase of a property will be regarded as capital expenditure.
5. **Raw Materials and Stores:** These are generally revenue in nature, but if raw materials and stores consumed in the making of a fixed asset, the same should be treated as capital expenditure.
6. **Development Expenditure:** All the expenditure incurred for the development of mines and plantations should be treated as capital expenditure.

Illustration: 1

State whether the following are capital, revenue or deferred revenue expenditure.

- (i) Carriage of ₹ 7,500 spent on machinery purchased and installed.
- (ii) Heavy advertising costs of ₹ 20,000 spent on the launching of a company's new product.
- (iii) ₹ 200 paid for servicing the company vehicle, including ₹ 50 paid for changing the oil.
- (iv) Construction of basement costing ₹ 1,95,000 at the factory premises.

Solution:

- (i) Carriage of ₹ 7,500 paid for machinery purchased and installed should be treated as a Capital Expenditure.
- (ii) Advertising expenses for launching a new product of the company should be treated as a Revenue Expenditure. (As per AS-26)
- (iii) ₹ 200 paid for servicing and oil change should be treated as a Revenue Expenditure.
- (iv) Construction cost of basement should be treated as a Capital Expenditure.

Illustration: 2

State whether the following are capital or revenue expenditure.

- (i) Paid a bill of ₹ 10,000 of Mr. Kumar, who was engaged as the erection engineer to set up a new automatic machine costing ₹ 20,000 at the new factory site.
- (ii) Incurred ₹ 26,000 expenditure on varied advertisement campaigns under taken yearly, on a regular basis, during the peak festival season.
- (iii) In accordance with the long-term plan of providing a well- equipped Labour Welfare Centre, spent ₹ 90,000 being the budgeted allocation for the year.

Solution:

- (i) Expenses incurred for erecting a new machine should be treated as a Capital Expenditure.
- (ii) Advertisement expenses during peak festival season should be treated as a Revenue Expenditure.
- (iii) Expenses incurred for Labour Welfare Centre should be treated as a Capital Expenditure.

Illustration: 3

Classify the following items as capital or revenue expenditure:

- (i) An extension of railway tracks in the factory area;
- (ii) Wages paid to machine operators;
- (iii) Installation costs of new production machine;
- (iv) Materials for extension to foremen's offices in the factory;
- (v) Rent paid for the factory;
- (vi) Payment for computer time to operate a new stores control system,
- (vii) Wages paid to own employees for building the foremen's offices.

Give reasons for your classification.

Solution:

- (i) Expenses incurred for extension of railway tracks in the factory area should be treated as a Capital Expenditure because it will yield benefit for more than one accounting period.
- (ii) Wages paid to machine operators should be treated as a Revenue Expenditure as it will yield benefit for the current period only.
- (iii) Installation costs of new production machine should be treated as a Capital Expenditure because it will benefit the business for more than one accounting period.
- (iv) Materials for extension to foremen's offices in the factory should be treated as a Capital Expenditure because it will benefit the business for more than one accounting period.
- (v) Rent paid for the factory should be treated as a Revenue Expenditure because it will benefit only the current period.
- (vi) Payment for computer time to operate a new stores control system should be treated as Revenue Expenditure because it has been incurred to carry on the normal business.
- (vii) Wages paid for building foremen's offices should be treated as a Capital Expenditure because it will benefit the business for more than one accounting period.

Illustration 4

For each of the cases numbered below, indicate whether the income/expenditure is capital or revenue.

- (i) Payment of wages to one's own employees for building a new office extension.
- (ii) Regular hiring of computer time for the preparation of the firm's accounts.
- (iii) The purchase of a new computer for use in the business.
- (iv) The use of motor vehicle, hired for five years, but paid at every six months.

Solution:

- (i) Payment of wages for building a new office extension should be treated as a Capital Expenditure.
- (ii) Computer hire charges should be treated as a Revenue Expenditure.
- (iii) Purchase of computer for use in the business should be treated as a Capital Expenditure.
- (iv) Hire charges of motor vehicle should be treated as a Revenue Expenditure.

Illustration 5

State with reasons whether the following are capital or revenue expenditure:

- (i) Freight and cartage on the new machine ₹ 150, and erection charges ₹ 500.
- (ii) Fixtures of the book value of ₹ 2,500 sold off at ₹ 1,600 and new fixtures of the value of ₹ 4,000 were acquired. Cartage on purchase ₹ 100.
- (iii) A sum of ₹ 400 was spent on painting the factory.
- (iv) ₹ 8,200 spent on repairs before using a second hand car purchased recently, to put it in usable condition.

Solution:

- (i) Freight and cartage totaling ₹ 650 should be treated as a Capital Expenditure because it will benefit the business for more than one accounting year.
- (ii) Loss on sale of fixtures ₹ (2,500 – 1,600) = ₹ 900 should be treated as a Capital Loss. The cost of new fixtures and carriage thereon should be treated as a Capital Expenditure because the fixture will be used for a long period. So ₹ (4,000+100) the cost of new fixture will be ₹ 4,100.
- (iii) Painting of the factory should be treated as a Revenue Expenditure because it has been incurred to maintain the factory building.
- (iv) Repairing cost of second hand car should be treated as a Capital Expenditure because it will benefit the business for more than one accounting year.

Illustration 6

State the nature (capital or revenue) of the following expenditure which were incurred by Vedanta & Co. during the year ended 30th June, 2015:

- (i) ₹ 350 was spent on repairing a second hand machine which was purchased on 8th May, 2015 and ₹ 200 was paid on carriage and freight in connection with its acquisition.
- (ii) A sum of ₹ 30,000 was paid as compensation to two employees who were retrenched.
- (iii) ₹ 150 was paid in connection with carriage on goods purchased.
- (iv) ₹ 20,000 customs duty is paid on import of a machinery for modernisation of the factory production during the current year and ₹ 6,000 is paid on import duty for purchase of raw materials.
- (v) ₹ 18,000 interest had accrued during the year on term loan obtained and utilised for the construction of factory building and purchase of machineries; however, the production has not commenced till the last date of the accounting year.

Solution:

- (i) Repairing and carriage totaling ₹ 550 for second hand machine should be treated as a Capital Expenditure.
- (ii) Compensation paid to employees shall be treated as a Revenue Expenditure.
- (iii) Carriage paid for goods purchased should be treated as a Revenue Expenditure.
- (iv) Customs duty paid on import of machinery to be treated as a Capital Expenditure. However, import duty paid for raw materials should be treated as a Revenue Expenditure.
- (v) Interest paid during pre-construction period to be treated as a Capital Expenditure.

Illustration 7

State with reasons whether the following items relating to Parvati Sugar Mill Ltd. are capital or revenue:

- (i) ₹ 50,000 received from issue of shares including ₹ 10,000 by way of premium.
- (ii) Purchased agricultural land for the mill for ₹ 60,000 and ₹ 500 was paid for land revenue.
- (iii) ₹ 5,000 paid as contribution to PWD for improving roads of sugar producing area.
- (iv) ₹ 40,000 paid for excise duty on sugar manufactured.
- (v) ₹ 70,000 spent for constructing railway siding.

Solution:

- (i) ₹ 40,000 (50,000 – ₹ 10,000) received from issue of shares will be treated as a Capital Receipt. The premium of ₹ 10,000 should be treated as a Capital Profit.
- (ii) Cost of land ₹ 60,000 to be treated as Capital Expenditure and land revenue of ₹ 500 to be treated as Revenue Expenditure.
- (iii) Contribution paid to PWD should be treated as a Revenue Expenditure.
- (iv) Excise duty of ₹ 40,000 should be treated as a Revenue Expenditure.
- (v) ₹ 70,000 spent for constructing railway siding to be treated as a Capital Expenditure.

Illustration 8

State with reasons whether the following are Capital Expenditure or Revenue Expenditure:

- (i) Expenses incurred in connection with obtaining a licensee for starting the factory were ₹ 10,000.
- (ii) ₹ 1,000 paid for removal of stock to a new site.
- (iii) Rings and Pistons of an engine were changed at a cost of ₹ 5,000 to get full efficiency.
- (iv) ₹ 2,000 spent as lawyer's fee to defend a suit claiming that the firm's factory site belonged to the Plaintiff. The suit was not successful.
- (v) ₹ 10,000 were spent on advertising the introduction of a new product in the market, the benefit of which will be effective during four years.
- (vi) A factory shed was constructed at a cost of ₹ 1,00,000. A sum of ₹ 5,000 had been incurred for the construction of the temporary huts for storing building materials.

Solution:

- (i) ₹ 10,000 incurred in connection with obtaining a license for starting the factory is a Capital Expenditure. It is incurred for acquiring a right to carry on business for a long period.
- (ii) ₹ 1,000 incurred for removal of stock to a new site is treated as a Revenue Expenditure because it is not enhancing the value of the asset and it is also required for starting the business on the new site.
- (iii) ₹ 5,000 incurred for changing Rings and Pistons of an engine is a Revenue Expenditure because, the change of rings and piston will restore the efficiency of the engine only and it will not add anything to the capacity of the engine.
- (iv) ₹ 2,000 incurred for defending the title to the firm's assets is a Revenue Expenditure.
- (v) ₹ 10,000 incurred on advertising is to be treated as a Revenue Expenditure (As per AS-26).
- (vi) Cost of construction of Factory shed of ₹ 1,00,000 is a Capital Expenditure, similarly cost of construction of small huts for storing building materials is also a Capital Expenditure.

Illustration 9

State clearly how you would deal with the following in the books of a Company :

- (i) The redecoration expenses ₹ 6,000.
- (ii) The installation of a new Coffee-making Machine for ₹ 10,000.
- (iii) The building of an extension of the club dressing room for ₹ 15,000.
- (iv) The purchase of Snacks & food stuff ₹ 2,000.
- (v) The purchase of V.C.R. and T.V. for the use in the club lounge for ₹ 15,000.

Solution:

- (i) The redecoration expenses of ₹6,000 shall be treated as a Deferred Revenue Expenditure.
- (ii) The installation of a new Coffee - Making Machine is a Capital Expenditure because it is the acquisition of an asset.
- (iii) ₹15,000 spent for the extension of club dressing room is a Capital Expenditure because it creates an asset of a permanent nature.
- (iv) The purchase of snacks & food stuff of ₹2,000 is a Revenue Expenditure.
- (v) The purchase of V.C.R. and T.V. for ₹15,000 is a Capital Expenditure, because it is the acquisition of assets.

Multiple Choice Questions:

1. An expenditure is capital in Nature when –
 - (a) The receiver of the amount is going to treat it for the purchase of fixed assets.
 - (b) It increase the quantity of fixed assets
 - (c) It is paid as interests on loans for the business
 - (d) It is maintains a fixed assets
2. Capital expenditures are recorded in the



- (a) Balance sheet (b) Profit and loss A/c (c) trading a/c (d) manufacturing a/c
3. Which of the following transaction is of capital nature
(a) Purchases of a truck (b) replacement of old trucks
(c) Cost of repairing of truck (d) all of the above
4. ₹ 5,000 incurred for up gradation of computer by installation of 128 MB Ram is
(a) Capital expenditure (b) deferred revenue expenditure
(c) revenue expenditure (d) none of the above
5. Entrance fee of ₹ 20,000 received by a club is a
(a) capital receipts (b) revenue receipt (c) capital expenditure (d) revenue expenditure
6. Life membership fees received by a club
(a) Revenue expenditure (b) capital expenditure (c) deferred revenue expenditure (d) capital receipt
7. Cost of goods purchased for resale is an example of –
(a) Capital expenditure (b) Revenue expenditure
(c) deferred revenue expenditure (d) none of these
8. Import duty of raw material purchased
(a) Revenue expenditure (b) capital expenditure
(c) deferred revenue expenditure (d) none of these
9. Received from soloman by co., an invoice for ₹ 1500 for repairs to factory walls
(a) Revenue expenditure (b) capital expenditure
(c) deferred revenue expenditure (d) none of these
10. Company received from government for compulsory acquisition of land
(a) Revenue expenditure (b) capital expenditure
(c) deferred revenue expenditure (d) none of these
11. All revenue receipts and expenditures are shown in: -
(a) Balance Sheet (b) Trading and Profit and Loss A/c
(c) Cash Flow Statement (d) Statement of Affairs
12. A bad debt recovered during the year will be
(a) Capital expenditure (b) Revenue expenditure
(c) Capital Receipt (d) Revenue Receipt
13. Insurance claim received on account of machinery damaged completely by fire is
(a) Capital Receipt (b) Revenue receipt (c) Capital expenditures (d) Revenue Expenditure
14. Amount of ₹5,000 spent as lawyers' fees to defend a suit claiming that the firm's factory site belonged to the plaintiff's land is
(a) Capital expenditures (b) Revenue Expenditure (c) Deferred revenue expenditures (d) None
15. Money spent ₹10,000 as travelling expenses of the directors on trips abroad for purchase of capital assets is
(a) Capital expenditures (b) Revenue Expenditures (c) Deferred revenue expenditures (d) None

Ans: 1. b 2. a 3. a 4. a 5. a 6. d 7. b 8. a 9. a 10. d 11. b 12. d 13. a 14. b 15. a

Fill in the blanks:

1. Revenue receipts are shown in ____ ("Trading and P & L account")
2. Any donation received for a specific purpose is a ____ ("Liability or capital receipt")
3. Capital expenditure provide ____ benefit ("Long period")
4. Amount received from a bank as a midterm loan for working capital ____ ("Capital expenditure")
5. ₹ 3,500 spent on painting new factory is ____ ("Capital Expenditure")
6. Extension to building occupied on lease for 5 years ____ ("Deferred revenue expenditure")
7. ₹ 20,000 received from an issue of further shares the expenses of issue being ₹ 2500 ____ ("Capital receipt ₹ 20,000 and deferred revenue expenditure ₹ 2500")
8. Taxes paid ____ ("Revenue expenditure")

9. Revenue is generally recognized as being earned at that point of time ____ ("Sale is effected")
10. Capital receipts are shown in ____ side of balance sheet ("liabilities")
11. White washing expenses are ____ (Revenue Expenditure)
12. ₹2,500 spent on the overhaul of Machinery purchased second hand is ____ (capital expenditure)
13. ₹1,200 spent on repairs on machinery ____ (Revenue expenditure)
14. Inauguration expenses incurred on the opening of new manufacturing unit in an existing business. ____ (Revenue expenditure)
15. Subsidy of ₹40,000 received from the government per working capital ____ (Revenue receipt.)

State whether the following statements true or false:

1. An expenditure in nature, when it benefits the current period (TRUE)
2. Paper purchased for use as stationery is capital expenditure (FALSE)
3. Purchase of machinery for sale is revenue expenditure (TRUE)
4. Gratuity and pension paid to employees after retirement is deferred revenue expenditure (FALSE)
5. A bad debt recovered during the year is revenue receipt (TRUE)
6. Freight paid on purchase of machinery is to be treated as Revenue Expenditure (FALSE)
7. Repainting of building done every 3 years "Revenue expenditure" (FALSE)
8. Which of the following is capital profit Premium received on issue of share (TRUE)
9. A motor tuck costing ₹ 15000 and standing in the books at ₹ 7250 was sold for ₹ 1200. "Capital loss ₹ 4750 & capital expenditure ₹ 1200" (FALSE)
10. A motor car which was purchased for ₹ 20,000 had its book value ₹ 12,000 was sold for ₹ 25,000 the capital profit will be "₹ 5000 (TRUE)

Match the following:

Group A

1. Sale of Goods	e	a) capital expenses
2. Bank charges	c	b) Liability
3. Preliminary expenses	a	c) revenue expenses
4. Capital receipts are shown as	b	d) profit & loss a/c
5. Revenue expenses are shown in	d	e) revenue receipt

Group B

1. Rent paid in advance	b	a) capital expenditure
2. Cost of copyrights	a	b) None
3. Petrol expenditure	d	c) capital receipts
4. Special donations received	c	d) revenue expenditure
5. Received interest	e	e) revenue receipt

1.2 DOUBLE ENTRY SYSTEM, BOOKS OF PRIME ENTRY, SUBSIDIARY BOOKS, CASH BOOK, JOURNAL, LEDGER, TRIAL BALANCE

Double Entry System

It was in 1494 that Luca Pacioli the Italian mathematician, first published his comprehensive treatise on the principles of Double Entry System. The use of principles of double entry system made it possible to record not only cash but also all sorts of Mercantile transactions. It had created a profound impact on auditing too, because it enhanced the duties of an auditor to a considerable extent.



Features of Double Entry System

- (i) Every transaction has two fold aspects, i.e., one party giving the benefit and the other receiving the benefit.
- (ii) Every transaction is divided into two aspects, Debit and Credit. One account is to be debited and the other account is to be credited.
- (iii) Every debit must have its corresponding and equal credit.

Advantages of Double Entry System

- (i) Since personal and impersonal accounts are maintained under the double entry system, both the effects of the transactions are recorded.
- (ii) It ensures arithmetical accuracy of the books of accounts, for every debit, there is a corresponding and equal credit. This is ascertained by preparing a trial balance periodically or at the end of the financial year.
- (iii) It prevents and minimizes frauds. Moreover frauds can be detected early.
- (iv) Errors can be checked and rectified easily.
- (v) The balances of receivables and payables are determined easily, since the personal accounts are maintained.
- (vi) The businessman can compare the financial position of the current year with that of the past years.
- (vii) The businessman can justify the standing of his business in comparison with the previous year purchase, sales, and stocks, incomes and expenses with that of the current year figures.
- (viii) Helps in decision making.
- (ix) The net operating results can be calculated by preparing the Trading and Profit and Loss A/c for the year ended and the financial position can be ascertained by the preparation of the Balance Sheet.
- (x) It becomes easy for the Government to decide the tax.
- (xi) It helps the Government to decide sickness of business units and extend help accordingly.
- (xii) The other stakeholders like suppliers, banks, etc take a proper decision regarding grant of credit or loans.

Limitations of Double Entry System

- (i) The system does not disclose all the errors committed in the books accounts.
- (ii) The trial balance prepared under this system does not disclose certain types of errors.
- (iii) It is costly as it involves maintenance of numbers of books of accounts.

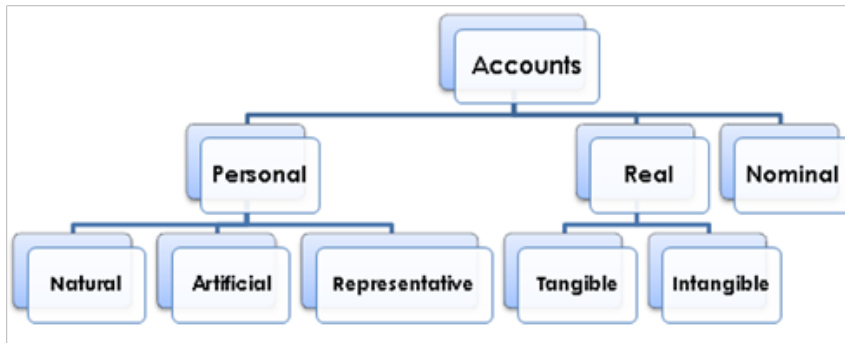
THE CONCEPTS OF 'ACCOUNT', 'DEBIT' AND 'CREDIT'

The concept of Account

- An account is defined as a summarized record of transactions related to a person or a thing e.g. when the business deals with customers and suppliers, each of the customers and supplier will be a separate account.
- The account is also related to things – both tangible and intangible. e.g. land, building, equipment, brand value, trademarks etc are some of the things. When a business transaction happens, one has to identify the 'account' that will be affected by it and then apply the rules to decide the accounting treatment.
- Typically, an account is expressed as a statement in form of English letter 'T'. It has two sides. The left hand side is called as "Debit" side and the right hand side is called as "Credit" side. The debit is denoted as 'Dr' and the credit by 'Cr'. The convention is to write the Dr and Cr labels on both sides as shown below. Please see the following example:

Dr.	Cash Account	Cr.
Debit side		Credit side

TYPES OF ACCOUNTS



Let us see what each type of account means:

- (1) **Personal Account:** As the name suggests these are accounts related to persons.
 - (a) These persons could be natural persons like Suresh's A/c, Anil's a/c, Rani's A/c etc.
 - (b) The persons could also be artificial persons like companies, bodies corporate or association of persons or partnerships etc. Accordingly, we could have Videocon Industries A/c, Infosys Technologies A/c, Charitable Trust A/c, Ali and Sons trading A/c, ABC Bank A/c, etc.
 - (c) There could be representative personal accounts as well. Although the individual identity of persons related to these is known, the convention is to reflect them as collective accounts. e.g. when salary is payable to employees, we know how much is payable to each of them, but collectively the account is called as 'Salary Payable A/c'. Similar examples are rent payable, Insurance prepaid, commission pre-received etc. The students should be careful to have clarity on this type and the chances of error are more here.
- (2) **Real Accounts:** These are accounts related to assets or properties or possessions. Depending on their physical existence or otherwise, they are further classified as follows:-
 - (a) **Tangible Real Account** – Assets that have physical existence and can be seen, and touched. e.g. Machinery A/c, Stock A/c, Cash A/c, Vehicle A/c, and the like.
 - (b) **Intangible Real Account** – These represent possession of properties that have no physical existence but can be measured in terms of money and have value attached to them. e.g. Goodwill A/c, Trade mark A/c, Patents & Copy Rights A/c, Intellectual Property Rights A/c and the like.
- (3) **Nominal Account:** These accounts are related to expenses or losses and incomes or gains e.g. Salary and Wages A/c, Rent of Rates A/c, Travelling Expenses A/c, Commission received A/c, Loss by fire A/c etc.

The concept of Debit and Credit

- In double entry book-keeping, debits and credits (abbreviated Dr and Cr, respectively) are entries made in account ledgers to record changes in value due to business transactions.
- Debit is derived from the latin word "debitum", which means 'what we will receive'. It is the destination, who enjoys the benefit.
- Credit is derived from the latin word "credere" which means 'what we will have to pay'. It is the source, who sacrifices for the benefit.
- The source account for the transaction is credited (an entry is made on the right side of the account's ledger) and the destination account is debited (an entry is made on the left).
- Each transaction's debit entries must equal its credit entries.
- The difference between the total debits and total credits in a single account is the account's balance. If debits exceed credits, the account has a debit balance; if credits exceed debits, the account has a credit balance.

THE ACCOUNTING PROCESS

There are two approaches for deciding an account is debited or credit.

1. American Approach or Modern Approach	Accounting Process	2. British Approach or Traditional Approach
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Mostly followed the British Rule.

A. American approach: In order to understand the rules of debit and credit according to these approach transactions are divided into the following five categories:

- (i) Transactions relating to owner, e.g., Capital – These are personal accounts
- (ii) Transactions relating to other liabilities, e.g., suppliers of goods – These are mostly personal accounts
- (iii) Transactions relating to assets, e.g., land, building, cash, bank, stock-in-trade, bills receivable – These are basically all real accounts
- (iv) Transactions relating to expenses, e.g., rent, salary, commission, wages, cartage – These are nominal accounts
- (v) Transactions relating to revenues, e.g., interest received, dividend received, sale of goods – These are nominal accounts

To Sum Up

For Assets	Increase in Assets Decrease in Assets	Dr. Cr.
For Liabilities	Decrease in Liabilities Increase in Liabilities	Dr. Cr.
For Capital	Decrease in Capital Increase in Capital	Dr. Cr.
For Incomes	Decrease in Income Increase in Income	Dr. Cr.
For Expense	Increase in Expense Decrease in Expense	Dr. Cr.
For Stock	Increase in Stock Decrease in Stock	Dr. Cr.

B. British Approach or Double Entry System:

When one identifies the account that is getting affected by a transaction and type of that account, the next step is to apply the rules to decide whether the accounting treatment is to debit or credit that account. The Golden Rules will guide us whether the account is to be debited or credited.

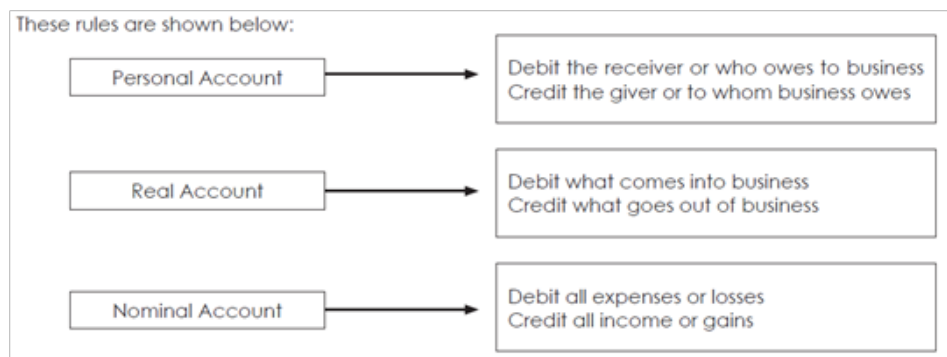


Illustration 1.

Ascertain the debit and credit from the following particulars under Modern Approach.

- (a) Started business with capital.
- (b) Bought goods for cash.
- (c) Sold goods for cash.
- (d) Paid salary.
- (e) Received Interest on Investment.
- (f) Bought goods on credit from Mr. Y
- (g) Paid Rent out of Personal cash.

Solution:

	Effect of Transaction	Account	To be debited/Credited
(a)	Increase in Cash Increase in Capital	Cash A/c Capital A/c	Debit Credit
(b)	Increase in Stock Decrease in Cash	Purchase A/c Cash A/c	Debit Credit
(c)	Increase in Cash Decrease in Stock	Cash A/c Sale A/c	Debit Credit
(d)	Increase in Expense Decrease in Cash	Salary A/c Cash A/c	Debit Credit
(e)	Increase in Cash Increase in Income	Cash A/c Interest A/c	Debit Credit
(f)	Increase in Stock Increase in Liability	Purchase A/c Y A/c	Debit Credit
(g)	Increase in Expense Increase in Liability	Rent A/c Capital A/c	Debit Credit

Illustration 2.

Ascertain the Debit Credit under British Approach or Double Entry System. Take Previous illustration.

Solution:

	Step-I	Step-II	Step-III	Step-IV
(a)	Cash A/c	Real	Comes in	Debit
	Capital A/c	Personal	Giver	Credit
(b)	Purchase A/c	Nominal	Expenses	Debit
	Cash A/c	Real	Goes out	Credit
(c)	Cash A/c	Real	Comes in	Debit
	Sales A/c	Nominal	Incomes	Credit
(d)	Salary A/c	Nominal	Expenses	Debit
	Cash A/c	Real	Goes out	Credit
(e)	Cash A/c	Real	Comes in	Debit
	Interest A/c	Nominal	Incomes	Credit
(f)	Purchase A/c	Nominal	Expenses	Debit
	Y' A/c	Personal	Giver	Credit
(g)	Rent A/c	Nominal	Expenses	Debit
	Capital A/c	Personal	Giver	Credit



ACCOUNTING EQUATION

The whole Financial Accounting depends on Accounting Equation which is also known as Balance Sheet Equation. The basic Accounting Equation is:

$$\text{Assets} = \text{Liabilities} + \text{Owner's equity}$$

$$\left. \begin{array}{l} \text{or } A = L + P \\ \text{or } P = A - L \\ \text{or } L = A - P \end{array} \right\} \text{Where } A = \text{Assets, } L = \text{Liabilities, } P = \text{Capital}$$

While trying to do this correlation, please note that incomes or gains will increase owner's equity and expenses or losses will reduce it.

Students are advised to go through the following illustration to understand this equation properly.

ACCOUNTING EQUATION

Illustration: 3

Prepare an Accounting Equation from the following transactions in the books of Mr. X for January, 2015 :-

- 1 Invested Capital in the firm ₹ 20,000
- 2 Purchased goods on credit from Das & Co. for ₹ 2,000
- 4 Bought plant for cash ₹ 8,000
- 8 Purchased goods for cash ₹ 4,000
- 12 Sold goods for cash (Cost ₹ 4,000 + Profit ₹ 2,000) ₹ 6,000.
- 18 Paid to Das & Co. in cash ₹ 1,000
- 22 Received from B. Banerjee ₹ 300
- 25 Paid salary ₹ 6,000
- 30 Received interest ₹ 5,000
- 31 Paid wages ₹ 3,000

Solution:

Effect of transaction on Assets, Liabilities and Capital

Date	Transaction	Assets=	Liabilities+	Capital
2015 Jan.1	Invested Capital in the firm ₹ 20,000	20,000	-	20,000
2	Purchased goods on credit from Das & Co. ₹2000	+2,000	+2,000	-
	Revised Equation	22,000=	2,000+	20,000
4	Bought Plant for cash ₹ 8,000	+8,000 -8,000	-	-
	Revised Equation	22,000=	2,000+	20,000
8	Purchased goods for cash ₹ 4,000	+4,000 -4,000	--	--
	Revised Equation	22,000=	2,000+	20,000
12	Sold Goods for cash (Cost ₹ 4,000 + Profit ₹ 2,000)	+6,000 -4,000		+2,000
	Revised Equation	24,000	2,000+	22,000
18	Paid to Das & Co. for ₹ 1,000	-1,000	-1,000	-
	Revised Equation	23,000=	1,000+	22,000
22	Received from B. Banerjee for ₹ 300	+300		

		-300		
	Revised Equation	23,000=	1,000+	22,000
25	Paid salary for ₹ 6,000	- 6,000		-6,000
	Revised Equation	17,000=	1,000+	16,000
30	Received Interest for ₹ 5,000	+5,000		+5,000
	Revised Equation	22,000=	1,000+	21,000
31	Paid Wages for ₹3,000	-3,000		-3,000
	Revised Equation	19,000=	1,000+	18,000

EXERCISE

1. Show the Accounting Equation on the basis of the following transactions:
 - (a) Rajesh started business with cash ₹9,000
 - (b) Purchased equipment for cash ₹7,400
 - (c) Purchased goods on credit ₹2,650
 - (d) Paid ₹300 to creditors
 - (e) Sold goods for cash ₹2,000 (cost price ₹1,200)
 - (f) Business expenses ₹700
 - (g) Goods worth ₹400 taken from business for personal use
 - (h) Depreciation on equipment ₹200
 - (i) Purchased goods for cash ₹1,000
 - (j) Rent outstanding ₹200

DOUBLE ENTRY SYSTEM, BOOKS OF PRIME ENTRY, SUBSIDIARY BOOKS

Double Entry System - This part we have already explained.

Books of Prime Entry

A journal is often referred to as Book of Prime Entry or the book of original entry. In this book transactions are recorded in their chronological order. The process of recording transaction in a journal is called as 'Journalisation'. The entry made in this book is called a 'journal entry'.

Functions of Journal

- (i) **Analytical Function:** Each transaction is analysed into the debit aspect and the credit aspect. This helps to find out how each transaction will financially affect the business.
- (ii) **Recording Function:** Accountancy is a business language which helps to record the transactions based on the principles. Each such recording entry is supported by a narration, which explain, the transaction in simple language. Narration means to narrate – i.e. to explain. It starts with the word – Being ...
- (iii) **Historical Function:** It contains a chronological record of the transactions for future references.

Advantages of Journal

The following are the advantages of a journal:

- (i) **Chronological Record:** It records transactions as and when it happens. So it is possible to get a detailed day-to-day information.
- (ii) **Minimizing the possibility of errors:** The nature of transaction and its effect on the financial position of the business is determined by recording and analyzing into debit and credit aspect.
- (iii) **Narration:** It means explanation of the recorded transactions.
- (iv) **Helps to finalize the accounts:** Journal is the basis of ledger posting and the ultimate Trial Balance.



The Trial balance helps to prepare the final accounts.

The specimen of a journal book is shown below.

Date	Particulars	Voucher number	Ledger folio	Debit amount (₹)	Credit amount (₹)
dd-mm-yy	Name of A/c to be debited Name of A/c to be credited (narration describing the transaction)	-----	Reference of page number of the A/c in ledger	-----	-----

Explanation of Journal

- (i) **Date Column:** This column contains the date of the transaction.
- (ii) **Particulars:** This column contains which account is to be debited and which account is to be credited. It is also supported by an explanation called narration.
- (iii) **Voucher Number:** This Column contains the number written on the voucher of the respective transaction.
- (iv) **Ledger Folio (L.F.):** This column contains the folio (i.e. page no.) of the ledger, where the transaction is posted.
- (v) **Dr. Amount and Cr. Amount:** This column shows the financial value of each transaction. The amount is recorded in both the columns, since for every debit there is a corresponding and equal credit.

All the columns are filled in at the time of entering the transaction except for the column of ledger folio. This is filled at the time of posting of the transaction to 'ledger'.

Example: As per voucher no. 31 of Roy Brothers, on 10.05.2014 goods of ₹ 50,000 were purchased. Cash was paid immediately. Ledger Folios of the Purchase A/c and Cash A/c are 5 and 17 respectively. Journal entry of the above transaction is given below:

In the books of Roy Brothers Journal Entries

Dr.							Cr.
Date	Particulars	Voucher No.	Ledger	Folio	Amount (₹)	Amount (₹)	
10.05.2014	Purchase A/c Dr.	31	5		50,000		
	To, Cash A/c (Being goods purchased for Cash)		17			50,000	

Illustration 4

Let us illustrate the journal entries for the following transactions:

2015 April

1. Mr. Vikas and Mrs. Vaibhavi who are husband and wife start consulting business by bringing in their personal cash of ₹ 5,00,000 and ₹ 2,50,000 respectively.
- 10 Bought office furniture of ₹ 25,000 for cash. Bill No. - 2015/F/3
- 11 Opened a current account with PP National Bank by depositing ₹ 1,00,000
- 15 Paid office rent of ₹ 15,000 for the month by cheque to M/s Realtors Properties. Voucher No. 3
- 20 Bought a motor car worth ₹ 4,50,000 from Millennium Motors by making a down payment of ₹ 50,000 by cheque and the balance by taking a loan from HH Bank. Voucher No. M/15/7

- 25 Vikas and Vaibhavi carried out a consulting assignment for AA Pharmaceuticals and raised a bill for ₹ 10,00,000 as consultancy fees. Bill No. B15/4/1 raised. Avon Pharmaceuticals have immediately settled ₹ 2,50,000 by way of cheque and the balance will be paid after 30 days. The cheque received is deposited into Bank.
- 30 Salary of one receptionist @ ₹ 5,000 per month and one officer @ ₹ 10,000 per month. The salary for the current month is payable to them.

Solution:

The entries for these transactions in a journal will look like:

**In the Books of Vikash & Vaibhavi
Journal Entries Journal Folio-1**

Date	Particulars	Voucher number	L.F	Amount (₹)	Amount (₹)
01-04-15	Cash A/c Dr. To Vikas's Capital A/c To Vaibhavi's capital A/c (Being capital brought in by the partners)		1 2 3	7,50,000	5,00,000 2,50,000
10-04-15	Furniture A/c Dr. To Cash A/c (Being furniture purchased in cash)	2015/F/3	4 1	25,000	25,000
11-04-15	PP National Bank A/c Dr. To Cash A/c (Being current account opened with PP National Bank by depositing cash)		5 1	1,00,000	1,00,000
15-04-15	Rent A/c Dr. To PP National Bank A/c (being rent paid to Realtors Properties for the month)	3	6 5	15,000	15,000
20-04-15	Motor Car A/c Dr. To PP National Bank A/c To Loan from HH Bank A/c (Being car purchased from Millennium Motors by paying down payment and loan arrangement)	M/15/7	7 5 8	4,50,000	50,000 4,00,000
25-04-15	PP National Bank A/c Dr. AA Pharma A/c Dr. To Consultancy Fees A/c (Being amount received and revenue recognized for fees charged)	B15/4/1	5 9 10	2,50,000 7,50,000	10,00,000
30-04-15	Salary A/c Dr. To Salary payable A/c (Being the entry to record salary obligation for the month)		11 12	15,000	15,000

Illustration 5

Journalise the following transactions in the books of Mr. Roy

2015

April

- 1 He started business with a capital of – Plant ₹ 10,000, Bank ₹ 8,000, Stock ₹ 12,000
- 2 Bought furniture for resale ₹ 5,000
Bought furniture for Office decoration ₹ 3,000



- 3 Paid rent out of personal cash for ₹ 2,000
8 Sold furniture out of those for resale ₹ 6,000
12 Paid Salary to Mr. X for ₹ 1,200
15 Purchased goods from Mr. Mukherjee for cash ₹ 3,000
18 Sold goods to Mr. Sen on credit for ₹ 8,000
20 Mr. Sen returned goods valued ₹ 1,000
22 Received cash from Mr. Sen of ₹ 6,500 in full settlement
28 Bought goods from Mr. Bose on credit for ₹ 5,000
30 Returned goods to Mr. Bose of ₹ 500 and paid to Mr. Bose ₹ 4,000 in full settlement.

Solution:

**In the Books of Mr. Roy
Journal Entries**

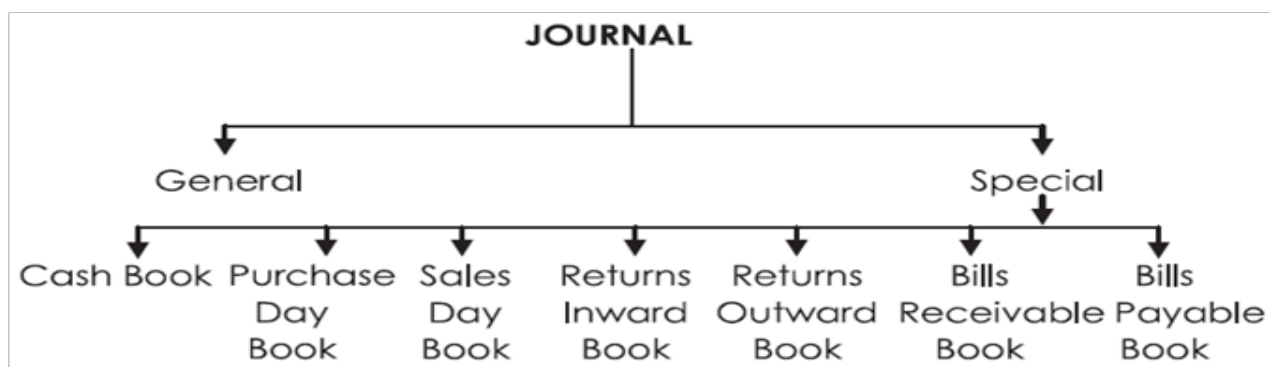
Date	Particulars	L. F.	Debit (₹)	Credit (₹)
2015 Apr.1	Plant A/c Dr. Bank A/c Dr. Stock A/c Dr. To, Capital A/c [Being Plant, Bank, Stock introduced to the business]		10,000 8,000 12,000	30,000
2	Purchase A/c Dr. To, Bank A/c [Being furniture purchased for resale] Furniture A/c Dr. To, Bank A/c [Being furniture purchased for office decoration]		5,000 3,000	5,000 3,000
3	Rent A/c Dr. To, Capital A/c [Being rent paid out of personal cash]		2,000	2,000
8	Cash A/c Dr. To, Sales A/c [Being furniture out of those meant for resale are sold]		6,000	6,000
12	Salary A/c Dr. To, Bank A/c [Being salary paid to Mr. X]		1,200	1,200
15	Purchase A/c Dr. To, Cash A/c [Being goods purchased]		3,000	3,000
18	Mr. Sen A/c Dr. To, Sales A/c [Being goods sold on credit to Mr. Sen]		8,000	8,000
20	Returns Inward A/c Dr. To, Mr. Sen A/c [Being goods returned from Mr. Sen]		1,000	1,000
22	Cash A/c Dr. Discount Allowed A/c Dr. To, Mr. Sen A/c [Being cash received from Mr. Sen in full settlement]		6,500 500	7,000

28	Purchase A/c Dr. To, Mr. Bose A/c [Being goods purchased from Mr. Bose on credit]		5,000	5,000
30	Mr. Bose A/c Dr. To, Cash A/c To, Returns Outward A/c To, Discount Received A/c [Being goods returned to Mr. Bose and paid cash in full settlement]		5,000	4,000 500 500

Please observe the convention of entry. Accounts to be debited are written first with 'Dr' as a suffix, and accounts to be credited are written subsequently with a prefix 'To'.

Sub-division of Journals

Journal is divided into two types -(i) General Journal and (ii) Special Journal.



(i) General Journal

- This is a book of chronological record of transactions.
- This book records those transactions which occur so infrequently that they do not warrant the setting up of special journals.

Examples of such entries: (i) opening entries (ii) closing entries (iii) rectification of errors.

The form of this general journal, is as under:

JOURNAL

Date	Particulars	L.F.	Dr. Amount	Cr. Amount
------	-------------	------	------------	------------

L.F. : Ledger Folio

Dr : Debit

Cr : Credit

Recording of transactions in this book is called journalising and the record of transactions is known as journal entry.

(ii) Special Journal

It is subdivided into Cash Book, Purchase Day Book, Sales Day Book, Returns Inward Book, Returns Outward Book, Bills Receivable Book and Bills Payable Book. These books are called subsidiary books.

Importance of Sub-division of journals

When the number of transactions is large, it is practically not possible to record all the transactions through one journal because of the following limitations of Journal:



- (i) The system of recording all transactions in a journal requires (a) writing down the name of the account involved as many times as the transaction occurs; and (b) an individual posting of each account debited and credited and hence, involves the repetitive journalizing and posting labour.
- (ii) Such a system cannot provide the information on a prompt basis.
- (iii) Such a system does not facilitate the installation of an internal check system because the journal can be handled by only one person.
- (iv) The journal becomes huge and voluminous.
- (v) To overcome the shortcomings of the use of the journal only as a book of original entry, the journal is sub-divided into special journal.

The journal is sub-divided in such a way that a separate book is used for each category of transactions which are repetitive in nature and are sufficiently large in number.

Compound Journal

If for a single transaction, only one account is debited and one account is credited, it is known as simple journal. If the transaction requires more than one account which is to be debited or more than one account is to be credited, it is known as Compound Journal. The following illustration will make it clear:

Illustration 6

- (i) Started business with Cash ₹50,000; Plant ₹24,000; Stock ₹4,000
- (ii) Sold Goods for Cash ₹8,000 and to Ms. Agarwal for ₹10,000
- (iii) Ms. Agarwal settled her account less discount ₹ 600

Solution:

In the Books of
Journal

Date	Particulars	L.F.	Debit ₹	Credit ₹
(i)	Cash A/c Dr. Plant A/c Dr. Stock A/c Dr. To Capital A/c (Being business started with cash, plant and stock as capital)		50,000 24,000 4,000	78,000
(ii)	Cash A/c Dr. Ms. Agarwal's A/c Dr. To Sales A/c (Being goods sold for cash ₹ 8,000 and on credit ₹ 10,000)		8,000 10,000	18,000
(iii)	Cash A/c Dr. Discount Allowed A/c Dr. To Ms. Agarwal's A/c (Being cash received as final settlement and discount allowed)		9,400 600	10,000

Multiple Choice Questions:

- Nominal Account represents
(a) Profit & gain (b) Loss/Expenses (c) None (d) Both (A) and (B)
- S.B.I Account is a ...
(a) Nominal (b) Artificial personal Account
(c) Representative personal Account (d) None
- The process of recording business transactions in a book of original entry is known as
(a) Journal (b) Balance (c) posting (d) none

4. Prepaid rent is a
(a) Nominal A/c (b) representative personal A/c
(c) tangible assets account (d) none
5. In an Account if debit > credit side, the balance is known as the
(a) Negative balance (b) Debit balance (c) Positive balance (d) Credit balance
6. A sale of goods to Ram for cash should be debited to:
(a) Ram (b) Cash (c) Sales (d) Capital
7. A withdrawal of cash from business by the proprietor should be credited to
(a) Drawing A/c (b) Capital A/c (c) Cash A/c (d) Purchase A/c
8. Rent Account
(a) Personal (b) Real (c) Nominal (d) None
9. Ledger contains various ____ in it
(a) Transactions (b) Entries (c) Accounts (d) None
10. The process of transfer of entries from day book to ledgers is called ____
(a) Simple posting (b) Journal posting (c) Transaction (d) Ledger posting
11. The rent paid to landlord is credited to
(a) Landlord's A/c (b) Rent A/c (c) Cash A/c (d) None
12. Which financial statement represents the accounting equation-
Assets = Liabilities + Owner's equity:
(a) Income Statement (b) Statement of Cash flows (c) Balance Sheet (d) None
13. The debts written off as bad, if recovered subsequently are
(a) Credited to Bad Debts recovered A/c (b) Credited to trade receivables Account
(c) Debited to profit and Loss Account (d) None
14. A trial balance will not balance if ____
(a) correct entry is posted twice
(b) The purchase on credit basis is debited to purchases and credited to cash
(c) ₹ 500 cash payment to creditors is debited to creditors for ₹ 50 and credited to cash as ₹ 500
(d) None of the above
15. A trial balance shows
(a) Honesty of accountants (b) Accuracy of account
(c) Only arithmetical accuracy of accounts (d) none of these

Ans: 1.d 2.b 3.a 4.b 5.b 6.b 7.c 8.c 9.c 10.d 11.c 12.c 13.a 14.c 15.c

Fill in the blanks

1. Cash account is _____ account (Real)
2. Liability account has _____ balance (credit)
3. Interest account has _____ balance ('debit or credit')
4. Opening entries are generally passed through _____ ('General journal')
5. Goodwill account is a/an _____ ('intangible asset')
6. The debit balance in a nominal account shows _____ (Expenditure)
7. The allowance made for prompt payment is called _____ (Cash Discount)
8. The left hand side of an account is called _____ side (Debit)
9. If the debit side of goods account exceeds the credit side the difference will be _____ (Closing stock)
10. The balance of _____ account will be shown in the debit column of trail balance. (Assets/Expenses)
11. The equality of debit and credit of the _____ does not mean that the individual accounts are also accurate. ("Trial balance")



12. Trial balance is statement which shows the ____ or the totals of all the accounts. ("balances")
13. ____ lists the balance and the title of account in the ledger (Trial balance)
14. Closing stock appearing in the trial balance is shown on the ____ balance sheet (asset side of)
15. The balance of liabilities account will be shown in the ____ of the trial balance. (credit column)

True or false

1. Ram has assets of ₹ 20,000/- and liabilities of ₹ 4,000/- his capital therefore would be ` 16,000/- (TRUE)
2. Depreciation is loss (TRUE)
3. Double accounting system owes its origin to Luca Pacioli (TRUE)
4. Profit or loss have no effect on network (FALSE)
5. Capital account is a real account (FALSE)
6. Trial balance is a final accounts (FALSE)
7. Trial balance contains the balances of only personal and real accounts (FALSE)
8. After preparation of ledgers, the next is the preparation of trial balance (TRUE)
9. Journal is the book of final entry (FALSE)
10. Trade discount will be entered in the book of accounts (FALSE)

Match the following

Group –A

1. Salary account	e	a) Artificial personal account
2. Drawings account	c	b) Representative personal account
3. Furniture account	d	c) Personal account
4. Income received in advance	b	d) Real account
5. Modern Academy	a	e) Nominal account

Group- B

1. Salary account	c	a) Real account
2. Capital account	d	b) Artificial Personal account
3. Goodwill account	a	c) Nominal account
4. Harish Account	e	d) Representative personal Account
5. State Bank of India	b	e) Personal account

SUBSIDIARY BOOKS

Subsidiary Books refers to books meant for specific transactions of similar nature. Subsidiary Books are also known as Special journals or day books. To overcome shortcoming of the use of the journal only as a book of original entry, the journal is subdivided into specific journals or subsidiary books.

The sub-division of journal is done as follows:

Transaction	Subsidiary Book
All cash and bank transactions	Cash Book - has columns for cash, bank and cash discount
All credit purchase of goods – only those Goods that are purchased for resale are covered here.	Purchase Day Book or Purchase register.
All credit sale of goods	Sales Day Book or sales register
All purchase returns – i.e. return of goods back to suppliers due to defects	Purchase Return Book or Return Outward Book
All sales returns – i.e. return of goods back from Customers	Sales Return Book or Return Inward Book

All bill receivables – these are bills accepted by customers to be honoured at an agreed date.	Bills Receivable Book
All bills payable - these are bills accepted by the business to be honoured by paying to suppliers at an agreed date.	Bills Payable Book
For all other transactions not covered in any of the above categories – i.e. purchase or sale of assets, expense accruals, rectification entries, adjusting entries, opening entries and closing entries.	Journal Proper

RECORDING OF CASH AND BANK TRANSACTIONS

Cash Book

A Cash Book is a special journal which is used for recording all cash receipts and all cash payments. Cash Book is a book of original entry since transactions are recorded for the first time from the source documents. The Cash Book is larger in the sense that it is designed in the form of a Cash Account and records cash receipts on the debit side and cash payments on the credit side. Thus, the Cash Book is both a journal and a ledger.

Illustration 7:

Write up a single column Cash Book of Mr. Y for the month of April 2015, April 2015

1. Balance in hand ₹ 5,000
4. Sold goods to Mr. Z on credit ₹ 3,000
6. Sold goods for Cash ₹ 1,000
8. Purchased goods on credit from Mr. P for ₹ 3,000
12. Paid to Mr. P for ₹ 2,000 and Received Discount ₹ 200
15. Returned goods to Mr. P for ₹ 800
20. Goods Returned by Mr. Z for ₹ 300
25. Z settled his account for ₹ 2,500
26. Paid salary by cheque for ₹ 1,000
30. Received interest for ₹ 1,000

Solution:

In the books of Mr. Y Cash Book (as the only Book of Single Entry)

Date	Particulars	L/F	Amount ₹	Date	Particulars	L/F	Amount ₹
2015 Apr.1	To Balance b/d		5,000	2015 12	To, Mr. P A/c (paid to Mr. P)		2,000
6	Sales A/c (Goods sold for cash)		1,000	30	By, Balance c/d		7,500
25	To, Z's A/c (Z settled his account)		2,500				
30	To, Interest A/c (Received interest)		1,000				
			9,500				9,500
May 1	To, Balance b/d		7,500				



Types of Cash Book

There are different types of Cash Book as follows:

- (i) **Single Column Cash Book**- Single Column Cash book has one amount column on each side. All cash receipts are recorded on the debit side and all cash payments on the payment side, this book is nothing but a Cash Account and there is no need to open separate cash account in the ledger.
- (ii) **Double Column Cash Book**- The Double Column Cash Book having two amounts. Columns on each side as under:
 - (a) Cash and discount columns
 - (b) Cash and bank columns
 - (c) Bank and discount columns
- (iii) **Triple Column Cash Book**- Triple Column Cash Book has three amount columns, one for cash, one for Bank and one for discount , on each side. All cash receipts, deposits into book and discount allowed are recorded on debit side and all cash payments, withdrawals from bank and discount received are recorded on the credit side. In fact, a triple-column cash book serves the purpose of Cash Account and Bank Account both. Thus, there is no need to create these two accounts in the ledger.
- (iv) The multi-column cash book having multiple columns on both the sides of the cash book.
- (v) The petty Cash Book.

Dr.				Specimen of Single Column Cash Book				Cr.			
Receipts				Payments							
Date	Particulars	L.F.	Cash	Date	Particulars	L.F.	Cash				

Dr.					Specimen of Double Column Cash Book					Cr.				
Receipts					Payments									
Date	Particulars	L.F.	Cash	Disc. Allowed	Date	Particulars	L.F.	Cash	Disc. Received					

Dr.						Specimen of Triple Column Cash Book						Cr.					
Receipts						Payments											
Date	Particulars	L.F.	Cash	Bank	Discount Allowed	Date	Particulars	L.F.	Cash	Bank	Discount Received						

Is the Cash Book Journal or Ledger?

- Cash Book is a book of original entry since transactions are recorded for the first time from the source documents.
- The cash book is ledger in the sense that it is designed in the form of a Cash Account and records cash receipts on the debit side and cash payments on the credit side.

Thus the cash Book is both a journal and a ledger.

1. Contra Transactions

Transactions which relates to allowing discount or receiving discount in cash after the settlement of the dues are known as Contra Transactions.

Example:

1. Cash deposited in to Bank

Bank A/c Dr.
To, Cash

2. Cash withdrawn from Bank

Cash A/c Dr.
To, Bank A/c

B. Cheque Transactions

When a cheque is received and no any other information at a later date about the same is given, it will be assumed that the said cheque has already been deposited into bank on the same day when it was received. Then the entry should be as under:

Bank A/c Dr.
To Debtors/Party A/c

But if it is found that the said cheque has been deposited into the bank at a later date, then the entry will be:

(i) When the cheque is received

Cash A/c Dr.
To Debtors/Party A/c

(ii) When the same was deposited into bank at a later date

Bank A/c Dr.
To Cash A/c

(iii) When the said cheque is dishonoured by the bank

Debtors/Party A/c Dr.
To Bank A/c

Illustration 8.

Let us see an illustration for the following cash and bank transactions in the books of Mr. Abhishek

- January 1 Opening cash balance was ₹ 3,800 and bank balance was ₹ 27,500
- January 4 Wages paid in cash ₹ 1,500
- January 5 received cheque of ₹ 19,800 from KBK enterprises after allowing discount of ₹ 200
- January 7 Paid to consultancy charges by cheque for ₹ 7,500
- January 10 Cash of ₹ 2,500 withdrawn from bank
- January 12 Received a cheque for ₹ 4,500 in full settlement of the account of Mr. X at a discount of 10% and deposited the same into the Bank.
- January 15 X's cheque returned dishonoured by the Bank

Solution:

In the Books of Mr. Abhishek Cash Book

Dr.						Cr.					
Receipts						Payments					
Date	Particulars	L.F	Cash (₹)	Bank (₹)	Dis Allowed (₹)	Date	Particulars	L.F	Cash (₹)	Bank (₹)	Dis received (₹)
1- Jan	Opening Balance		3,800	27,500		4- Jan	Wages paid		1,500		
5- Jan	Recd from KBK			19,800	200	7- Jan	Consultancy fees			7,500	
10- Jan	Cash withdrawn		2,500			10- Jan	Cash withdrawn			2,500	
12- Jan	Mr. X			4,500	500	15- Jan	Mr. X			4,500	500
							Closing balance		4,800	37,300	
			6,300	51,800	700				6,300	51,800	500



Please note that the balance of discount columns is not taken and these are posted directly to the respective ledger account separately. The balance of cash and bank columns are posted into cash and bank accounts periodically. The posting into ledger is explained later in this chapter.

PURCHASE DAY BOOK

The purchase day book records the transactions related to credit purchase of goods only. It follows that any cash purchase or purchase of things other than goods is not recorded in the purchase day book. Periodically, the totals of Purchase day book are posted to Purchase account in the ledger. The specimen Purchase day book is given below:

In the Books of Purchase Day Book

Date	Name of the Suppliers and details of Goods Purchased	Invoice reference	L. F.	Amount (₹)	Remarks
------	--	-------------------	-------	------------	---------

The format for Purchase Return is exactly the same; hence separate illustration is not given. Let us see an illustration for following transactions for a furniture shop:

Illustration 9

- Bought 20 tables @ ₹ 500 per table from M.M Appliances on credit @ 12% trade discount as per invoice number 22,334 on 2nd March.
- Purchased three dozen chairs @ ₹ 250 each from Metro chairs as per invoice number 1112 on 4th March.
- Second hand furniture bought from Golden Furnitures on credit as per invoice number 375 for ₹ 1200 on 7th March.
- Purchased seven book racks from Mayur Furnitures for ₹ 4,900 paid for in cash on 6th March.
- Purchased Machinery for ₹ 30,000 from Kirloskar Ltd on 9th March as per invoice number 37.

Solution:

In the Books of Furniture Shop Purchase Day Book

Date	Name of the Suppliers and Details of goods purchased	Invoice reference	L. F.	Amount (₹)
2 nd Mar.	M.M Appliances 20 tables@ 500 and 12% trade discount (20 * 500) = 10000 less 12% discount	22334		8,800
4 th Mar.	Metro Chairs (3 dozen chairs @ 250 per chair)	1112		9,000
7 th Mar.	Golden Furniture	375		1,200
	Total			19,000

Please note that the transaction for purchase of book rack will not be entered in the purchase book as it is not purchased on credit. (Where will it go then? it will go to the cash book!). Similarly purchase of machinery will not form part of purchase book. It will be entered in Journal Proper.

SALES DAY BOOK

The sales day book records transaction of credit sale of goods to customers. Sale of other things, even on credit, will not be entered in the sales day book but will be entered in Journal Proper. If goods are sold for cash, it will be entered in cash book. Total of sales day book is periodically posted to sales account in the ledger. The specimen of a sales day book is given below.

In the books of
Sales Day Book

Date	Particulars	Invoice reference	L. F.	Amount	Remarks
------	-------------	-------------------	-------	--------	---------

The format of sales return book is exactly the same; hence a separate illustration is not given. Let us see how will be the following transaction recorded in the books of a Cloth Merchant.

Illustration 10.

1st July	Sold Tip Top clothing 50 suits of ₹ 2,200 each on two months credit on invoice number -2
11th July	Sold to New India Woolen 100 sweaters @ ₹ 250 each on invoice number 55
13th July	Received an order from Modern clothing for 100 trousers @ ` 500 at trade discount of 10%
17th July	Sold 50 sarees to Lunkad brothers @ ₹ 750 each
25th July	Sold T-shirts at exhibition hall for cash for ₹ 7,500

Solution:

In the books of Cloth Merchant
Sales Day Book

Date	Particulars	Invoice reference	L. F.	Amount
1st July	Tip Top Clothing (50 suits @ ₹ 2,200)	2		1,10,000
11th July	New India Woolen (100 sweaters @ ₹ 250)	55		25,000
17th July	Lunkad brother 50 sarees @ ₹ 750			37,500
	Total			1,72,500

Here again, cash sales at exhibition hall are not recorded. Also, merely getting an order for goods is not a transaction to be entered in sales book.

OTHER SUBSIDIARY BOOKS – RETURNS INWARD, RETURN OUTWARD, BILLS RECEIVABLE, BILLS PAYABLE

(i) Return Inward Book- The transactions relating to goods which are returned by the customers for various reasons, such as not according to sample, or not up to the mark etc. contain in this book. It is also known as Sales Return Book.

Generally when a customer returns good to suppliers he issues a Debit Note for the value of the goods returned by him. Similarly the supplier who receives those goods issues a Credit Note.

Returns Inward Day Book

Date	Particulars	Outward Invoice	L.F.	Details	Totals	Remarks
------	-------------	-----------------	------	---------	--------	---------

(ii) Return Outward Book- This book contains the transactions relating to goods that are returned by us to our creditors e.g. goods broken in transit, not according to the sample etc. It's also known as Purchase Return Book.

Return Outward Day Book

Date	Particulars	Debit Note	L.F	Details	Totals	Remarks
------	-------------	------------	-----	---------	--------	---------

(iii) Bills Receivable Book- It is such a book where all bills received are recorded and there from posted directly to the credit of the respective customer's account. The total amounts of the bills so received during the period (either at the end of the week or month) is to be posted in one sum to the debit of Bills Receivable A/c.



Bills Receivable Day Book

No. of Bills	Date of Receipt of Bill	From whom	Name of the Receiver	Name of Drawer	Name of Acceptor	Date of Bill	Due Date	L.F.	Amount of Bill	How disposed off
--------------	-------------------------	-----------	----------------------	----------------	------------------	--------------	----------	------	----------------	------------------

(iv) Bills Payable Book- Here all the particulars relating to bills accepted are recorded and there from posted directly to the debit of the respective creditor's account. The total amounts of the bills so accepted during the period (either at the end of the week or month) is to be posted in one sum to the credit of Bills Payable Account.

Bills Payable Day Book

No. of Bills	Date of Acceptance	To whom given	Name of Drawer	Name of the Payee	Where Payable	Date of Bill	Term	Due Date	L.F.	Amount of Bill How disposed off
--------------	--------------------	---------------	----------------	-------------------	---------------	--------------	------	----------	------	------------------------------------

JOURNAL PROPER

Credit transactions that cannot be entered in any other subsidiary book are entered in journal proper. It will cover purchase or sale of assets, expense accruals, rectification entries, adjusting entries, opening entries and closing entries. The format of journal proper is exactly the same as Journal.

LEDGER ACCOUNTS

The book which contains accounts is known as the ledger. Since finding information pertaining to the financial position of a business emerges only from the accounts, the ledger is also called the Principal Book. As a result, all the necessary information relating to any account is available from the ledger. This is the most important book of the business and hence is rightly called the "King of All Books". Also Known as Book of Final Entry.

The specimen of a typical ledger account is given below:

Dr				Ledger-Account				Cr			
Date	Particulars	J. F.	Amount (₹)	Date	Particulars	J. F.	Amount (₹)				

Ledger Posting

As and when the transaction takes place, it is recorded in the journal in the form of journal entry. This entry is posted again in the respective ledger accounts under double entry principle from the journal. This is called ledger posting.

The rules for writing up accounts of various types are as follows:

Assets:	Increases on the left hand side or the debit side and decreases on the credit side or the right hand side.
Liabilities:	Increases on the credit side and decreases on the debit side.
Capitals:	The same as liabilities.
Expenses:	Increases on the debit side and decreases on the credit side.
Incomes or gain:	Increases on the credit side and decrease on the debit side.

To summarise

Dr.	Assets	Cr.
Increase		Decrease
Dr.	Expenses or Losses	Cr.
Increase		Decrease

Dr.	Liabilities & Capital	Cr.
Decrease		Increase
Dr.	Income or Gains	Cr.
Decrease		Increase



- 2) The posting in the account which is credited, is done on the credit side by writing the name of the account or accounts that are debited with the prefix 'By'.

Illustration 11.

Let us now see how we can create ledger account for the seven journal entries that we passed for Illustration 4.

Folio No. 1

Dr.				Cr.			
Cash Account							
Date	Particulars	J. F.	Amount (₹)	Date	Particulars	J. F.	Amount (₹)
1.4.2015	To Vikas's capital	1	500,000	10.4.2015	By Furniture	1	25,000
1.4.2015	To Vaibhavi's capital	1	250,000	11.4.2015	By Punjab National Bank	1	1,00,000
				30.4.2015	By Balance c/d		6,25,000
			750,000				7,50,000
1.5.2015	To Balance b/d		625,000				

Folio No. 2

Dr.				Cr.			
Mr. Vikas's Capital Account							
Date	Particulars	J. F.	Amount (₹)	Date	Particulars	J. F.	Amount (₹)
30.4.2015	To Balance c/d		5,00,000	1.4.2015	By Cash	1	5,00,000
			5,00,000				5,00,000
				1.5.2015	By Balance b/d		5,00,000

Folio No. 3

Dr.				Cr.			
Mrs. Vaibhavi's Capital Account							
Date	Particulars	J. F.	Amount (₹)	Date	Particulars	J. F.	Amount (₹)
30.4.2015	To Balance c/d		2,50,000	1.4.2015	By Cash	1	2,50,000
			2,50,000				2,50,000
				1.5.2015	By Balance b/d		2,50,000

Folio No. 4

Dr.				Cr.			
Furniture Account							
Date	Particulars	J. F.	Amount (₹)	Date	Particulars	J. F.	Amount (₹)
10.04.2015	To Cash		25,000	30.4.2015	By Balance c/d		25,000
			25,000				25,000
1.05.2015	To Balance b/d		25,000				

Folio No. 5

Dr.				Cr.			
Punjab National Bank Account							
Date	Particulars	J. F.	Amount (₹)	Date	Particulars	J. F.	Amount (₹)
11.4.2015	To Cash	1	1,00,000	15.4.2015	By Rent	1	15,000
25.4.2015	To Consultancy Fees	1	2,50,000	20.4.2015	By Motor Car		1 50,000
					By Balance c/d		2,85,000
			3,50,000				3,50,000
1.05.2015	To Balance b/d		2,85,000				

Folio No. 6

Dr.		Rent Account				Cr.	
Date	Particulars	J. F.	Amount (₹)	Date	Particulars	J. F.	Amount (₹)
15.4.2015	To Punjab National Bank	1	15,000				

Folio No. 7

Dr.		Motor Car Account				Cr.	
Date	Particulars	J. F.	Amount (₹)	Date	Particulars	J. F.	Amount (₹)
20.4.2015	To Punjab National Bank		1 50,000				
	“ To Loan from HDFC Bank	1	4,00,000				

Folio No. 8

Dr.		Loan from HDFC Bank Account				Cr.	
Date	Particulars	J. F.	Amount (₹)	Date	Particulars	J. F.	Amount (₹)
20.4.2015	By Motor Car	1	4,00,000				

Folio No. 9

Dr.		Avon Pharmaceuticals Account				Cr.	
Date	Particulars	J. F.	Amount (₹)	Date	Particulars	J. F.	Amount (₹)
25.4.2015	To Consultancy Fees	1	7,50,000				

Folio No. 10

Dr.		Consultancy Fees Account				Cr.	
Date	Particulars	J. F.	Amount (₹)	Date	Particulars	J. F.	Amount (₹)
25.4.2015	By Punjab National Bank	1	2,50,000				
25.4.2015	By Avon Pharma	1	7,50,000				

Folio No. 11

Dr.		Salary Account				Cr.	
Date	Particulars	J. F.	Amount (₹)	Date	Particulars	J. F.	Amount (₹)
30.4.2015	To Salary payable	1	15,000				

Folio No. 12

Dr.		Salary Payable Account				Cr.	
Date	Particulars	J. F.	Amount (₹)	Date	Particulars	J. F.	Amount (₹)
				30.4.2015	By Salary	1	15,000

Please carefully observe the posting of journal entries into various ledger accounts. Do you see some further calculation in the Cash A/c and Mr. Vikas's Capital A/c? What is done is that after posting all transactions to these accounts, the difference between the debit and credit sides is calculated. This difference is put on the side with smaller amount in order to tally grand totals of both sides. The convention is to write "To Balance c/d" or "By balance c/d" as the case may be. This procedure is normally done at the end of an accounting period. This process is called as "balancing of ledger accounts".



Once the ledgers are balanced for one accounting period, the balance needs to be carried forward to the next accounting period as a running balance. This is done by writing "To Balance b/d" or "By balance b/d" as the case may be after the grand totals. This is also shown in the Cash A/c and Mr. Vikas's Capital Account.

Could you now attempt to balance the other ledger accounts and carry the balances to the next accounting period?

Important note: Please remember the balances of personal and real accounts only are carried down to the next accounting period as they represent resources and obligations of the business which will continue to be used and settled respectively in future. Balances of nominal accounts (which represent incomes or gains and expenses or losses) are not carried down to the next period. These balances are taken to the Profit and Loss account (or Income statement) prepared for the period. The net result of the P & L Account will show either net income or net loss which will increase or decrease the owner's equity.

In the above example, please note that the balances of Rent Account, Consultancy Fees Account and Salary Account will not be carried down to the next period, but to the P & L Account of that period. As illustration, we have shown it for Rent Account.

Posting to Ledger Accounts from Subsidiary books

In the above section, we explained posting to ledger accounts directly on the basis of journal entries. In practice, however, we know that use of subsidiary books is in vogue. Let us see how the posting to ledger accounts is done based on these records.

For each of the subsidiary books, there is a ledger account e.g. for purchase book, there is Purchase Account, for sales book there's Sales A/c, for cash book there will be Cash A/c as well as Bank A/c and so on.

Illustration 12.

Let us continue with illustration seen in the section Illustrations 8 9 and 10 above and post the totals into respective ledger accounts.

Solution:

Dr.				Cash Account				Cr.			
Date	Particulars	J. F.	Amount (₹)	Date	Particulars	J. F.	Amount (₹)				
1st Jan	To Balance b/d		3,800		By Sundries as per cash book		1,500				
	To Miscellaneous Receipts		2,500		By Balance c/d		4,800				
			6,300				6,300				

Dr.				Purchases Account				Cr.			
Date	Particulars	J. F.	Amount (₹)	Date	Particulars	J. F.	Amount (₹)				
	To Sundries as per purchase book		19,000		By Transfer to P & L A/c		19,000				

Dr.				Sales Account				Cr.			
Date	Particulars	J. F.	Amount (₹)	Date	Particulars	J. F.	Amount (₹)				
	To Transfer to P&L A/c		1,72,500		By Sundries as per sales book		1,72,500				

Typical Ledger Account Balances

We have seen how to balance various ledger accounts. It can be seen that while some accounts will show debit balance, while the other will show credit balance. Is there any relationship between the type of account (whether it is the account of asset, liability, capital, owner's equity, incomes or gain, expenses or losses) and the kind of balance (debit or credit) it should show?

The answer is generally 'Yes'. You may test to find the following are typical relationships.

Type of Account	Type of balance
All asset accounts	Debit balance
All liability accounts	Credit balance
Capital & Owner's equity account	Credit balance
Expenses or loss accounts	Debit balance
Incomes or gain accounts	Credit balance

Let us test these possibilities for confirmation. How does one go about testing this? Consider 'Cash A/c'. Whenever business receives cash we debit it, and whenever it is paid we credit it. Is it possible to see a situation that credits to cash are more than debits? In other words could we have negative cash in hand? No. Cash account will therefore always show a debit balance. So is true for all real asset accounts.

After solving problems, if the contrary is observed, there is every chance that an error has been made while passing the accounting entries.

Closing Balance and Opening Balance

The debit or credit balance of an account what we get at the end of the accounting period is known as closing balance of that account.

The "balance of the nominal accounts" is closed by transferring to trading account and the profit and loss account which shows the net operating results – net profit or net loss.

The "balance of the personal accounts and real accounts" representing assets, liabilities, owner's equity are reflected in the Balance sheet, which shows the financial position of a business on a particular date. These balances are transported as opening balance in the succeeding accounting period.

Some terms used:

Casting — totaling

Balancing — to find the difference between debit side total and credit side total of an account.

C/d -Carried down

B/d -Brought down

C/o - Carried over

B/o - Brought over

C/f - Carried forward

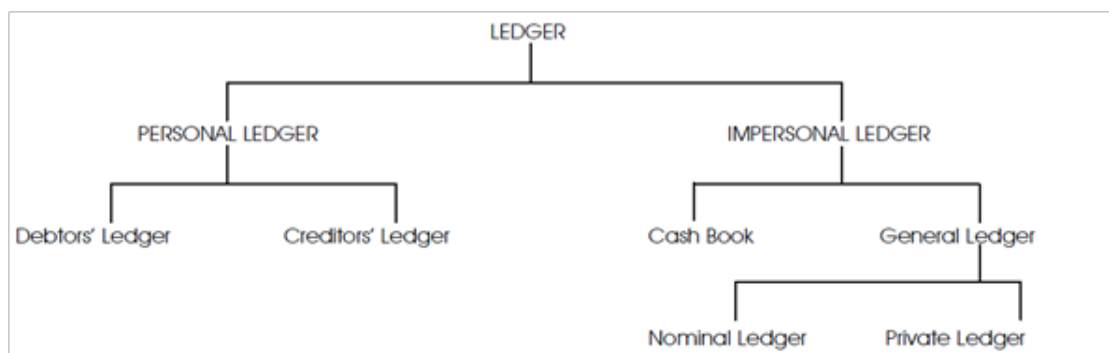
B/f - Brought forward

Subdivisions of Ledger

Practically, the Ledger may be divided into two groups -

(a) Personal Ledger &

(b) Impersonal Ledger. They are again sub-divided as :



Personal Ledger: The ledger where the details of all transactions about the persons who are related to the accounting unit, are recorded, is called the Personal Ledger.

Impersonal Ledger: The Ledger where details of all transactions about assets, incomes & expenses etc. are recorded, is called Impersonal Ledger.

Again, Personal Ledger may be divided into two groups:
Viz. (a) Debtors' Ledger, & (b) Creditors' Ledger.

- (a) **Debtors' Ledger:** The ledger where the details of transactions about the persons to whom goods are sold, cash is received, etc. are recorded, is called Debtors' Ledger.
- (b) **Creditors' Ledger:** The ledger where the details of transactions about the persons from whom are purchase goods on credit, pay to them etc. are recorded, is called Creditors' Ledger.

Impersonal Ledger may, again be divided into two group, viz, (a) Cash Book; and (b) General Ledger.

- (a) **Cash Book:** The Book where all cash & bank transactions are recorded, is called Cash Book.
- (b) **General Ledger:** The ledger where all transactions relating to real accounts, nominal accounts, details of Debtors' Ledger and Creditors' Ledger are recorded, is called General Ledger.

General Ledger may, again, be divided into two groups. viz, Nominal Ledger; & Private Ledger.

- (a) **Nominal Ledger:** The ledger where all transactions relating to incomes and expenses are recorded is called Nominal Ledger.
- (b) **Private Ledger:** The Ledger where all transactions relating to assets and liabilities are recorded is called Private Ledger.

Advantages of sub-division of Ledger:

The advantages of sub-division of ledger are:

- (a) **Easy to Divide work :** As a result of sub-division, the division of work is possible and records can be maintained efficiently by the concerned employee.
- (b) **Easy to handle :** As a result of sub-division, the size and volume of ledger is reduced.
- (c) **Easy to collect information:** From the different classes of Ledger a particular type of transactions can easily be found out.
- (d) **Minimizations of mistakes:** As a result of sub-division chances of mistakes are minimized.

- (e) **Easy to compute** : As a result of sub-division, the accounting work may be computed quickly which is very helpful to the management.
- (f) **Fixation of responsibility**: Due to sub-division, allotment of different types of work to different employees is done for which concerned employee will be responsible.

TRIAL BALANCE

Trial balance may be defined as a statement or a list of all ledger account balances taken from various ledger books on a particular date to check the arithmetical accuracy. According to the Dictionary for Accountants by Eric. L. Kohler, Trial Balance is defined as “a list or abstract of the balances or of total debits and total credits of the accounts in a ledger, the purpose being to determine the equality of posted debits and credits and to establish a basic summary for financial statements”. According to Rolland, Trial Balance is defined as “The final list of balances, totaled and combined, is called Trial Balance”.

As this is merely a listing of balances, this will always be as on a particular date. Further it must be understood that Trial Balance does not form part of books of account, but it is a report prepared by extracting balances of accounts maintained in the books of accounts.

When this list with tallied debit and credit balances is drawn up, the arithmetical accuracy of basic entries, ledger posting and balancing is ensured. However, it does not guarantee that the entries are correct in all respect. This will be explained later in this chapter.

Although it is supposed to be prepared at the end of accounting period, computerized accounting packages are capable of providing instant Trial Balance reports even on daily basis, as the transactions are recorded almost on line.

Let us prepare the trial balance for the ledger accounts from the illustration 4.

Trial Balance as on...

Account name	Debit (₹)	Credit (₹)
Cash A/c	6,25,000	
Vikas's capital A/c		5,00,000
Vaibhavi's capital A/c		2,50,000
Furniture A/c	25,000	
PP National Bank A/c	2,85,000	
Rent A/c	15,000	
Motor Car	4,50,000	
Loan from HH A/c		4,00,000
AA Pharmaceuticals	7,50,000	
Consultancy fees A/c		10,00,000
Salary A/c	15,000	
Salary payable A/c		15,000
Total	21,65,000	21,65,000

It can be seen that the totals of debit and credit balances is exactly matching. This is the result of double entry book-keeping wherein every debit has equal corresponding credit.

Feature's of a Trial Balance

1. It is a list of debit and credit balances which are extracted from various ledger accounts.
2. It is a statement of debit and credit balances.
3. The purpose is to establish arithmetical accuracy of the transactions recorded in the Books of Accounts.



4. It does not prove arithmetical accuracy which can be determined by audit.
5. It is not an account. It is only a statement of account.
6. It is not a part of the final statements.
7. It is usually prepared at the end of the accounting year but it can also be prepared anytime as and when required like weekly, monthly, quarterly or half-yearly.
8. It is a link between books of accounts and the Profit and Loss Account and Balance sheet.

Preparation of Trial Balance:

1. It may be prepared on a loose sheet of paper.
2. The ledger accounts are balanced at first. They will have either "debit-balance" or "credit balance" or "nil-balance".
3. The accounts having debit-balance is written on the debit column and those having credit-balance are written on the credit column.

The sum total of both the balances must be equal, for "Every debit has its corresponding and equal credit".

Purpose of a Trial Balance

It serves the following purposes:

1. To check the arithmetical accuracy of the recorded transactions.
2. To ascertain the balance of any ledger Account.
3. To serve as an evidence of fact that the double entry has been completed in respect of every transaction.
4. To facilitate the preparation of final accounts promptly.

Is Trial Balance indispensable?

It is a mere statement prepared by the accountants for his own convenience and if it agrees, it is assumed that at least arithmetical accuracy has been done although there may be a lot of errors.

Trial Balance is not a process of accounts, but its preparation helps us to finalise the accounts. Since it is prepared on a particular date, as at / as on is stated.

Forms of a Trial Balance

A trial balance may be prepared in two forms, they are –

1. Journal Form
2. Ledger Form

The trial balance must tally irrespective of the form of a trial balance.

1. **Journal Form:** This form of a Trial balance will have a format of Journal Folio. It will have a column for serial number, name of the account, ledger folio, debit amount and credit amount columns in this journal form.

The ledger folio will show the page number on which such account appears in the ledger.

Specimen of Journal Form of Trial Balance:

Trial Balance as on

Sl. No.	Name of the Account	L.F.	Debit Balance ₹	Credit Balance ₹

2. **Ledger Form:** This form of a trial balance have two sides i.e. debit side and credit side. In fact, the ledger form of a trial balance is prepared in the form of an account. Each side of the trial balance will have particulars (name of the account) column, folio column and the amount column.

Specimen of ledger form of Trial Balance

Dr.				Trial Balance as on				Cr.			
Date	Name of the Account	L.F.	Amount ₹	Date	Name of the Account	L.F.	Amount ₹				

Method of Preparation

1. Total Method or Gross Trial Balance.
2. Balance Method or Net Trial Balance.
3. Compound Method.

These are explained as under :-

1. **Total Method or Gross Trial Balance :** Under this method, two sides of the accounts are totaled. The total of the debit side is called the “debit total” and the total of the credit side is called the “credit total”. Debit totals are entered on the debit side of the Trial Balance while the credit total is entered on the credit side of the Trial Balance.

If a particular account has total in one side, it will be entered either in the debit column or the credit column as the case may be.

Advantages:

- (a) It facilitates arithmetical accuracy of the accounts.
- (b) Extraction of ledger balances is not required at the time of preparation of Trial Balance.

Disadvantages: Preparation of final accounts is not possible.

2. **Balance Method or Net Trial Balance:** Under this method, all the ledger accounts are balanced. The balances may be either “debit-balance” or “credit balance”.

Advantages:

- (a) It helps in the easy preparation of final accounts.
- (b) It saves time and labour in constructing a Trial Balance.

Disadvantages: Errors may remain undisclosed irrespective of the agreement of Trial Balance.

3. **Compound Method:** Under this method, totals of both the sides of the accounts are written in the separate columns. Along with this, the balances are also written in the separate columns. Debit balances are written in the debit column and credit balances are written in the credit column of the Trial Balance.

Advantages: It offers the advantage of both the methods.

Disadvantages: Lengthy process and more time consumed in the preparation of a Trial Balance.

Summary of Rules

Debit Balance — All Assets, Drawings, Debtors, Expenses and losses.

Credit Balance — All liabilities, Capital, Creditors, Gains and Incomes.

Trial Balance – Utility and Interpretation

The utility of Trial balance could be found in the following:

- (1) It forms the basis for preparation of Financial statements i.e. Profit and Loss Account and Balance sheet.
- (2) A tallied trial balance ensures the arithmetical accuracy of the entries made. If the trial balance does not tally, the errors can be found out, rectified and then financial statements can be prepared.
- (3) It acts as a quick reference. One can easily find out the balance in any ledger account without actually



referring to the ledger.

- (4) If the listing of ledger accounts is systematically done in the trial balance, one can do quick time analysis. Hence, listing is usually done in the sequence of Asset accounts, Liability accounts, Capital accounts, Owner's equity accounts, Income or gain accounts and Expenses or losses accounts in that order.

One can draw some quick inferences from trial balance by interpreting the same. If one plots monthly trial balances side by side, one can analyse the movement of balances in various accounts e.g. one can see how expenses are increasing or decreasing or showing a trend of movements. By comparing the owner's equity balances as on two dates, one can interpret the business result e.g. if the equity has gone up, one can interpret that business has earned net profit and vice versa.

**Trial Balance
as at / as on**

Heads of Accounts	Side of Trial Balance	Reasons
Cash in hand	Debit	Assets
Cash at Bank	Debit	Assets
Cash at Bank (overdrawn)	Credit	Liability
Bank Overdraft	Credit	Liability
Capital	Credit	Liability
Opening stock	Debit	Assets
Wages	Debit	Expenses
Purchase	Debit	Expense/Increase in stock
Carriage Inwards	Debit	Expenses
Freight	Debit	Expenses
Royalty on production	Debit	Expenses
Gas, Water, Fuel	Debit	Expenses
Motive Power	Debit	Expenses
Import Duty	Debit	Expenses
Sales	Credit	Income/Decrease in stock
Discount Allowed	Debit	Losses
Discount Received	Credit	Gains
Bad Debts	Debit	Losses
Reserve /Provision for Bad & Doubtful Debt (Opening)	Credit	Gains
Commission Received	Credit	Incomes
Salaries	Debit	Expenses
Commission paid	Debit	Expenses
Rent, rates, and taxes	Debit	Expenses
Repairs and maintenance	Debit	Expenses
Insurance	Debit	Expenses
Carriage outward	Debit	Expenses
Trade charges	Debit	Expenses
Royalty on sales	Debit	Expenses
Interest paid	Debit	Expenses
Interest received	Credit	Income
Advertisement	Debit	Expenses
Sundry expenses	Debit	Expenses
Miscellaneous expenses	Debit	Expenses
Miscellaneous receipts	Credit	Incomes

Heads of Accounts	Side of Trial Balance	Reasons
Income tax	Debit	Drawings/Assets
L.I.C. Premium	Debit	Drawings/Assets
Office expenses	Debit	Expenses
Export duty	Debit	Expenses
Allowances	Debit	Losses
Rebates	Debit	Losses
Sales tax	Debit	Expenses
Horses and Carts	Debit	Assets
Watch Dog Squad	Debit	Assets
Loan Secured	Credit	Liability
Loans Advanced	Debit	Assets
Reserve Funds	Credit	Liability
Sinking Fund	Credit	Liability
Sinking Fund Investments	Debit	Assets
Ecology Fund	Credit	Liability
Ecology Fund Investments	Debit	Assets
Building Fund	Credit	Liability
Building	Debit	Assets
Land	Debit	Assets
Plant	Debit	Assets
Machinery	Debit	Assets
Furniture & fittings	Debit	Assets
Motor vehicles	Debit	Assets
Computer	Debit	Assets
Office equipments	Debit	Assets
Goodwill	Debit	Assets
Patent rights	Debit	Assets
Copyrights	Debit	Assets
Trade marks	Debit	Assets
Investments	Debit	Assets
Shares & Securities	Debit	Assets
G. P. Notes	Debit	Assets
Sundry debtors	Debit	Assets
Sundry creditors	Credit	Liability
General Reserve	Credit	Liability
Bill Receivable	Debit	Assets
Bills Payable	Credit	Liability
Provision for Discount on Debtors	Credit	Liability
Provision for Discount on Creditors	Debit	Assets
Lighting and Heating	Debit	Expense
Drawings	Debit	Assets
Contribution to Provident Fund	Debit	Assets
Prize Fund	Credit	Liability



Heads of Accounts	Side of Trial Balance	Reasons
Depreciation	Debit	Losses
Provision for Depreciation	Credit	Liability
Returns Inwards	Debit	Losses
Returns Outwards	Credit	Gains
Freehold Property	Debit	Assets
Premises	Debit	Assets
Leasehold Property	Debit	Assets
Loose Tools	Debit	Assets
Petty Cash	Debit	Assets
Provident Fund	Credit	Liability
Debentures Purchased	Debit	Assets
Debentures (from Public)	Credit	Liability
Loan on Mortgage	Credit	Liability
Prepaid Expenses	Debit	Assets
Outstanding Expenses	Credit	Liability
Bad Debts Recovered	Credit	Gains
Accrued Incomes	Debit	Assets
Apprenticeship Premium received	Credit	Income
Books	Debit	Assets
Newspaper and Magazine	Debit	Expenses
Profit and Loss A/c (Dr.)	Debit	Losses
Profit and Loss A/c (Cr.)	Credit	Gains
Accumulated Depreciation	Credit	Liability
Postage and Telegram	Debit	Expense
Travelling & Conveyance	Debit	Expenses

Illustration 13.

From the following ledger account balances, prepare a Trial Balance of Mr. Sen for the year ended 31st March, 2015. Capital ₹ 80,000; Sales ₹ 10,00,000; Adjusted Purchase ₹ 8,00,000; Current A/c (cr) ₹ 10,000; Petty Cash ₹ 10,000; Sales Ledger Balance ₹ 1,20,000; Purchase Ledger Balance ₹ 60,000; Salaries ₹ 24,000; Carriage Inwards ₹ 4,000; Carriage Outward ₹ 6,000; Discount Allowed ₹ 10,000; Building ₹ 80,000; Outstanding Expenses ₹ 10,000; Prepaid Insurance ₹ 2,000; Depreciation ₹ 4,000; Cash at Bank ₹ 80,000; Loan A/c (cr) ₹ 66,000; Profit & Loss A/c (cr) ₹ 20,000; Bad Debts Recovered ₹ 2,000; Stock at 31.03.2015 ₹ 1,20,000; Interest Received ₹ 10,000; Accrued Interest ₹ 4,000; Investment ₹ 20,000; Provision for Bad Debts (01.04.2014) ₹ 6,000; General Reserve ₹ 20,000.

Solution.

Dr.		Trial Balance of Mr. Sen as on 31st March, 2015		Cr.	
Heads of Accounts	Amount (₹)	Heads of Accounts	Amount (₹)		
Adjusted Purchase	8,00,000	Capital	80,000		
Petty Cash	10,000	Sales	10,00,000		
Sales Ledger Balance	1,20,000	Current A/c	10,000		
Salaries	24,000	Purchase Ledger Balance	60,000		
Carriage Inward	4,000	Outstanding Expenses	10,000		
Discount Allowed	10,000	Loan A/c	66,000		

Building	80,000	Profit & Loss A/c(cr)	20,000
Prepaid Insurance	2,000	Bad Debts Recovered	2,000
Depreciation	4,000	Interest Received	10,000
Cash at Bank	80,000	Provision for Bad debts	6,000
Stock (31.03.2015)	1,20,000	General Reserve	20,000
Accrued Interest	4,000		
Investment	20,000		
Carriage outward	6,000		
Total	12,84,000	Total	12,84,000

Note: Closing Stock will appear in Trial Balance since there is adjusted purchase.
Adjusted purchase = Opening Stock + Purchase - Closing Stock.

It may be noted that if only adjusted purchase is considered then the matching concept is affected. Hence, to satisfy the matching concept, closing stock is also considered in Trial Balance.

Multiple Choice Questions:

- Purchases book is used to record
 - All purchases of goods
 - All credit purchase
 - All credit purchases of goods
 - All credit purchases of assets other than goods
- Goods bought from Mr. P the payment for which is due after a month__
 - cash book
 - purchase book
 - sales book
 - purchase return book
- The source document or voucher used for recording entries in sales book is
 - invoice received
 - invoice sent out
 - credit notes sent out
 - debit notes received
- A debit note issued to a creditor for goods returned by us is to be recorded in the
 - bills receivable book
 - purchases book
 - journal proper (general journal)
 - purchases returns book
- Sales returns book is used to record
 - Returns of fixed assets sold on credit
 - returns of goods sold for cash
 - returns of goods sold on credit
 - sale of goods
- Closing entries are recorded in
 - cash book
 - ledger
 - journal proper
 - balance sheet
- Cash book is a
 - subsidiary book
 - subsidiary journal and ledger
 - ledger account
 - none of these
- Cash book is a form of
 - Trail balance
 - journal
 - Ledger
 - All the above
- The cash book records
 - All cash receipts
 - All cash payments
 - All cash receipts and payments
- Cash book does not record
 - Credit purchases
 - credit sales
 - Outstanding expenses
 - All the above transactions
- Single column cash book may show –
 - only a debit balance
 - only a credit balance
 - either debit or a credit balance
 - neither debit nor credit balance
- A cash book with discount and bank column is called
 - Single column cash book
 - two column cash book
 - Three column cash book
 - petty cash book
- The total of discounts column on the debit side of the cash book, recording cash discount deducted by customers when paying their accounts, is posted to the
 - Credit of the discount allowed account
 - Debit of the discount received account
 - Credit of the discount received account
 - Debit of the discount allowed account



14. Trade discount allowed at the time of sale of goods
(a) Is recorded in Sales Book (b) Is recorded in Cash Book
(c) Is recorded in Journal (d) Is not recorded in Books of Accounts
15. The periodical total of the Sales Return Book is posted to the
(a) Debit of Sales Account (b) Debit of Return Account
(c) Credit of Sales Return Account (d) Debit of Debtors Account

Ans: 1.c 2.b 3.b 4.d 5.c 6.c 7.b 8.c 9.c 10.d 11.c 12.c 13.d 14.d 15.b

Fill in the blanks:

- Debit note is sent by the ____ (buyer)
- Invoice is sent by the ____ (seller)
- Loss of goods due to theft is recorded in ____ (journal proper)
- Credit note is sent by ____ (seller)
- Bad debts written off ____ (journal proper)
- Opening entries are generally passed through ____ (journal proper)
- A transaction recorded on the debit side of cash book is transferred to the ledger __ (credit side of account)
- If a cheque is returned dishonored, it is recorded in ____ (Bank column on the credit side.)
- Payments are recorded on the ____ side of cash book. (credit)
- The balance in the petty cash book is ____ (An Asset)
- The balance on the debit side of the bank column in cash book indicates ____ (Cash at bank)
- Bank column of the cash book ____ balance (either debit or credit)
- The periodical total of the sales book is posted to ____ (Debit side of sales account)
- Depreciation on fixed asset is initially journalized in ____ (Journal Proper or General Journal)
- If Ram has sold goods for cash, the entry will be recorded in ____ (Cash Book)

True or false:

- Trade discount allowed at the time of sale of goods – is recorded in cash book (FALSE)
- The periodic total of sales day book is posted to sales return Account (FALSE)
- Overcasting of purchases journal would affect purchases account (TRUE)
- Goods worth ₹ 5000 sold to varsha @ 10% trade discount and 5% sales tax was charged extra. By this transaction the sales account will be credited with ₹ 4500 (TRUE)
- Credit sale of goods – sale invoice and sales book (TRUE)
- Due to damage of goods Ravi was sent credit note of ₹200. It will be recorded in – sale book (FALSE)
- Salaries due for the month will appear no where in cash book (TRUE)
- Receipts are recorded on the credit side of cash book (FALSE)
- The main objective of cash book is to know the cash and bank balance of the business (TRUE)
- Paid insurance by cheque ₹ 1000 recorded in cash column in debit side (FALSE)

Match the following:

1. Purchases returns book	d	a) Sales book
2. Sales returns book	c	b) Purchases book
3. General journal is also known as	e	c) Credit note
4. Credit sale of goods	a	d) Debit note
4. Credit purchase of goods	b	e) Journal proper

Illustration 14.

Journalize the following transactions in the books of Gaurav, post them into ledger and prepare trial balance for June 2015:

June 1: Gaurav started business with ₹10,00,000 of which 25% amount was borrowed from wife.

June 4: Purchased goods from Aniket worth ₹40,000 at 20% TD and 1/5th amount paid in cash.

June 7: Cash purchases ₹ 25,000.

June 10: Sold goods to Vishakha ₹ 30,000 at 30% TD and received 30% amount in cash.

June 12: Deposited cash into bank ₹ 20,000.

June 15: Uninsured goods destroyed by fire ₹ 5,500.

June 19: Received commission ₹ 3,500.

June 22: Paid to Aniket ₹ 25,500 in full settlement of A/c.

June 25: Cash stolen from cash box ₹ 1,000.

June 27: Received from Vishakha ₹ 14,500 and discount allowed ₹ 200.

June 30: Interest received ₹ 2,400 directly added in our bank account.

Solution:

**In the books of Gaurav
Journal**

Date 2015	Particulars	L.F.	Amount(₹)	Amount(₹)
1-Jun	Cash A/c To Capital A/c To Loan from Wife A/c (Being capital brought into business)	Dr	1,000,000	750,000 250,000
4-Jun	Purchases A/c To Cash A/c To Aniket's A/c (Being goods purchased at 20% TD & 1/5th amount paid in cash)	Dr	32,000	6,400 25,600
7-Jun	Purchases A/c To Cash A/c (Being cash purchases)	Dr	25,000	25,000
10-Jun	Cash A/c Vishakha's A/c To Sales A/c (Being goods sold at 30% TD & 30% amount received in cash)	Dr Dr	6,300 14,700	21,000
12-Jun	Bank A/c To Cash A/c (Being cash deposited in bank)	Dr	20,000	20,000
15-Jun	Loss by Fire A/c To Purchases A/c (Being uninsured goods lost by fire)	Dr	5,500	5,500
19-Jun	Cash A/c To Commission A/c (Being commission received)	Dr	3,500	3,500
22-Jun	Aniket's A/c To Cash A/c To Discount A/c (Being paid to Aniket in full settlement & discount received)	Dr	25,600	25,500 100
25-Jun	Loss by Theft A/c To Cash A/c (Being cash stolen)	Dr	1,000	1,000



27-Jun	Cash A/c Discount A/c To Vishakha's A/c (Being amount received from Vishakha & discount allowed)	Dr Dr	14,500 200	14,700
30-Jun	Bank A/c To Interest A/c (Being interest received directly added into bank account)	Dr.	2,400	2,400

Cash Account

Cr.

Date	Particulars	J.F.	Amount (₹)	Date	Particulars	J.F.	Amount (₹)
1/6/15	To Capital A/c		7,50,000	4/6/15	By Purchases A/c		6,400
1/6/15	To Loan from Wife A/c		2,50,000	7/6/15	By Purchases A/c		25,000
10/6/15	To Sales A/c		6,300	12/6/15	By Bank A/c		20,000
19/6/15	To Commission A/c		3,500	22/6/15	By Aniket's A/c		25,500
27/6/15	To Vishakha's A/c		14,500	25/6/15	By Loss by Theft A/c		1,000
				30/6/15	By Balance c/d		9,46,400
			10,24,300				10,24,300
1/7/15	To Balance b/d		9,46,400				

Dr.

Capital Account

Cr.

Date	Particulars	J.F.	Amt. (₹)	Date	Particulars	J.F.	Amt. (₹)
30/6/15	To Balance c/d		7,50,000	1/6/15	By Cash A/c		7,50,000
			7,50,000				7,50,000
1/7/15	By Balance b/d		7,50,000				

Dr.

Loan from Wife Account

Cr.

Date	Particulars	J.F.	Amount (₹)	Date	Particulars	J.F.	Amount (₹)
30/6/15	To Balance c/d		2,50,000	1/6/15	By Cash A/c		2,50,000
			2,50,000				2,50,000
				1/7/15	By Balance b/d		2,50,000

Dr.

Purchases Account

Cr.

Date	Particulars	J.F.	Amt. (₹)	Date	Particulars	J.F.	Amt. (₹)
4/6/15	To Cash A/c		6,400	15/6/15	By loss by fire		5,500
4/6/15	To Aniket's A/c		25,600	30/6/15	By Bal c/d		51,500
7/6/15	To Cash A/c		25,000				
			57,000				57,000
1/7/15	To Balance b/d		51,500				

Dr.

Aniket's Account

Cr.

Date	Particulars	J.F.	Amt. (₹)	Date	Particulars	J.F.	Amt. (₹)
22/6/15	To Cash A/c		25,500	4/6/15	By Purchases A/c		25,600
22/6/15	To Discount A/c		100				
			25,600				25,600

Dr. Vishakha's Account				Cr.			
Date	Particulars	J.F.	Amt. (₹)	Date	Particulars	J.F.	Amt. (₹)
10/6/15	To Sales A/c		14,700	27/6/15	By Cash A/c		14,500
				27/6/15	By Discount A/c		200
			14,700				14,700

Dr. Sales Account				Cr.			
Date	Particulars	J.F.	Amt. (₹)	Date	Particulars	J.F.	Amt. (₹)
30/6/15	To Balance c/d		21,000	10/6/15	By Cash A/c		6,300
10/6/15	By Vishakha's A/c		14,700				
			21,000				21,000
1/7/15	By Balance b/d		21,000				

Dr. Bank Account				Cr.			
Date	Particulars	J.F.	Amt. (₹)	Date	Particulars	J.F.	Amt. (₹)
12/6/15	To Cash A/c		20,000	30/6/15	By Balance c/d		22,400
30/6/15	To Interest A/c		2,400				
			22,400				22,400
1/7/15	To Balance b/d		22,400				

Dr. Loss by Fire Account				Cr.			
Date	Particulars	J.F.	Amt. (₹)	Date	Particulars	J.F.	Amt. (₹)
15/6/15	To Purchases A/c		5,500	30/6/15	By Balance c/d		5,500
			5,500				5,500
1/7/15	To Balance b/d		5,500				

Dr. Commission Account				Cr.			
Date	Particulars	J.F.	Amt. (₹)	Date	Particulars	J.F.	Amt. (₹)
30/6/15	To Balance c/d		3,500	19/6/15	By Cash A/c		3,500
			3,500				3,500
1/7/15	By Balance b/d		3,500				

Dr. Discount Account				Cr.			
Date	Particulars	J.F.	Amt. (₹)	Date	Particulars	J.F.	Amt. (₹)
27/6/15	To Vishakha's A/c		200	22/6/15	By Aniket's A/c		100
				30/6/15	By Balance c/d		100
			200				200
1/7/15	To Balance b/d		100				

Dr. Loss by Theft Account				Cr.			
Date	Particulars	J.F.	Amt. (₹)	Date	Particulars	J.F.	Amt. (₹)
25/6/15	To Cash A/c		1,000	30/6/15	By Balance c/d		1,000
			1,000				1,000
1/7/15	To Balance b/d		1,000				



Dr.				Interest Account				Cr.			
Date	Particulars	J.F.	Amt. (₹)	Date	Particulars	J.F.	Amt. (₹)				
30/6/15	To Balance c/d		2,400	30/6/15	By Bank A/c		2,400				
			2,400				2,400				
				1/7/15	By Balance b/d		2,400				

Trial Balance as on 30.6.15

Name of Account	Dr.	Cr.
	(₹)	(₹)
Cash A/c	9,46,400	-----
Capital A/c	-----	7,50,000
Loan from Wife A/c	-----	2,50,000
Purchases A/c	51,500	-----
Aniket's A/c	-----	-----
Vishakha's A/c	-----	-----
Sales A/c	-----	21,000
Bank A/c	22,400	-----
Loss by Fire A/c	5,500	-----
Commission A/c	-----	3,500
Discount A/c	100	-----
Loss by Theft A/c	1,000	-----
Interest A/c	-----	2,400
Total	10,26,900	10,26,900

Illustration 15.

Journalize the following transactions in the books of M/s Kothari & Sons, post them into ledger and prepare trial balance for April 2015:

Apr. 1: Commenced business with ₹ 40,000.

Apr. 4: Bought goods for cash ₹ 4,000

Apr. 7: Sold goods ₹ 700

Apr. 10: Bought goods from M/s Bhandari Bros. ₹ 3,000 at 10% trade discount.

Apr. 14: Purchased machinery of ₹ 5,000 from M/s Kirloskar Bros.

Apr. 16: Paid for transportation of machinery ₹ 500 & installation charges ₹ 300 on it.

Apr. 20: Paid quarterly interest on borrowed amount of ₹ 5,000 at 12% p.a.

Apr. 24: Supplied goods to M/s Kunal & Sons ₹ 3,500.

Apr. 27: Paid to M/s Bhandari Bros. ₹ 2,600 in full settlement of account.

Apr. 28: M/s Kunal & Sons returned goods worth ₹ 300 & paid for ₹ 1,200 on account.

Apr. 29: Received commission ₹ 250.

Apr. 30: Paid conveyance to manager ₹ 450.

Solution:

**In the books of M/s Kothari and Sons
Journal**

Date	Particulars	L.F.	Dr. Amt. ₹	Cr. Amt. ₹
2015				
1-Apr	Cash A/c To Capital A/c (Being cash introduced as capital)		40,000	40,000

4-Apr	Purchases A/c To Cash A/c (Being bought goods for cash)	Dr		4,000	4,000
7-Apr	Cash A/c To Sales A/c (Being sold goods for cash)	Dr		700	700
10-Apr	Purchases A/c To M/s Bhandari Bros. A/c (Being purchased goods at 10% TD)	Dr		2,700	2,700
14-Apr	Machinery A/c To M/s Kirloskar Bros. A/c (Being purchased machinery on credit)	Dr		5,000	5,000
16-Apr	Machinery A/c To Cash A/c (Being transportation & installation charges on machinery paid)	Dr		800	800
20-Apr	Interest A/c To Cash A/c (Being paid quarterly interest on borrowed amt. of ₹5000 at 12% p.a.)	Dr		150	150
24-Apr	M/s Kunal & Sons A/c To Sales A/c (Being goods sold on credit)	Dr		3,500	3,500
27-Apr	M/s Bhandari Bros. A/c To Cash A/c To Discount A/c (Being paid in full settlement & discount received)	Dr		2,700	2,600 100
28-Apr	Return Inwards A/c Cash A/c To M/s Kunal & Sons A/c (Being goods returned & received on account)	Dr Dr		300 1,200	1,500
29-Apr	Cash A/c To Commission A/c (Being commission received)	Dr		250	250
30-Apr	Conveyance A/c To Cash A/c (Being conveyance paid to manager)	Dr		450	450
	Total			61,750	61,750

Ledger

Dr.		Cash Amount				Cr.	
Date	Particulars	J.F	Amt. (₹)	Date	Particulars	J.F	Amt. (₹)
1/4/15	To Capital A/c		40,000	4/4/15	By Purchases A/c		4,000
7/4/15	To Sales A/c		700	16/4/15	By Machinery A/c		800
28/4/15	To M/s Kunal & Sons A/c		1200	20/4/15	By Interest A/c		150
29/4/15	To Commission A/c		250	27/4/15	By M/s Bhandari Bros. A/c 2,600		
				30/4/15	By Conveyance A/c		450
				30/4/15	By Balance c/d		34,150
			42,150				42,150
1/5/15	To Balance b/d		34,150				



Dr. Capital Account				Cr.			
Date	Particulars	J.F.	Amt. (₹)	Date	Particulars	J.F.	Amt. (₹)
30/4/15	To Balance c/d		40,000	1/4/15	By Cash A/c		40,000
			40,000				40,000
				1/5/15	By Balance b/d		40,000

Dr. Purchases Account				Cr.			
Date	Particulars	J.F.	Amt. (₹)	Date	Particulars	J.F.	Amt. (₹)
4/4/15	To Cash A/c		4,000	30/4/15	By Balance c/d		6700
10/4/15	To M/s Bhandari Bros. A/c		2,700				
			6,700				6,700
1/5/15	To Balance b/d		6,700				

Dr. Sales Account				Cr.			
Date	Particulars	J.F.	Amt. (₹)	Date	Particulars	J.F.	Amt. (₹)
30/4/15	To Balance c/d		4,200	7/4/15	By Cash A/c		700
				24/4/15	By M/s Kunal & Sons A/c		3,500
			4,200				4,200
				1/5/15	By Balance b/d		4,200

Dr. M/s Bhandari Bros. Account				Cr.			
Date	Particulars	J.F.	Amt. (₹)	Date	Particulars	J.F.	Amt. (₹)
27/4/15	To Cash A/c		2,600	10/4/15	By Purchases A/c		2,700
27/4/15	To Discount A/c		100				
			2,700				2,700

Dr. Machinery Account				Cr.			
Date	Particulars	J.F.	Amt. (₹)	Date	Particulars	J.F.	Amt. (₹)
14/4/15	To M/s Kirloskar Bros. A/c		5,000	30/4/15	By Balance c/d		5,800
16/4/15	To Cash A/c		800				
			5,800				5,800
1/5/15	To Balance b/d		5,800				

Dr. M/s Kirloskar Bros. Account				Cr.			
Date	Particulars	J.F.	Amt. (₹)	Date	Particulars	J.F.	Amt. (₹)
30/4/15	To Balance c/d		5,000	14/4/15	By Machinery A/C		5,000
			5,000				5,000
				1/5/15	By Balance b/d		5,000

Dr. Interest Account				Cr.			
Date	Particulars	J.F.	Amt. (₹)	Date	Particulars	J.F.	Amt. (₹)
20/4/15	To Cash A/c		150	30/4/15	By Balance c/d		150
			150				
1/5/15	To Balance b/d		150				

Dr. M/S Kunal & Sons Account				Cr.			
Date	Particulars	J.F.	Amt. (₹)	Date	Particulars	J.F.	Amt. (₹)
24/4/15	To Sales A/c		3,500	28/4/15	By Return Inwards A/c		300
				28/4/15	By Cash A/c		1,200
				30/4/15	By Balance c/d		2,000
			3,500				3,500
1/5/15	To Balance b/d		2,000				

Dr. Discount Account				Cr.			
Date	Particulars	J.F.	Amt. (₹)	Date	Particulars	J.F.	Amt. (₹)
30/4/15	To Balance c/d		100	27/4/15	By M/s Bhandari Bros. A/c		100
			100				100
				1/5/15	By Balance b/d		100

Dr. Return Inwards Account				Cr.			
Date	Particulars	J.F.	Amt. (₹)	Date	Particulars	J.F.	Amt. (₹)
28/4/15	To M/s Kunal & Sons A/c		300	30/4/15	By Balance c/d		300
			300				300
1/5/15	To Balance b/d		300				

Dr. Commission Account				Cr.			
Date	Particulars	J.F.	Amt. (₹)	Date	Particulars	J.F.	Amt. (₹)
30/4/15	To Balance c/d		250	29/4/15	By Cash A/c		250
			250				250
				1/5/1	By Balance b/d		250

Dr. Conveyance Account				Cr.			
Date	Particulars	J.F.	Amt. (₹)	Date	Particulars	J.F.	Amt. (₹)
30/4/15	To Cash A/c		450	30/4/15	By Balance c/d		450
			450				450
1/5/15	To Balance b/d		450				

Trial Balance as on 30.4.15

	Dr.	Cr.
Name of Account	(₹)	(₹)
Cash A/c	34,150	----
Capital A/c	----	40,000
Purchases A/c	6700	----
Sales A/c	----	4,200
M/s Bhandari Bros. A/c	----	----
Machinery A/c	5,800	----
M/s Kirloskar Bros. A/c	----	5,000
Interest A/c	150	----
M/s Kunal & Sons A/c	2,000	----
Discount A/c	----	100
Return Inwards A/c	300	----



Commission A/c	-----	250
Conveyance A/c	450	-----
Total	49,550	49,550

Illustration 16.

Enter the following transactions in the proper subsidiary books and post them to ledger accounts. Also prepare Trial Balance:

2015

- Jan. 1: Purchased goods worth ₹ 6,000 from M/s Akshaykumar & Sons.
 Jan. 5: Sold goods to M/s Vinay kumar ₹ 2,000.
 Jan. 7: Purchased goods from M/s Vinod Bros. ₹ 4,000 at 5% TD.
 Jan. 9: Sold goods to Pravinkumar on cash ₹ 500.
 Jan. 12: Bought goods from Jayant Kumar ₹ 3,500 at 10% TD.
 Jan. 17: Supplied goods to M/s Rajnikant ₹ 2,500 at 5% TD.
 Jan. 20: Sold furniture to M/s Narendrakumar worth ₹ 1,200.
 Jan. 22: Returned goods to M/s Vinod Bros. ₹ 500 gross.
 Jan. 25: M/s Vinaykumar returned goods worth ₹ 500.
 Jan. 27: Sent debit note to M/s Akshaykumar for ₹ 200.
 Jan. 30: Sold goods to Narendrakumar worth ₹ 9,000 and received half amount on the spot.

Solution:

Purchases Book

Date	Name of Supplier	Inward Invoice No.	L.F	Amt (₹)
1/1/15	M/s Akshaykumar			6,000
7/1/15	M/s Vinod Bros. (4000 - 5% TD)			3,800
12/1/15	Jayant Kumar (3500 - 10% TD)			3,150
				12,950

Sales Book

Date	Name of Customer	Outward Invoice No.	L.F	Amt (₹)
5/1/15	M/s Vinaykumar			2,000
17/1/15	M/s Rajnikant (2500 - 5% TD)			2,375
30/1/15	M/s Narendrakumar			4,500
				8,875

Return Inwards Book

Date	Name of Customer	Credit Note No.	L.F	Amt (₹)
25/1/15	M/s Vinaykumar			500
				500

Return Outwards Book

Date	Name of Supplier	Debit Note No.	L.F	Amt (₹)
22/1/15	M/s Vinod Bros. (500 - 5% TD)			475
27/1/15	M/s Akshaykumar			200
				675

Dr. Cash Book Cr.

Date	Particulars	J.F.	Amt (₹)	Date	Particulars	J.F.	Amt (₹)
9/1/15	To Sales A/c		500	31/1/15	By Balance c/d		5,000
	(Being cash sales)						
30/1/15	To Sales A/c		4,500				

	(Being cash sales)						
			5,000				5,000
1/2/15	To Balance b/d		5,000				

Dr.				Purchases Account				Cr.			
Date	Particulars	J.F.	Amt (₹)	Date	Particulars	J.F.	Amt (₹)				
31/1/15	To Sundries as per purchases book		12,950								
				31/1/15	By Balance c/d		12,950				
1/2/15	To Balance b/d		12,950				12,950				

Dr.				Sales Account				Cr.			
Date	Particulars	J.F.	Amt (₹)	Date	Particulars	J.F.	Amt (₹)				
31/1/15	To Balance c/d		13,875	9/1/15	By Cash A/c		500				
				30/1/15	By Cash A/c		4,500				
				31/1/15	By Sundries as per Sales Book		8,875				
			13,875				13,875				
				1/2/15	By Balance b/d		13,875				

Dr.				Return Inwards Account				Cr.			
Date	Particulars	J.F.	Amt (₹)	Date	Particulars	J.F.	Amt (₹)				
31/1/15	To Sundries as per return inwards book		500	31/1/15	By Balance c/d		500				
			500				500				
1/2/15	To Balance b/d		500								

Dr.				Return Outwards Account				Cr.			
Date	Particulars	J.F.	Amt (₹)	Date	Particulars	J.F.	Amt (₹)				
31/1/15	To Balance c/d		675	31/1/15	By Sundries as per return outwards book		675				
			675				675				
1/2/15	By Balance b/d		675								

Dr.				M/s Akshaykumar Account				Cr.			
Date	Particulars	J.F.	Amt (₹)	Date	Particulars	J.F.	Amt (₹)				
27/1/15	To Return Outwards A/c		200	1/1/15	By Purchases A/c		6000				
31/1/15	To Balance c/d		5,800								
			6,000				6,000				
				1/2/15	By Balance b/d		5,800				

Dr.				M/s Vinod Bros Account				Cr.			
Date	Particulars	J.F.	Amt (₹)	Date	Particulars	J.F.	Amt (₹)				
22/1/15	To Return Outwards A/c		475	7/1/15	By Purchases A/c		3,800				
31/1/15	To Balance c/d		3,325								
			3,800				3,800				
				1/2/15	By Balance b/d		3,325				



Dr. Jayant Kumar Account				Cr.			
Date	Particulars	J.F.	Amt (₹)	Date	Particulars	J.F.	Amt (₹)
31/1/15	To Balance c/d		3,150	12/1/15	By Purchases A/c		3,150
				1/2/15	By Balance b/d		3,150

Dr. M/s Vinaykumar Account				Cr.			
Date	Particulars	J.F.	Amt (₹)	Date	Particulars	J.F.	Amt (₹)
5/1/15	To Sales A/c		2,000	25/1/15	By Return Inwards A/c		500
				31/1/15	By Balance c/d		1,500
			2,000				
1/2/15	To Balance b/d		1,500				

Dr. M/s Rajnikant Account				Cr.			
Date	Particulars	J.F.	Amt (₹)	Date	Particulars	J.F.	Amt (₹)
17/1/15	To Sales A/c		2,375	31/1/15	By Balance c/d		2,375
1/2/15	To Balance b/d		2,375				

Dr. M/s Narendrakumar Account				Cr.			
Date	Particulars	J.F.	Amt (₹)	Date	Particulars	J.F.	Amt (₹)
20/1/15	To Furniture A/c		1,200	31/1/15	By Balance c/d		5,700
30/1/15	To Sales A/c		4,500				
			5,700				5,700
1/2/15	To Balance b/d		5,700				

Dr. Furniture Account				Cr.			
Date	Particulars	J.F.	Amt (₹)	Date	Particulars	J.F.	Amt (₹)
31/1/15	To Balance c/d		1,200	20/1/15	By M/s Narendra kumar A/c		1,200
				1/2/15	By Balance b/d		1,200

Trial Balance as on 31.1.15

	Dr.	Cr.
Name of Account	(₹)	(₹)
Cash A/c	5,000	----
Purchases A/c	12,950	----
Sales A/c	----	13,875
Return Inwards A/c	500	----
Return Outwards A/c	----	675
M/s Akshaykumar A/c	----	5,800
M/s Vinod Bros. A/c	----	3,325
Jayant Kumar A/c	----	3,150
M/s Vinaykumar A/c	1,500	----
M/s Rajnikant A/c	2,375	----
M/s Narendrakumar A/c	5,700	----
Furniture A/c	----	1,200
Total	28,025	28,025

Illustration 17.

The total of debit side of Trial Balance of a larger boot and shoe repairing firm as on 31.12.2013 is ₹ 1,66,590 and that of the credit side is ₹ 42,470. After several checking and re-checking the mistakes are discovered:

Items of Account	Correct Figure (as it would be) ₹	Figures as it appear in the Trial Balance ₹	
Opening Stock	14,900	14,800	
Repairs (outstanding)	61,780	61,780	(appear in the Debit side)
Rent & Taxes	2,160	2,400	
Sundry Creditors	6,070	5,900	
Sundry Debtors	8,060	8,310	

Ascertain the correct total of the Trial Balance.

Solution:

Particulars	Debit (₹)	Credit (₹)
Total as per Trail Balance	1,66,590	42,470
Opening Stock understated (14,900-14,800)	+100	-
Repairs being credit balance, but shown as debit balance	-61,780	+61,780
Rent & Taxes overstated (2,400-2,160)	-240	-
Sundry Creditors understated (6,070-5,900)	-	+170
Sundry Debtors overstated (8,310-8,060)	-250	-
Total	1,04,420	1,04,420

Illustration:18.

Record following transactions in the Personal Account of Raman:

		₹
2015 Sept. 1	Sold goods to Raman	5,420
4	Received from Raman cash	5,150
	And allowed him discount	270
15	Raman bought goods	6,000
28	Received cash from Raman on account	2,000
Oct.1	Balance from last month b/d	4,000
13	Sold goods to Raman	10,000
20	Received from Raman cash	3,960
	And allowed him discount	40
31	Received cash in full settlement of Raman's account	9,800

Solution:**Raman Account**

Dr.			Cr.		
Date	Particulars	Amount ₹	Date	Particulars	Amount ₹
Sept.1	To Sales c/d	5,420	Sept.4	By Cash A/c	5,150
15	To Sales	6,000	4	By Discount	270
			28	By Cash	2,000
			30	By Balance c/d	4,000
		11,420			11,420
Oct.1	To Balance b/d	4,000	Oct.20	By Cash	3,960



13	To Sales	10,000	20	By Discount	40
			31	Cash	9,800
			31	Discount (Balancing figure)	200
		14,000			14,000

EXERCISE

1. Journalise the following transactions:

2015		₹	2015		₹
Jan 3	Received cash from Ram	15,000	Jan. 17	Receive from Hari	1,100
4	Purchased goods for cash	2,500	20	Bought furniture from Ram	2,200
11	Sold goods to Hari	3,200	27	Paid Rent	480
13	Paid Ramesh	1,400	30	Paid salary	1,100

Ans: Total of Journal: ₹26,980

2. Journalise the following transactions:

2015		₹	2015		₹
Jan 1	Started business with cash	50,000	Jan.15	Paid to M/s Singh & Co.	21,000
2	Paid into bank	36,000		Discount allowed by them	1,000
3	Bought goods from M/s Singh & Co. on credit	22,000	25	Sold goods to M/s Ray & Co.	5,000
4	Purchased furniture	4,200	26	Received Cheque from M/s Sharda & co. in full settlement of amount due by them	4,560
	Purchased adding machine & typewriter (Payment in all cases made by cheque)	8,400	31	Paid for: Electric Charges	100
6	Paid for postage	215		Paid salary	1,500
8	Sold goods for cash	5,400		Paid rent by cheque	2,000
9	Sold goods on credit to M/s Sharda & co.	4,600		Drew for private use	3,500

Ans: Total of Journal: ₹1,69,515

3. Journalise the following transactions IN THE BOOKS OF Rama & Co.

2015		₹	2015		₹
Jan1	Business started with	50,000	Jan15	Cash paid to Z in full settlement of his account	8,800
	Cash deposited in Bank	20,000	16	Cash received from Y in full settlement of his account	24,500
	Goods purchased	10,000	20	Goods sold to B	6,000
2	Furniture purchased for cash	3,000		Goods purchased	9,000
	Office Stationary purchased for cash	2,000	25	Cash withdrawn from bank	5,000
3	Goods purchased from X	20,000		Cash paid to X	4,000
5	Goods sold to Y	25,000	28	Allowed us a discount	100
	Paid rent	1,000		Cash received from B	3,000
8	Paid for repairs	800	30	Allowed a discount	200
9	Paid for advertisement	1,500	31	Cash deposited in bank	4,000

	Cash paid to X	10,000		Cash paid for electricity	400
	discount received	50		Cash paid for Salaries	1,000
10	Good purchased from Z	9,000		Wages paid	500
	Goods purchased in cash from A	6,000		Rent paid	400

Ans: Total of Journal: ₹2,25,950

Prepare the Ledger account of Mr. Solkar from the following:

2015 March 1	Debit balance to his account ₹ 2,000.
3	Sold goods on credit to him worth ₹ 10,800
8	Received cash from him ₹12,600 and allowed discount of ₹ 200.
10	Solkar bought goods on credit ₹ 3,000.
15	Received cash from him ₹ 2,900 and allowed him discount ₹ 100
20	Purchased goods on credit from Solkar worth ₹ 2,000
25	Paid cash to Solkar ₹ 1,000
28	Returned goods to him ₹ 200.
31	Paid cash to him in full settlement of his account ₹ 780.

4. Prepare Ledger Accounts for the following transactions

Debit Balance on January 1, 2014

Cash in Hand ₹8,000. Cash at Bank ₹25,000, Inventory of goods ₹20,000, Building ₹10,000. Trade receivables: Vijay ₹2,000 and Madhu ₹2,000

Credit Balance on January 1, 2014:

Trade Payables: Anand ₹5,000, Capital ₹55,000

Following were further transactions in the month of January, 2014:

Jan. 1 Purchased goods worth ₹5,000 for cash less 20% trade discount and 5% cash discount.

Jan. 4 Received ₹1,980 from Vijay and allowed him ₹20 as discount

Jan. 8 Purchased plant from Mukesh for ₹5,000 and paid ₹100 as cartage for bringing the plant to the factory and another ₹200 as installation charges.

Jan. 12 Sold goods to Rahim on credit ₹600

Jan. 15 Rahim became insolvent and could pay only 50 paise in a rupee

Jan. 18 Sold goods to Ram for cash ₹1,000.

5. Enter the following transactions in the subsidiary books of Soundarya Saree Shop.

2014 Aug 1	Purchased from Pathi Silk Kendra, 100 Silk sarees at ₹250 each.
5	Purchased from NSR and company, 200 Kanchi Silk sarees at ₹1,000 each
7	Sold to Kumar on account, 50 printed sarees at ₹300 and 100 Kanchi sarees at ₹1,000 each
8	Claimed for damages from Pathi Silk Kendra ₹500
9	Returned damaged goods to NSR and Co. 5 Kanchi sarees
12	Purchased from Sudharshan Silks 150 Mysore Silk at ₹250 each, 100 Handloom sarees at ₹750 each, less trade discount at 10%
16	Sold to Kala on account 20 printed sarees at ₹300 each, 25 Kanchi sarees at ₹1,300 each, 20 Mysore Silk sarees at ₹300 each, less trade discount at 5%.
20	Sold to Kusum sarees, 40 Handloom sarees at ₹1,000 each
21	Kumar returned, 10 printed sarees and 20 Kanchi sarees
25	Returned to Sudharshan's Silk, 25 Mysore Silk
27	Returned from Kusum sarees, 10 handloom sarees
30	Purchased from Nandi Silk, 400 Nandi brand sarees at ₹500 each



6. Enter the following transactions in Simple Cash Book and post them into ledger:

2014 July 1	Balance of cash in hand ₹15,000
8	Purchased goods for cash from X for ₹3,200
15	Sold goods for cash ₹4,800
20	Received commission ₹650
	Paid commission ₹550
31	Paid salary to the office clerk ₹1,000 and office rent ₹600

Ans: Cash Book Balance = ₹7,950

7. Enter the following transactions in a two (Cash & discount) Column and post them into Ledger Accounts:

2014		₹	2014		₹
Dec.1	Commenced business with cash	50,000	Dec.16	Paid into bank	10,000
2	Brought goods for cash	28,000	18	Cash sales	2,500
5	Received cash from Arun	2,000	20	Purchased stationery for cash	250
7	Paid cash to Sanjay	2900	23	Paid suresh cash	3900
	Discount allowed by him	100		Discount allowed	100
10	Paid wages	3000	26	Received from Rajesh	1,900
14	Received from Rajesh cash	950		Allowed him discount	100
	Allowed him discount	50	30	Paid salaries	2,000

Ans: Cash Balance = ₹7,300, Discount = Dr. ₹150, Cr. ₹200

8. Prepare a Three Column Cash Book from following transactions and bring down the balance for the start of next month

2015		₹	2015		₹
Apr.1	Cash in hand	2,500	Apr.19	Paid into Bank	400
1	Cash at bank	10,000	23	Withdrew from Bank for private exp.	600
2	Paid into Bank	1,000	24	Received cheque from Patel	1,430
5	Bought furniture and issued cheque	2,000		Allowed him discount	20
8	Purchased goods for cash	500	26	Deposited Patel's cheque into bank	
12	Received from mohinder	980	28	Withdrew cash from Bank for the office use	2,000
14	Cash sales	4,000	30	Paid rent by cheque	800
16	Paid to Amarnath by cheque	1,450			
	Discount allowed	50			

Ans: Cash = (Dr) ₹7,580, Bank = (Dr.) ₹5,980, Discount = (Dr.) ₹40, Cr. ₹50

9. Prepare a Three Column Cash Book from following transactions having cash, bank and discount columns:

2015Apr.1	Balance of cash in hand ₹400, overdraft at Bank ₹5,000
4	Invested further capital ₹10,000 out of which ₹6,000 deposited bank
5	Sold goods for cash ₹8,000
6	Collected from Sridhar a debtor of last year ₹8,000 discount allowed ₹200
7	Paid Ramvilas, out creditor, ₹2,500, discount allowed by him ₹65
13	Commission paid to Robert our agent ₹530
14	Office furniture purchased from Keshar ₹200

17	Draw cheque for personal use ₹700
18	Collection from Atal ₹4,000; deposited in the bank on 19th
20	Draw from bank for office use ₹500
21	Draw cheque for petty cash ₹150
29	Drew from the bank and paid salary of office staff ₹1,500
30	Deposited cash in the bank ₹10,000

Ans: Cash in hand ₹7,870, Bank = (Dr.) ₹12,150, Discount = (Dr.) ₹ , Cr. ₹

10. Prepare Columnar Petty Cash Book on imprest system from the following particulars:

2015		₹	2015		₹
June 1	Received for petty cash payments	1,000	June 20	Paid for conveyance	44
2	Paid for postage	80	25	Paid for travelling expenses	160
5	Paid for stationery	50	27	Paid for postage	100
8	Paid for advertisement	100	28	Wages to office cleaner	20
12	Paid for wages	40	30	Paid for telegrams	40
16	Paid for carriage	30	30	Sent registered notice to landlord	6

Ans: Petty Cash balance = ₹330

Multiple Choice Questions:

- Nominal Account represents
(a) Profit & gain (b) Loss/Expenses (c) None (d) Both (A) and (B)
- S.B.I Account is a ...
(a) Nominal (b) Artificial personal Account (c) Representative personal Account (d) None
- The process of recording business transactions in a book of original entry is known as
(a) Journal (b) Balance (c) posting (d) none
- Prepaid rent is a
(a) Nominal A/c (b) representative personal A/c (c) tangible assets account (d) none
- In an Account if debit > credit side, the balance is known as the
(a) Negative balance (b) Debit balance (c) Positive balance (d) Credit balance
- A sale of goods to Ram for cash should be debited to:
(a) Ram (b) Cash (c) Sales (d) Capital
- A withdrawal of cash from business by the proprietor should be credited to
(a) Drawing A/c (b) Capital A/c (c) Cash A/c (d) Purchase A/c
- Rent Account
(a) Personal (b) Real (c) Nominal (d) None
- Ledger contains various ____ in it
(a) Transactions (b) Entries (c) Accounts (d) None
- The process of transfer of entries from day book to ledgers is called ____
(a) Simple posting (b) Journal posting (c) Transaction (d) Ledger posting
- The rent paid to landlord is credited to
(a) Landlord's A/c (b) Rent A/c (c) Cash A/c (d) None
- Which financial statement represents the accounting equation-
Assets = Liabilities + Owner's equity:
(a) Income Statement (b) Statement of Cash flows (c) Balance Sheet (d) None
- The debts written off as bad, if recovered subsequently are
(a) Credited to Bad Debts recovered A/c (b) Credited to trade receivables Account
(c) Debited to profit and Loss Account (d) None
- A trial balance will not balance if ____
(a) correct entry is posted twice



(b) The purchase on credit basis is debited to purchases and credited to cash
 (c) ₹ 500 cash payment to creditors is debited to creditors for ₹ 50 and credited to cash as ₹ 500 (d) None of the above

15. A trial balance shows
 (a) Honesty of accountants (b) Accuracy of account
 (c) Only arithmetical accuracy of accounts (d) none of these

Ans: 1.d 2.b 3.a 4.b 5.b 6.b 7.c 8.c 9.c 10.d 11.c 12.c 13.a 14.c 15.c

Fill in the blanks:

- Cash account is ___ (Real account)
- Liability account has ___ balance (credit)
- Interest account ___ balance ('debit or credit')
- Opening entries are generally passed through ___ ('General journal')
- goodwill account is a/an ___ ('intangible asset')
- The debit balance in a nominal account shows (Ans: Expenditure)
- The allowance made for prompt payment is called (Ans: Cash discount)
- The left hand side of an account is called (Ans: Debit)
- If the debit side of goods account exceeds the credit side the difference will be – (Ans: Closing stock)
- The balance of ___ account will be shown in the debit column of trail balance. (Assets/Expenses)
- The equality of debit and credit of the ___ does not mean that the individual accounts are also accurate. ("Trial balance")
- Trial balance is statement which shows the ___ or the totals of all the accounts. ("balances")
- ___ lists the balance and the title of account in the ledger an given data (Trial balance)
- Closing stock appearing in the trial balance is shown on the ___ balance sheet (asset side of)
- The balance of liabilities account will be shown in the ___ of the trial balance. (credit column)

True or false:

- Ram has assets of ₹20,000/- and liabilities of ₹4,000/- his capital therefore would be ₹16,000/- (TRUE)
- Depreciation is loss (TRUE)
- Double accounting system owes its origin to Luca Pacioli (TRUE)
- Profit or loss have no effect on network (FALSE)
- Capital account is a real account (FALSE)
- Trial balance is a final accounts (FALSE)
- Trial balance contains the balances of only personal and real accounts (FALSE)
- After preparation of ledgers, the next is the preparation of trial balance (TRUE)
- Journal is the book of final entry (FALSE)
- Trade discount will be entered in the book of accounts (FALSE)

Match the following:

Group –A

Salary account	e	a) Artificial personal account
Drawings account	c	b) Representative personal account
Furniture account	d	c) Personal account
Income received in advance	b	d) Real account
Modern Academy	a	e) Nominal account

Group- B

Rent account	c	Real account
Capital account	d	Artificial Personal account
Goodwill account	a	Nominal account
Harish Account	e	Representative personal Account
State Bank of India	b	Personal account

1.4 DEPRECIATION - METHODS (STRAIGHT LINE AND DIMINISHING BALANCE METHODS)

Depreciation is derived from the Latin word "Depretium", where "De" – decline "Pretium" – Price. This decline in price is due to constant use, wear and tear. "Depreciation is the gradual and permanent decrease in the value of an asset from any cause.

Accounting Standard (AS 10) states that "Depreciation is allocated so as to charge a fair proportion of the depreciable amount in each accounting period during the expected useful life of the asset."

Amortization

- Intangible assets such as goodwill, trademarks and patents are written off over a number of accounting periods covering their estimated useful lives.
- This periodic write off is known as Amortization and that is quite similar to depreciation of tangible assets.
- The term amortization is also used for writing off leasehold premises.
- Amortization is normally recorded as a credit to the asset account directly or to a distinct provision for depreciation account.
- Though the write off of intangibles that have no limited life is not approved by some Accountants.
- Some concerns do amortize such assets on the ground of conservatism.

Depletion

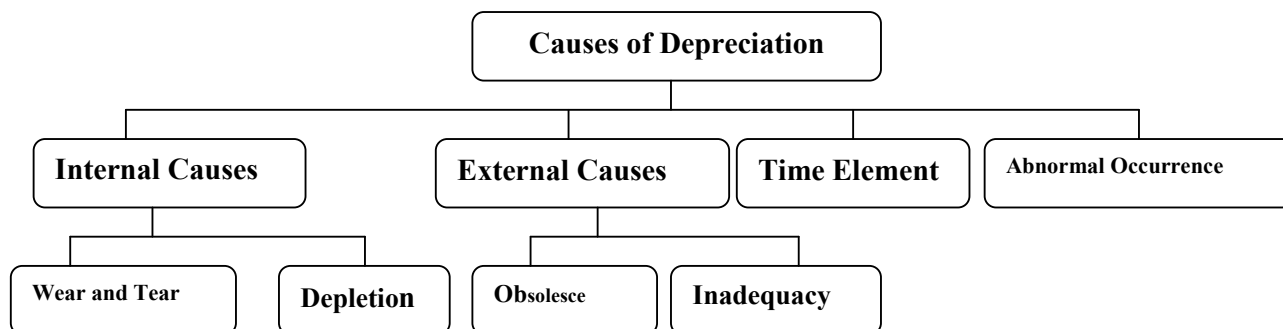
- This method is specially suited to mines, oil wells, quarries, sandpits and similar assets of a wasting character.
- In this method, the cost of the asset is divided by the total workable deposits of the mine etc. And by following the above manner rate of depreciation can be ascertained.
- Depletion can be distinguishable from depreciation in physical shrinkage or lessening of an estimated available quantity and the latter implying a reduction in the service capacity of an asset.

Obsolescence

- The term 'Obsolescence' refers to loss of usefulness arising from such factors as technological changes, improvement in production methods, change in market demand for the product output of the asset or service or legal or medical or other restrictions.
- It is different from depreciation or exhaustion, wear and tear and deterioration in that these terms refer to functional loss arising out of a change in physical condition.

Dilapidation

- In one sentence Dilapidation means a state of deterioration due to old age or long use. This term refers to damage done to a building or other property during tenancy.



A. Internal Causes

(i) **Wear and tear:** Plant & machinery, furniture, motor vehicles etc suffer from loss of utility due to vibration, chemical reaction, negligent handling, rusting etc.

(ii) **Depletion (or exhaustion):** The utility or resources of wasting assets (like mines etc.) decreases with regular extractions.

B. External or Economic Causes

(i) **Obsolescence:** Innovation of better substitutes, change in market demand, imposition of legal restrictions may result into discarding an asset.

(ii) **Inadequacy:** Changes in the scale of production or volume of activities may lead to discarding an asset.

C. Time element: With the passage of time some intangible fixed assets like lease, patents, Copy- rights etc., lose their value or effectiveness, whether used or not. The word "amortization" is a better term to speak for the gradual fall in their values.

D. Abnormal occurrences: An accident, fire or natural calamity can damage the service potential of an asset partly or fully. As a result the effectiveness of the asset is affected and reduced.

METHODS OF PROVIDING DEPRECIATION:

Methods of Depreciation	Fixed Instalment method/ equal Instalment method/ Original cost method/ straight line method	A fixed percentage on original cost	$\text{Depreciation} = \frac{\text{Cost of Asset} - \text{Residual Value}}{\text{Expected life of Asset (in year)}}$ $\text{Rate of Depreciation} = \frac{\text{Amount of Depreciation}}{\text{Original cost of the Asset}} \times 100$
	Diminishing balance method/ written down value method/ reducing balance method	A fixed percentage on reducing balance of asset	$\text{Depreciation} = \text{Cost / WDV of Asset} \times \text{Rate of Depreciation}$ $\text{Rate of Depreciation} = 1 - \sqrt[n]{\frac{\text{Net Residual Value}}{\text{Cost of Acquisition}}} \times 100$ <p>Where n = Life of the Asset in Years</p>
	Annuity method	Interest of investment on Asset is taken into Consideration	$\text{Depreciation} = [\text{Cost of Asset} - \text{Residual Value}] \times \text{Annuity factor}$
	Depreciation fund/ Sinking fund method	Interest earned on investments made with Depreciation is taken into Calculations	$\text{Depreciation} = [\text{Cost of Asset} - \text{Residual Value}] \times \text{fund Tables, for given rate of Interest}$
	Depletion method	On Wasting Assets Like mines, quarries, oil wells	$\text{Depreciation} = \frac{\text{Estimated Total Cost Value} - \text{Scrap Value}}{\text{Estimated Total Output (Units)}} \times \text{Actual output during the Year (in units)}$
	Machine hour rate method/ Service hours method	Application on plant & Machinery, Vehicles etc.	$\text{Depreciation} = \frac{\text{Original Cost} - \text{Scrap Value of assets}}{\text{Life of Assets in Hours}} \times \text{Actual hours used during the Year}$
	Production units method	On machinery, Projects	$\text{Depreciation} = \frac{\text{Estimated Total Cost Value} - \text{Scrap Value}}{\text{Estimated Total Output (Units)}} \times \text{Actual output during the Year (in units)}$
	Sum of Years of Digits method	A Variant of the reducing balance method	$\text{Depreciation} = \left[\frac{\text{Original Cost} - \text{Scrap Value}}{\text{Sum of the years digits of life of the asset}} \right] \times \frac{\text{No. of years of the Remaining Life of the Asset (including Current years)}}{\text{Sum of the years digits of life of the asset}}$

Note = Sum of years Digits = $\frac{N(n+1)}{2}$

Fixed/Equal Installment OR Straight Line Method

Features:

- (i) A fixed portion of the cost of a fixed asset is allocated and charged as periodic depreciation.
- (ii) Such depreciation becomes an equal amount in each period.
- (iii) The formula for calculation of depreciation is :

$$\text{Depreciation} = (V-S)/n$$
 Where, V = Cost of the Asset
 S = Residual value or the expected scrap value
 n = estimated life of the asset



Formula for calculation of rate of depreciation under Written Down Value Method:

$$1 - \sqrt[n]{\frac{\text{Residual Value}}{\text{Cost of the Asset}}}$$

Example:

If a plant costs ₹ 16,000 with an estimated salvage value of ₹ 2,000 at the end of third year of its useful life, compute the rate of depreciation.

$$100 \times \left[1 - \sqrt[3]{\frac{2,000}{16,000}} \right] = 50\%$$

Reducing / Diminishing Balance Method OR Written Down Value Method

Features

Depreciation is calculated at a fixed percentage on the original cost in the first year. But in subsequent years it is calculated at the same percentage on the written down values gradually reducing during the expected working life of the asset.

The rate of allocation is constant (usually a fixed percentage) but the amount allocated for every year gradually decreases.

Methods of Recording Depreciation:

Depreciation can be recorded in the books of account by two different methods. They are discussed below:

1. When a provision for Depreciation Account is maintained:

In case of this method, the amount of depreciation to be charged in a particular year is debited to Depreciation A/c and credited to Provision for Depreciation Account. The Asset Account appears in the books at original cost. In case the asset is sold, the provision for Depreciation Account is transferred to the Asset Account. Any amount released on account of sale of asset is also credited to Asset Account. The balance, if any, in the Asset Account is transferred to the Profit and Loss Account.

2. When a provision for Depreciation Account is not maintained:

In case a Provision for Depreciation Account is not maintained, the amount of depreciation is debited to the Depreciation Account and credited to the Asset Account. The Asset Account thus appears in the books at written down value. The Depreciation Account is transferred to the Profit and Loss account like any other item of expense.

Accounting Treatment under different methods:

Sl. No.	Transaction	If Provision for Depreciation A/c is NOT maintained (ordinary method)	If Provision for Depreciation A/c is maintained	
			If Asset Disposal A/c is NOT opened	If Asset Disposal A/c is opened
1.	For the purchase of an asset (including exp. Incurred till it is brought into use)	Asset A/c Dr. To Cash/Bank A/c	Asset A/c Dr. To Cash/Bank A/c	Asset A/c Dr. To Cash/Bank A/c

2.	For the depreciation on the asset.	Depreciation A/c Dr. To Asset A/c	Depreciation A/c Dr. To Prov. for Dep. A/c	Depreciation A/c Dr. To Prov. for Dep. A/c
3.	For the transfer of depreciation to P & L a/c	Profit & Loss A/c Dr. To Depreciation A/c	Profit & Loss A/c Dr. To Depreciation A/c	Profit & Loss A/c Dr. To Depreciation A/c
4.	When the asset is to be sold	No Entry	No Entry	Asset Disposal A/c Dr. To Asset A/c
	a. For the transfer of original cost of the asset to Asset Disposal A/c			
	b. For the transfer of provision for Depreciation A/c	No Entry	Prov. for Dep A/c Dr. To Asset A/c	Prov. for Dep A/c Dr. To Asset Disposal A/c
	c. For the sale of asset	Cash / Bank A/c Dr. To Asset A/c	Cash / Bank A/c Dr. To Asset A/c	Cash / Bank A/c Dr. To Asset Disposal A/c
	d. For the profit on the sale of asset.	Asset A/c Dr. To Profit & Loss A/c	Asset A/c Dr. To Profit & Loss A/c	Asset Disposal a/c Dr. To Profit & Loss A/c
	e. For the loss on the sale of asset	Profit & Loss A/c Dr. To Asset A/c	Profit & Loss A/c Dr. To Asset A/c	Profit & Loss A/c Dr. To Asset Disposal a/c

Illustration 1

Purchase price of a machine ₹1,80,000; Freight charges ₹30,000; installation charges ₹10,000; residual vale ₹16,000 and useful life 5 years. Calculate the depreciation for third year under the straight line method. Under straight line method, the depreciation for each year

Solution:

$$\text{Depreciation} = \frac{\text{Cost of Machine} + \text{Repair} + \text{Installation} - \text{Residual Value}}{\text{Useful Life}}$$

$$\text{Hence, the depreciation for the third year} = \frac{1,80,000 + 30,000 + 10,000 - 16,000}{5} = ₹ 40,800$$

Illustration 2

Calculate the Rate of Depreciation under Straight Line Method (SLM) in each of the following:-

Machine No.	Cost of Machine (₹)	Expenses incurred at the time of purchase to be capitalized (₹)	Estimated Residual Value (₹)	Expected Useful Life in years
1	90,000	10,000	20,000	8
2	24,000	7,000	3,100	6
3	1,05,000	20,000	12,500	5
4	2,50,000	30,000	56,000	10



Solution:

Ma- chine No	Cost of Machine (₹)	Expenses incurred at the time of purchase to be capitalized (₹)	Depreciation= (d-e)/f (₹)	Total Cost of Asset = (b+c) (₹)	Estimated Residual Value(₹)	Expected Useful Life in years	Rate of Depreciation under SLM = (g/d)×100
a	b	c	g	d	e	f	h
1	90,000	10,000	10,000	1,00,000	20,000	8	10%
2	24,000	7,000	4,650	31,000	3,100	6	15%
3	1,05,000	20,000	22,500	1,25,000	12,500	5	18%
4	2,50,000	30,000	22,400	2,80,000	56,000	10	8%

Illustration 3

A machine is purchased for ₹ 7,00,000. Expenses incurred on its cartage and installation ₹ 3,00,000. Calculate the amount of depreciation @ 20% p.a. according to Straight Line Method for the first year ending on 31st March, 2015, if this machine is purchased on:

(a) 1st April, 2014 (b) 1st July, 2014 (c) 1st October, 2014 (d) 1st January, 2015

Solution:

Here, Total Cost of Asset = Purchased Price + Cost of Cartage and Installation
= ₹ 7,00,000 + ₹ 3,00,000 = ₹ 10,00,000

= Total Cost of Asset × Rate of Depreciation × $\frac{\text{Period from the date of purchase of date od closing accounts}}{12}$

(a) The machine was purchased on 1st April, 2012:

$$\text{Amount of Depreciation} = ₹ 10,00,000 \times 20\% \times \frac{12}{12} = ₹ 2,00,000$$

(b) 1st July, 2012

$$\text{Amount of Depreciation} = ₹ 10,00,000 \times 20\% \times \frac{9}{12} = ₹ 1,50,000$$

(c) 1st October, 2012

$$\text{Amount of Depreciation} = ₹ 10,00,000 \times 20\% \times \frac{6}{12} = ₹ 1,00,000$$

(d) 1st January, 2013

$$\text{Amount of Depreciation} = ₹ 10,00,000 \times 20\% \times \frac{3}{12} = ₹ 50,000$$

Illustration 4

A company whose accounting year is the calendar year, purchased on 1st April, 2013 Machinery costing ₹ 30,000. It purchased further machinery on 1st October, 2013 costing ₹ 20,000 and on 1st July, 2014 costing ₹ 10,000. On 1st January, 2015 on third of the Machinery installed on 1st April, 2013 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 installment method at 10 p.c. per annum.

Solution:

Dr.		Machinery Account				Cr.
2013	Particulars	₹	2013	Particulars	₹	
Apr.1	To Bank A/c	30,000	Dec.31	By Depreciation A/c (on ₹ 30,000 for nine months and on ₹ 20,000 for 3 months)	2,750	
	To Bank A/c	20,000	Dec.31	By Balance c/d	47,250	

		50,000			50,000
2014					
Jan.1	To Balance b/d	47,250	2014		
July1	To Bank A/c	10,000	Dec.31	By Depreciation A/c (on ₹ 50,000 for one year and on ₹ 10,000 for 6 months)	5,500
			2005		
			Dec.31	By Balance c/d	51,750
		57,250			57,250
2015			2015		
Jan.1	To Balance b/d	51,750	Jan. 1	By Bank a/c	3,000
			Jan.1	By Profit and Loss A/c (loss on sale) (1)	5,250
			Dec.31	By Depreciation (on `50,000 for one year) A/c	5,000
			Dec.31	By Balance c/d	38,500
		51,750			51,750
2016					
Jan.1	To Balance b/d	38,500			

Working Note:

(1) Calculation of Loss on sale of 1/3 of the Machinery

	₹	₹
Value of Machinery		10,000
Less: Depreciation for 2013 for 9 months	750	
Depreciation for 2014	1,000	
		1,750
Written down value of Machinery 1-1-2015		8,250
Less: Amount realized		3,000
Loss transferred to profit and loss A/c		5,250

Illustration 5

On July 1, 2012 Granites Ltd. purchased second hand machine for ₹40,000 and reconditioned the same by spending ₹6,000. On January 1, 2013 a new machine was purchased for ₹24,000. On June 30, 2014 the machine purchased on January 1, 2013 was sold for ₹16,000 and another machine was installed at a cost of ₹30,000. The company writes of 10% on original cost every year on March 31. Show the Machinery account update.

Solution:

Dr.			Machinery Account		Cr.	
Date	Particulars	₹	Date	Particulars	₹	
1-7-12	To Bank (₹40,000 + ₹6,000)	46,000	31-3-13	By depreciation A/c $\text{₹ } 46,000 \times \frac{9}{12} \times \frac{10}{100} = 3,450$		
1-1-13	To Bank	24,000		$\text{₹ } 24,000 \times \frac{3}{12} \times \frac{10}{100} = 600$	4,050	
			31-3-13	By balance c/d	65,950	
		70,000			70,000	
1-4-13	To Balance b/d	65,950	31-3-14	By depreciation A/c (on ₹ 70,000 at 10%)	7,000	



			31-3-12	By balance c/d	58,950
		65,950			65,950
1-4-14	To balance b/d	58,950	30-6-14	By Bank (Sale of Machinery)	16,000
30-6-14	To Bank	30,000	30-3-15	By P & L A/c (1)	4,400
			31-3-15	By Depreciation (2)	7,450
				By balance c/d	61,100
		88,950			88,950
1-4-15	To balance b/d	61,100			

Working Notes:

1. Calculation of Loss on sale of machinery:

Cost of Machinery on 1-1-2013		24,000
Less: Depreciation upto 31-3-2013 ($\text{₹ } 24,000 \times \frac{3}{12} \times \frac{10}{100}$)	$\frac{600}{23,400}$	
Less: Depreciation upto 31-3-2014 (on ₹ 24,000 at 10%)	$\frac{2,400}{21,000}$	
Less: Depreciation till the date of sale of machinery i.e. (30-6-2014) ($\text{₹ } 24,000 \times \frac{3}{12} \times \frac{10}{100}$)	$\frac{600}{20,400}$	
Less: Amount realized on sale of machinery	$\frac{16,000}{4,400}$	
Loss on sale of machinery		4,400

2. Calculation of depreciation on the balance of machinery form 1-4-2014 to 31-3-2015:

Depreciation on the machinery sold for 3 months form 1-4-2014 to 30-6-2014 (date of sale) ($\text{₹ } 24,000 \times \frac{3}{12} \times \frac{10}{100}$)	600
On ₹ 46,000 at 10%	4,600
On ₹ 30,000 at 10% for 9 months ($\text{₹ } 30,000 \times \frac{9}{12} \times \frac{10}{100}$)	2,250
	7,450

Illustration 6

A company purchased some machineries for ₹1,00,000 on 1st April, 2011. It charges depreciation @ 10% p.a. on reducing balance method every year. On 30th September, 2015 a part of machinery was sold for ₹14,000, the original cost of the machine was ₹20,000. Calculate the profit or loss on sale of machinery.

Solution:

Particulars	Amt. (₹)	Amt. (₹)
Original cost of the machines as on 1.4.2011		20,000
(-) Depreciation for the year 2011-12	2000	
2012-13	1800	
2013-14	1620	
2014-15	1458	
2015-16	656	(7534)
Written down value as on 30-9-2015		12466
Sales price		14000
Profit on sale of machinery		1534

Illustration 7

On 1.1.2013 a machine was purchased for ₹1,00,000 and ₹50,000 was paid for installation. Assuming that the rate of depreciation was 10% on Reducing Balance Method, calculate amount of depreciation upto 31.12.2015.

Solution:

Year	Opening Book Value (₹)	Rate	Depreciation (₹)	Closing Book Value (₹)
2013	1,50,000	10%	15,000	1,35,000
2014	1,35,000	10%	13,500	1,21,500
2015	1,21,500	10%	12,150	1,09,350

Note: Cost of the machine (i.e. Opening Book Value for the year 2013)
 = Cost of Purchase + Cost of Installation
 = ₹ 1,00,000 + ₹ 50,000 = ₹ 1,50,000

Illustration 8

A Manufacturing concern whose books are closed on 31st March, Purchased Machinery for ₹1,50,000 on 1st April 2011. Additional machinery was acquired for ₹ 40,000 on 30th September, 2012 and for ₹ 25,000 on 1st April, 2014. Certain machinery, which was purchased for ₹ 40,000 on 30th September, 2012, was sold for ₹ 34,000 on 30th September, 2014.

Give the Machinery Account for the year ending 31st March, 2015 taking into account depreciation at 10% per annum on the written-down value.

Solution:
Dr.

Machinery Account

Cr.

Date	Particulars	₹	Date	Particulars	₹
2011 April	To Bank	1,50,000	Mar. 31	By Depreciation	15,000
				By Bal. c/d	1,35,000
		1,50,000			1,50,000
2012 April 1	To Bal. b/d	1,35,000	2013 Mar. 31	By depreciation (13,500+2,000)	15,500
Sept. 30	To Bank	40,000		By Bal. c/d	1,59,500
		1,75,000			1,75,000
2013 Apr.1	To Bal B/d	1,59,500	Mar. 31	By Depreciation (12,150+3,800)	15,950
				By Bal. c/d	1,43,550
		1,59,500			1,59,500
2014 April 1	To balance b/d	1,43,550	2014 Sept. 30	By Depreciation A/c	1,710
	To Bank (additions)	25,000		By Bank A/c	34,000
2014 Sept. 30	To P & L A/c (profit on sale of machinery) (₹ 34,000 – ₹ 32,490)	1,510	2015 Mar. 31	By depreciation (10,935+ 2,500)	13,435
				By Balance c/d	1,20,915
		1,70,060			1,70,060
2015 April 1	To Bal. b/d	1,20,915			

Calculation of profit on sale of machinery:

Cost of machinery on 30-9-2012		40,000
Less: Depreciation for 2012-2013 (i/1 year)	2,000	
2013-14	3,800	
2014-15 (1/2 year)	1,710	
		7,510



		32,490
Less: Amount realized on sale of machinery		34,000
Profit on sale of Machinery		1,510

Illustration 9

One lathe machine whose original value was ₹1,20,000 on 1.4.2013, being the date of installation was sold on 30.9.2015 for ₹1,00,000. Depreciation is charged at the rate of 10% on reducing balance. Show machinery account and assets disposable account.

Solution:**Machinery Account**

Dr.			Cr.		
Date	Particulars	Amt. (₹)	Date	Particular	Amt.(₹)
2013 Apr. 1	To Balance b/d	1,20,000	2014 Mar 31	By Depreciation A/c (1,20,000*10%)	12,000
			Mar 31	By Balance c/d	1,08,000
		1,20,000			1,20,000
2014 Apr.1	To Balance b/d	1,08,000	2015 Mar 31	By Depreciation A/c (1,08,000*10%)	10,800
			Mar 31	By Balance c/d	97,200
		1,08,000			1,08,000
2015 Apr.1	To Balance b/d	97,200	Sep 30	By Machinery disposal A/c	97,200
		97,200			97,200

Machinery Disposal Account

Dr.		Cr.	
Particular	Amt. (₹)	Particular	Amt. (₹)
To Machinery A/c	97,200	By Bank A/c	1,00,000
To Profit and Loss A/c (profit on sale of Machinery)	7,660	By depreciation A/c (1.4.08-30.9.15)	4,860
	1,04,860		1,04,860

Meaning of Provision:

The term 'provision' means any amount written off or retained by way of providing depreciation, renewals or diminution in the value of assets or retained by way of providing for any known liability the amount of which may not be determined with substantial accuracy. If the amount of such liability can be ascertained it will be a liability and not a provision. Provisions for depreciation, provision for bad and doubtful debts, provisions for taxation, provision for repairs and renewal and provision for contingencies are some examples of provisions. It is a charge to profit and loss account.

The main purpose of provision for repairs and renewals is to give a uniform charge to profit and loss account in respect of machinery. This is all the more necessary as the usefulness of the machinery is also uniform from year to year. Under this method the total repairs over the life of the asset are estimated and then average is found. This amount is debited to the profit and loss account of every year and credited to the provisions of repairs and renewals account. The actual amount of repairs and renewals is debited to the provision for repairs and renewals account, the balance of the account appears on the liabilities side in the balance sheet. As soon as the life of the asset is over, the account is automatically closed.

Illustration 10

A firm desires to debit its profit and loss account with a uniform figure every year in respect of repairs and renewals. It expects that considering the life of the asset in question ` 10,000 will be the average amount to be spent per year. Actual repairs are ` 1,000 in the first year, ` 2,300 in the second year and ` 3,700 in the third year. Show the provision for repairs and renewals account.

Solution:

Provision for Repairs and Renewals Account

Dr.			Cr.		
Year I	To Bank (repairs)	1,000	Year – I	By P & L A/c	10,000
	To Balance c/d	9,000			
		10,000			10,000
Year II	To Bank (repairs)	2,300	Year – II	By Balance b/d	9,000
	To Balance c/d	16,700		By P. & L. A/c	10,000
		19,000			19,000
Year III	To Bank (repairs)	3,700	Year III	By Balance b/d	16,700
	To Balance c/d	23,000		By P & L A/c	10,000
		26,700			26,700

Meaning of Reserve

Any sum which is appropriated out of profit and loss appropriation account is not meant to cover up liability, contingency, commitment. Or reduction in the value of an asset is a reserve. It is provided for meeting prospective losses or liabilities, creation of reserves to increase the working capital in the business, strengthen its financial position to equalize the dividend during the period of inadequate profit and to comply with legal requirements. Sometimes the amount is not kept in the business as additional working capital but is invested in the purchase of outside securities, then it is called reserve fund and not a reserve. Reserve may be (i) capital reserve and (ii) revenue serve.

EXERCISE:

1. M/s Suba Pharmaceuticals has imported a machinery on 1st July, 2012 for ₹1,60,000 paid custom duty and freight ₹80,000 and incurred erection charges ₹ 60,000. Another local machinery costing ₹1,00,000 was purchased on January 1, 2013. On 1st July, 2014 a portion of the imported machinery (value one third) got out of order and was sold for ₹34,800. Another machinery was purchased to replace the same for ₹50,000. Depreciation is to be calculated at 20% p.a. on straight line method. Show the machinery account for 2012, 2013 and 2014.

Ans: Balance in Machinery Account ₹2,05,000; Loss on sale ₹25,200

2. A manufacturing concern, whose books are closed on 31st March, purchased machinery for ₹ 1,50,000 on 1st April 2010. Additional machinery was acquired for ₹ 40,000 on 30th September 2011 and for ₹ 25,000 on 1st April, 2013. Certain machinery, which was purchased for ₹ 40,000 on 30th September, 2011 was sold for ₹ 34,000 on 30th September, 2013. Give the machinery account for the year ending 31st March, 2014 taking into account depreciation at 10% per annum on the written – down value.

Ans: Balance in Machinery Account ₹1,20,915; Profit on sale of Machinery = ₹1,510

3. A Transport company purchased 5 trucks at ₹2,00,000 each on April 1, 2012. The company observes calendar year as its accounting year.

On October 1, 2014 one of the trucks is involved in an accident and is completely destroyed. Insurance company pays ₹90,000 in full settlement of the claim. On the same day the company purchases an used truck for ₹1,00,000 and spends ₹20,000 on its overhauling.



Prepare truck account (in clummnar form) for the three years ending on December, 2014 if the company writes off depreciation @ 20% per annum on
Original cost method and
diminishing balance method.

Ans: Balance i) ₹4,74,000; Loss on sale of machinery ₹10,000

ii) ₹5,49,200; Loss on sale of machinery ₹25,600

Multiple Choice Questions:

- Depreciation refers to the process of __-
(a) Asset valuation (b) Allocation of cost of the assets over the period of its life
(c) verification of assets (d) increasing or decreasing the value of asset
- In case the depreciable assets are revalued, the provision for depreciation is based on
(a) market value of the assets (b) historical cost of assets (c) depreciated value of the assets (d) The revalued amount over the estimate of the remaining useful life of such asset
- Which of the following is the internal causes for depreciation?
(a) wear and tear (b) depletion or exhaustion (c) both a & b (d) none of the above
- Which are the methods of depreciation is prescribed by the income tax act __
(a) straight line and annuity method (b) sinking fund and double declining method
(c) equal installment and written down value method
(d) production hour and sum of year's digit method
- Depreciation is not provided for which of the following asset?
(a) goodwill (b) land (c) inventory of goods (d) both B & c
- Obsolescence means decline in the value due to
(a) physical wear and tear (b) efflux of time
(c) fall in market price (d) innovations and inventions
- The depreciation account is closed at the end of the year by transfer to the
(a) general reserve a/c (b) profit and loss a/c
(c) provision for depreciation a/c (d) fixed asset a/c
- Which of the following is an external cause for depreciation
(a) Obsolescence (b) time element (c) abnormal occurrences (d) all of the above
- Accumulated depreciation is an example of
(a) A liability (b) An expense (c) An income (d) An unrecorded revenue
- Purchase price of machine 8,90,000, freight and cartage 7000, installation charges 30,000, Insurance charges 20000, residual value is 40,000, estimated useful life 5 years. Calculate the amount of annual depreciation under straight line method?
(a) 1,77,400 (b) 181400 (c) 197400 (d) 177900
- Depreciation of a ten-year lease is best done on the method
(a) WDV (b) SLM (c) Annuity method (d) both a & b
- Original cost is ₹ 1,50,000 residual value is 10,000, depreciation for 3rd year @ 10% p.a. under WDV method __
(a) 14,000 (b) 12150 (c) 11,340 (d) 12,240
- For charging depreciation, on which of the following assets, the depletion method is adopted?
(a) plant & machinery (b) land & building (c) goodwill (d) Wasting assets like mines and quarries
- The value of an asset after deducting depreciation from the historical cost is known as
(a) Fair value (b) market value (c) net realizable value (d) book value
- If the original cost of the machine = 1,00,000, life = 5 years residual value = 2,000. If the depreciation for 4th year as per SLM is 19,600, then the rate of depreciation p.a. is
(a) 10% (b) 15% (c) 20% (d) 5%

Answer:

1. (b) 2. (d) 3. (c) 4. (c) 5. (d) 6. (d) 7.(b) 8. (a) 9.(a) 10.(a) 11.(b) 12.(b) 13.(d) 14.(d) 15.(c)

Fill in the blanks:

1. Depreciation means ____ (decrease in the value of an asset.)
2. Amortization means ____ (charging a period with the proportionate cost of an intangible asset.)
3. Depreciation accounts is ____ type of account (Nominal)
4. ____ is a charge against the profits.(Provision)
5. The amount of depreciation charged on a machinery will be debited to ____ account (Depreciation)
6. Profit on sale of machinery is ____ to P & L. (credited)
7. The amount charged to depreciation declines in ____ (reducing balance method.)
8. Formula to calculate rate of depreciation under diminishing balance method ____ ($1 - n\sqrt{(R/C)}$)
9. Depreciation is a ____ item (non- cash)
10. Obsolescence of a depreciable asset is caused by ____ changes. (Technological)
11. In case of down ward revaluation of an asset which is for the first time revalued, the account debited is ____ (profit and loss account.)
12. ____ is an expenses accruing from use of fixed assets.(Depreciation)
13. For providing depreciation on hand tools, the appropriate method of depreciation is ____ (Revaluation method)
14. In ____ method physical wear and tear are more important than economic obsolescence. (straight line)
15. Formula to calculate depreciation under straight line method ____ (Cost of the Asset – Estimated Scrap Value / Estimated Life Time)

True or false:

1. In case of mineral resources depreciation is not provided, but depletion is charged (TRUE)
2. Under straight line method the cost of the asset written off in equal proportion, during its economic life (TRUE)
3. Depreciation is charged on tangible fixed assets and it is not charged on any current asset (TRUE)
4. Depreciation is a process of allocation and not of valuation (TRUE)
5. An asset is purchased for ` 25,000, depreciation is to be provided annually according to straight line method useful life if the asset is 10 years and scrap value is 5000. Is the rate of depreciation is 10% (FALSE)
6. If the written down value of the machine on 1-1-95 is 9,72,000 what will be the value of machine on 1-1-93. If the method is RBM and rate of depreciation is 10%. The value on 1-1-93 is 12,00,000 (TRUE)
7. Under the RBM of depreciation, the value of machinery never comes to zero and, under SLM of depreciation the value of machinery comes to zero at the end of its useful life. (TRUE)
8. Original cost of a machine was ` 2,52,000. Salvage value was 12,000, Depreciation for 2nd year @ 10% under WDV method is 21,600. (TRUE)
9. The portion of the acquisition of cost of the asset, yet to be allocated is known as written down value (TRUE)
10. Under diminishing balance method, depreciation decrease every year. (TRUE)

Match the following:

Group - I

1.Patent	b	a) No depreciation
2.Building	d	b) Amortization
3.Mineral deposit	e	c)Wear and tear
4.Land	a	d)Depreciation
5. Internal cause	c	e) Depletion



Group - II

1. Depreciation	d	Written down value method
2. Straight line method	b	Equal installment method
3. Fixed assets	e	Depletion method
4. Reducing balance method	a	As-6
5. Units of production method	c	As-10

1.5 RECTIFICATION OF ERRORS

Every concern is interested in ascertaining its true profit and financial position at the close of the trading year. But in spite of the best efforts of the book-keeper and the accountant certain errors are committed in the recording of the transactions which affect the final accounts of the concern. It, therefore, becomes utmost important for the book-keeper and the accountant to locate such errors and rectify them so that correct profit and financial position of the concern may be ascertained. So whenever errors in accounting records come to notice, they should be rectified without waiting till the end of the accounting year when Trial Balance is to be prepared.

Stages of Errors:

Errors may occur at any of the following stages of the accounting process:

At the Stage of Recording the Transactions in Journal

Following types of errors may happen at this stage:

- i) Errors of principle,
- ii) Errors of omission,
- ii) Errors of commission.

AT THE STAGE OF POSTING THE ENTRIES IN LEDGER

- i) Errors of omission:
 - a) Partial omission,
 - b) Complete omission.
- ii) Errors of commission:
 - a) Posting to wrong account,
 - b) Posting on the wrong side,
 - c) Posting of wrong amount.

AT THE STAGE OF BALANCING THE LEDGER ACCOUNTS

- a) Wrong totaling of accounts,
- b) Wrong balancing of accounts.

AT THE STAGE OF PREPARING THE TRIAL BALANCE

- a) Errors of omission,
- b) Errors of commission:
 1. Taking wrong account,
 2. Taking wrong amount,
 3. Taking to the wrong side.

On the above basis, we can classify the errors in four broad categories:

1. Errors of Principle,
2. Errors of Omission,
3. Errors of Commission,
4. Compensating Errors.

Types of Errors

Basically errors are of two types:

- a) **Errors of principle:** When a transaction is recorded in contravention of accounting principles, like treating the purchase of an asset as an expense, it is an error of principle. In this case there is no effect on the trial balance since the amounts are placed on the correct side, though in a wrong account. Suppose on the purchase of a typewriter, the office expenses account is debited; the trial balance will still agree.

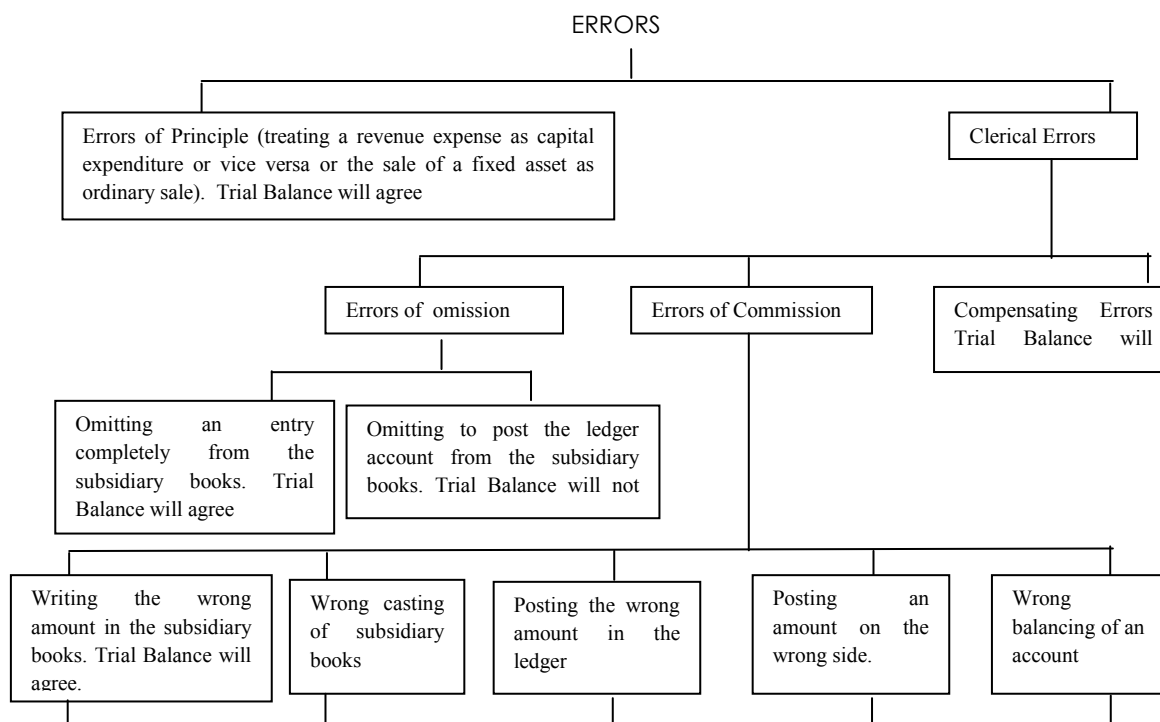
Clerical errors: These errors arise because of mistake committed in the ordinary course of the accounting work. These are of three types:

- (i) **Errors of Omission:** If a transaction is completely or partially omitted from the books of account, it will be case of omission. Examples would be: not recording a credit purchase of furniture or not posting an entry into the ledger.
- (ii) **Errors of Commission:** If an amount is posted in the wrong account or it is written on the wrong side or the totals are wrong or a wrong balance is struck, it will be a case of "errors of commission".
- (iii) **Compensating Errors:** if the effect of errors committed cancel out, the errors will be called compensating errors. The trial balance will agree. Suppose an amount of `10 received from A is not credited to his account and the total of the sales book is `10 in excess. The omission of credit to A's account will be made up by the increased credit to the Sales Account.

From another point of view, error may be divided into two categories:

- a) Those that affect the trial balance –because of the errors that trial balance does not agree; and
 - (i) Wrong casting of the subsidiary books
 - (ii) Wrong balancing of an account
 - (iii) Posting an amount on the wrong side
 - (iv) Wrong posting, i.e., writing the wrong amount
 - (v) Omitting to post an amount from a subsidiary book
 - (vi) Omitting to post the totals of subsidiary book
 - (vii) Omitting to write the cash book balances in the trial balance
 - (viii) Omitting to write the balance of an account in the trial balance.
 - (ix) Writing a balance in wrong column of the trial balance
 - (x) Totaling the trial balance wrongly.
- b) The errors that do not affect the trial balancing are the following:
 - i) Omitting an entry altogether from the subsidiary book
 - ii) Making an entry in the wrong subsidiary book
 - iii) Posting an amount in a wrong account but on the correct side, e.g., an amount to be debited to A is debited to B, the trial balance will still agree.

A chart of the types of errors is given below:



Trial Balance will not agree

Steps to Locate Errors:

Even if there is only a very small difference in the trial balance, the errors leading to it must be located and rectified. A small difference may be the result of a number of errors. The following steps will be useful in locating errors:

- i) The two columns of the trial balance should be totaled again. If in place of a number of accounts, only one amount has been written in the trial balance the list of such accounts should be checked and totaled again. List of Trade receivables is the example from which Trade receivable balance is derived.
- ii) It should be seen that the cash and bank balances have been written in the trial balance.
- iii) The exact difference in the trial balance should be established. The ledger should be gone through it is possible that a balance equal to the difference has been omitted from the trial balance. The difference should also be halved; it is possible that balance equal to half the difference has been written in the wrong column.
- iv) The ledger accounts should be balanced again.
- v) The casting of subsidiary books should be checked again, especially if the difference is `1, `100 etc.
- vi) If the difference is very big, the balance in various accounts should be compared with the corresponding accounts in the previous period. If the figures differ materially the cases should be seen; it is possible that an error has been committed. Suppose the sales account for the current year shows a balance of `32,53,000 whereas it was ₹36,45,000 last year; it is possible that there is an error in the Swales Account.
- vii) Postings of the amounts equal to the difference or half the difference should be checked. It is possible that an amount has been omitted to be posited or has been posted on the wrong side.
- viii) If there is still a difference in the trial balance, a complete checking will be necessary. The posting of all the entries including the opening entry should be check. It may be better to begin with the nominal accounts.

Rectification of Errors:

Errors should never be corrected by overwriting. If immediately after making an entry it is clear that an error has been committed, it may be corrected by neatly crossing out the wrong entry and making the correct entry. If however the errors are located after some time, the correction should be made by making another suitable entry,

called rectification entry. In fact the rectification of an error depends on at which stage it is detected. An error can be detected at any one of the following stages:

- a) Before preparation of Trial Balance
- b) After Trial Balance but before the final account are drawn.
- c) After final accounts, i.e., in the next accounting period.

Before Preparation of Trial Balance:

- (i) The sales book for November is undercast by ₹200. The effect of this error is that the Sales Account has been credited short by ₹200. Since the account is posted by the total of the sales book, there is no error in the accounts of the customers since they are posted with amounts of individual sales. Hence only the Sales Accounts is to be corrected. This will be done by making an entry for ₹200 on the credit side: "By Undercasting of Sales Book for November ₹200".
- (ii) While posting the discount column on the debit side of the cash book the discount of ₹10 allowed to Ramesh has not been posted. There is no error in the cash book, the total of discount column presumably has been posted to the discount account on the debit side. The error is in not crediting Ramesh by ₹10. This should now be done by the entry "By omission of posting of discount on ₹10".
- (iii) ₹50 was received from Mahesh and entered on the debit side of the cash book but was not posted to his account. By the error, which affects only the account of Mahesh, ₹50 has been omitted from the credit side of his account. The rectification will be by the entry. "By Omission of posting on the ₹50."
- (iv) Goods purchased from Vinod for ₹1,000 was wrongly credited to Vimal account by ₹100. Again we cannot pass a complete journal entry for rectifications even through two accounts are involved. The rectification will be done by the entry "To wrong posting on ₹100" in the debit of Vimal account and "By omission of posting on ₹1,000" in the credit of Vinod account.

After Trial Balance but before Final Accounts

The method of correction of error indicated so far is appropriate when the errors have been located before the end of the accounting period. After the corrections the trial balance will agree. Sometimes the trial balance is artificially made to agree inspite of errors by opening suspense account and putting the difference in the trial balance to the account – the suspense account will be debited if the total of the credit column in the trial balance exceeds the total of the debit column; it will be credited in the other case.

One must note that such agreement of the trial balance will not be real. Effort must be made to locate the errors.

The rule of rectifying errors detected at this stage is simple. Those errors for which complete journal entries were not possible in the earlier stage of rectification (i.e., before trial balance) can now be rectified by way of journal entry(s) with the help of suspense account, for it these errors which gave rise to the suspense account in the trial balance. The rectification entry for other type of error i.e., error affecting more than one account in such a way that a complete journal entry is possible for its rectification, can be rectified in the same way as in the earlier stage (i.e., before trial balance).

In a nutshell, it can be said that each and every error detected at this stage can only be corrected by a complete journal entry. Those errors for which journal entries were not possible at the earlier stage will now be rectified by a journal entry(s), the difference or the unknown side is being taken care of by suspense account. Those errors for which entries were possible even at the first stage will now be rectified in the same way.

Suppose, the sales book for November, 2010 is cast ₹100short; as a consequence the trial balance will not agree. The credit column of the trial balance will be ₹100 short and Suppose Account will be credited by ₹100. To rectify the error the Sales Account will be credited (to increase the credit to the right figure. Since now one error remains, the suspense Account must be closed – it will be debiting the Suspense Account. The entry will be:



Suspense Account	Dr.	₹100	
	To Sales Account		₹100

(Correction of error of Undercasting the sales Book for Nov. 2010)

Illustration: 1

Correct the following errors without opening a Suspense Account

- The Sales Book has been totaled ₹100 short.
- Goods worth ₹150 returned by Green & Co. have not been recorded anywhere.
- Furniture purchased from Gulab & Bros., ₹1,000 has been entered in Purchases Day Book.
- Discount allowed to G. Mohan & Co. ₹18 has not been entered in the Discount Column of the Cash Book. The account of G. Mohan & Co. has, however, been correctly posted.

Solution:

If a Suspense Account is not opened:

- Since sales book has been cast ₹100 short, the Sales Account has been similarly credited ₹100 short. The correcting entry is to credit the Sales Account by ₹100 as "By wrong totaling of the Sales Book ₹100".
- To rectify omission, the Return Inwards Account has to be debited and the Account of Green & Co. credited. The entry:

Returns Inward Account	Dr.	₹150	
	To Green & Co.		₹150

(Goods returned by the firm, previously omitted from the Returns Inward Book)

- By this error Purchases Account has to be debited by ₹1,000 whereas the debit should have been to the Furniture Account. The correcting entry will be:

Furniture Account	Dr.	₹1,000	
	To Purchase Account		₹1,000

(Correction of the mistake by which purchases Account was debited instead of the Furniture Account)

- In this case the account of the customer has been correctly posted; the discount account has been debited ₹18 short since it has been omitted from the discount column on the debit side of the cash book. The discount account should now be debited by the entry. "To Omission of entry in the Cash Book ₹18".

Correction in the Next Accounting Period

Rectification of errors discussed so far assumes that it was carried out before the books were closed for the concerned year. However, sometimes, the rectification is carried out in the next year, carrying forward the balance in the Suspense Account or even transferring it to the Capital Account. Suppose, the Purchase Book was cast short by ₹1,000 in December, 2014 and Suspense Account was opened with the difference in the trial balance. If the error is rectified next year and more than the amount relating to year 2014 and thus the profit that year 2014 will be less than the actual for that year. Thus, correction of errors in this manner will 'falsify' the Profit and Loss Account.

To avoid this, correction of all amounts concerning nominal account, i.e., expenses and incomes should be through a special account styled as "Prior Period Items" or "Profits and Loss Adjustment Account". The balance in the account should be transferred to the Profits and Loss Account. However, these Prior Period Items should be charged after deriving net profit of the current year. 'Prior Period items' are material income or expenses which rise in the current period as a result of errors or omissions in the preparation of the financial statements of one or more periods. Prior Period Items should be separately disclosed in the current statement of profit and loss together with their nature and amount in a manner that their impact on current profit or loss can be perceived.

Illustration: 2

Mr. A closed his books of account on September 30, 2014 in spite of a difference in the trial balance. The difference was ₹830 the credits being short; it was carried forward in a suspense account in 2015 following errors were located:

- (i) A sale of ₹2,300 to Mr. Lala was posted to the credit of Mr. Mala.
- (ii) The total of the Returns Inward Book for July, 2014 ₹1,240 was not posted in the ledger.
- (iii) Freight paid on a machine ₹5,600 was posted to the Freight account as ₹6,500.
- (iv) White carrying forward the total in the Purchase Account to the next page, ₹65,590 was written instead of ₹56,950.
- (v) A sale of machine on credit to Mr. Mehta for ₹9,000 was not entered in the books at all. The book value of machine was ₹7,500. The firm has the practice of writing off depreciation @10% on the balance at the end of the year.

Pass journal entries to rectify the errors. Have you any comments to make?

Solution:

Journal of Mr. A

Date	Particulars		L.F.	Dr.(₹)	Cr.(₹)
2011	Mr. Mala A/c	Dr.		2,300	
(i)	Mr. Lala A/c	Dr.		2,300	
	To Suspense A/c (Correction of error by which a sale of ₹2,300 to Mr. Lala was posted to the Credit of Mrs. Mala)				4,600
(ii)	Profit and Loss Adjustment A/c	Dr.		1,240	
	To Suspense A/c				1,240
	(Rectification of omission to post the total of Returns Inward Book for July, 2014)				
iii)	a) Machinery A/c	Dr.		5,600	
	Suspense A/c	Dr.		900	
	To Profit & Loss Adjustment A/c				6,500
	(Correction of error by which freight paid for a machine ₹5,600 was posted to Freight Account at ₹6,500 instead of capitalizing it)				
	b) Profit & Loss Adjustment A/c	Dr.		560	
	To Plant and Machinery A/c				560
	(Depreciation @ 10% charged on freight paid on a machine capitalized)				
iv)	Suspense A/c	Dr.		8,640	
	To Profit & Loss Adjustment A/c				8,640
	(Correction of wrong carry forward of total in the purchase Account to the next page ₹65,590 instead of ₹56,950)				
v)	Mr. Mehta	Dr.		9,000	
	To Plant & Machinery A/c				6,750
	To Profit & Loss Adjustment A/c				2,250
	(Correction of omission of sale of machine on credit to Mr. Mehta for ₹9,000 with a book value of ₹7,500 on which depreciation @10% has been charged in 2010)				

**Comments:**

The Suspense Account will not appear as shown below:

Suspense Account

Dr.			Cr.		
Date	Particulars	Amount ₹	Date	Particulars	Amount ₹
2015	To Profit and Loss Adjustment A/c	900	2014	By Balance b/d	830
	To Profit and Loss Adjustment A/c	8,640		By Sundries: Mr. Mala	2,300
				Mr. Lala	2,300
				By Profit and Loss Adjustment A/c	1,240
				By balance c/d	2,870
		9,540			9,540

Since the suspense Account still shows a balance, it is obvious that there are still some errors left in the books.

**Profit & Loss Adjustment Account
(For Prior Period Items)**

Dr.			Cr.		
Date	Particulars	Amount ₹	Date	Particulars	Amount ₹
2015	To Suspect A/c	1,240	2015	By Machinery A/c	5,600
	To Plant & Machinery A/c	560		By Suspense A/c	900
	To Balance c/d	15,590		By Suspense A/c	8,640
				By Mr. Mehta	2,250
		17,390			17,390

ERRORS DISCLOSED BY TRIAL BALANCE:

The following errors are disclosed by Trial balance.

- Posting of transaction in wrong side of the account.
 - Posting of transaction on correct side with wrong amount.
 - Errors in totaling.
 - Error is made in carrying forward.
 - Wrong balancing in the ledger account.
 - Posting of one aspect of Journal entry in Ledger account.
 - Recording of one aspect of entry twice.
- Recording in subsidiary book and not posted to concerned amount.

Illustration: 3

Rectify the following errors assuming that the errors were detected

- Before the Preparation of Trial Balance;
- After the preparation of Trial Balance and
- After the preparation of Final Accounts.
 - Purchase Plant for ₹ 10,000 wrongly passed through Purchase Account.
 - Sales Day Book was cast short by ₹ 1,000.
 - Cash paid to Mr. X for ₹ 1,000 was posted to his account as ₹ 100.
 - Purchase goods from Mr. T for ₹ 3,500 was entered in the Purchase Day Book as ₹ 500.
 - Paid salary for ₹ 3,000 wrongly passed through wages account.

Solution:

**In the Books of
Journal (without narration)**

Date	Before preparation of Trial Balance		After preparation of Trial Balance		After preparation of Final Accounts	
	Dr.	Cr.	Dr.	Cr.	Dr.	Cr.
(i)	Plant A/c 10,000		Plant A/c 10,000		Plant A/c 10,000	
	To Purchase A/c.	10,000	To Purchase A/c.	10,000	To P&L Adjustment A/c	10,000
(ii)	Sales account will be credited with ₹ 1,000		Suspense A/c Dr.	1,000	Suspense A/c Dr.	1,000
			To Sales A/c.	1,000	To P&L Adjustment A/c	1,000
(iii)	X Account will be debited when ₹ 900		X A/c Dr.	900	X A/c Dr.	900
			To Suspense A/c.	900	To Suspense A/c	900
(iv)	Purchase A/c Dr.	3,000	Purchase A/c Dr.	3,000	P&L Adjustment A/c Dr.	3,000
	To T A/c	3,000	To T A/c	3,000	To T's A/c.	3,000
(v)	Salary A/c Dr.	3,000	Salary A/c Dr.	3,000	P&L Adjustment A/c. Dr.	3,000
	To Wages A/c	3,000	To wages A/c.	3,000	To P&L Adjustment A/c	3,000

Illustration: 4

A merchant, while balancing his books of accounts notices that the T.B. did not tally. It showed excess credit of ₹ 1,700. He placed the difference to Suspense A/c. Subsequently he noticed the following errors:

- (a) Goods brought from Narayan for ₹ 5,000 were posted to the credit of Narayan's A/c as ₹ 5,500
- (b) An item of ₹ 750 entered in Purchase returns book was posted to the credit of Pandey to whom the goods had been returned.
- (c) Sundry items of furniture sold for ₹ 26,000 were entered in the sales book.
- (d) Discount of ₹ 300 from creditors had been duly entered in creditor's A/c but was not posted to discount A/c. Pass necessary journal entries to rectify these errors. Also show the Suspense A/c

Solution:

(a) Goods bought from Narayan are posted to credit of his A/c as ₹ 5,500 instead of ₹ 5,000. Here, it is correct to credit Narayan's A/c. But the mistake is extra credit of ₹ 500. This is one sided error, as posting to purchases A/c is correctly made. So the rectification entry will affect the suspense A/c. This needs to be reversed by the rectification entry:

Narayan's A/c	Dr.	500
To Suspense A/c		500

(b) Goods bought from Pandey were returned back to him. It should have appeared on the debit side of his A/c. For rectifying we will need to debit his A/c with double the amount i.e. ₹ 1500 (₹ 750 to cancel the wrong credit and another ₹ 750 to give effect for correct debit) and the effect will go to Suspense A/c. The correction entry is:

Pandey A/c	Dr.	1,500
To Suspense A/c		1,500

(c) Sale of furniture was recorded in sales book. What's wrong here? Remember that sales book records sale of goods only and nothing else. Sale of furniture will appear in either cash book (if sold for cash) or journal proper (if



sold on credit). Hence, wrong credit to Sales A/c must be removed and credit should be given to Furniture A/c. It's important to note that this rectification entry will not affect the Suspense A/c. The correction entry is:

Sales A/c	Dr	26,000	
			26,000
		To Furniture A/c	

(d) The discount received from creditor is not entered in discount A/c but was correctly recorded in creditors' A/c. This is one sided error and will therefore be routed through suspense for correction. A discount is received; it must be credited being an income.

Suspense A/c	Dr	300	
			300
		To Discount received A/c	

Let us now see how suspense A/c will look like. Excess credit of ₹ 1,700 in Trial Balance will be shown on the debit side of suspense A/c. This will bring in total debit equal to total credit.

Dr				Suspense Account				Cr	
Date	Particulars	J. F.	Amount ₹	Date	Particulars	J. F.	Amount ₹		
	To Balance b/d		1,700		By Narayan		500		
	To Discount received		300		By Pandey		1,500		
			2,000				2,000		

Please observe that after correcting passing all rectification entries, the Suspense A/c tallies automatically.

Illustration: 5

Pass necessary journal entries to rectify the following errors:

- (a) An amount of ₹ 200 withdrawn by owner for personal use was debited to trade expenses.
- (b) Purchase of goods of ₹ 300 from Nathan was wrongly entered in sales book.
- (c) A credit sale of ₹ 100 to Santhanam was wrongly passed through purchase book.
- (d) ₹ 150 received from Malhotra was credited to Mehrotra.
- (e) ₹ 375 paid as salary to cashier Dhawan was debited to his personal A/c.
- (f) A bill of ₹ 2,750 for extension of building was debited to building repairs A/c
- (g) Goods of ₹ 500 returned by Akashdeep were taken into stock, but returns were not posted.
- (h) Old furniture sold for ₹ 200 to Sethi was recorded in sales book
- (i) The period end total of sales book was under cast by ₹ 100
- (j) Amount of ₹ 80 received as interest was credited to commission.

Solution:

Sl. No.		Particulars	Debit (₹)	Credit (₹)
(a)	Wrong Entry	Trade Expenses Dr	200	
		To Cash		200
	Correct entry	Drawings Dr	200	
		To cash		200
	Rectification entry	Drawings Dr	200	
		To Trade Expenses		200
(b)	Wrong Entry	Nathan Dr	300	
		To Sales		300
	Correct entry	Purchases Dr	300	
		To Nathan		300
	Rectification entry	Purchases Dr	300	
		Sales Dr	300	
		To Nathan		600

(c)	Wrong Entry	Purchases Dr	100	
		To Santhanam		100
	Correct entry	Santhanam Dr	100	
		To Sales		100
	Rectification entry	Santhanam Dr	200	
		To Sales		100
		To Purchases		100
(d)	Wrong Entry	Cash Dr	150	
		To Mehrotra		150
	Correct entry	Cash Dr	150	
		To Malhotra		150
	Rectification entry	Mehrotra Dr	150	
		To Malhotra		150
(e)	Wrong Entry	Dhawan Dr	375	
		To cash		375
	Correct entry	Salary Dr	375	
		To cash		375
	Rectification entry	Salary Dr	375	
		To Dhawan		375
(f)	Wrong Entry	Building Repairs Dr	2,750	
		To Cash		2,750
	Correct entry	Buildings Dr.	2,750	
		To Cash		2,750
	Rectification entry	Buildings	2,750	
		To Building Repairs		2,750
(g)	Wrong Entry	No entry passed		
	Correct entry	Sales Returns Dr	500	
		To Akashdeep		500
	Rectification entry	Sales Returns Dr	500	
		To Asashdeep		500
(h)	Wrong Entry	Sethi Dr	200	
		To Sales		200
	Correct entry	Sethi Dr	200	
		To Furniture		200
	Rectification entry	Sales Dr	200	
		To Furniture		200
(i)	Wrong Entry	No entry passed		
	Correct entry	Suspense Dr	100	
		To Sales		100
	Rectification entry	Suspense Dr	100	
		To Sales		100
(j)	Wrong Entry	Cash Dr	80	
		To Commission		80



	Correct entry	Cash Dr	80	
		To Interest		80
	Rectification entry	Commission Dr	80	
		To Interest		80

Illustration: 6

Rectify the following error and find out the effect of the errors on Net Profit.

- Purchases of ₹300 from Raman passed through Sales Book
- Bill received from Ramu for ₹500 passed through Bills Payable Book.
- An item of ₹150 relating to Prepaid Rent was omitted to be brought forward from last year.
- ₹400 paid to Mehta B, against our acceptance was debited to Mehta N.
- Received ₹300 from Ajit whose account for ₹300 was written off earlier and posted to the credit of Amit.
- Transistor sold to Karun for ₹750 passed through Sales Book twice.

Solution:

RECTIFYING ENTRIES

	Particulars	L.F.	Dr.(₹)	Cr.(₹)
(i)	Purchase A/c Sales A/c To Raman A/c (Being the amount passed through sales book cancelled and debited to purchases account)	Dr. Dr.	300 300	600
(ii)	Bills Receivable A/c Bills Payable A/c To Ramu's A/c (Being prepaid Insurance omitted to bring into books of accounts earlier, now brought into books of accounts)	Dr. Dr.	500 500	1,000
(iii)	Prepaid Insurance A/c To Suspence A/c (Being prepaid Insurance omitted to bring into books of accounts earlier, now brought into books of accounts)	Dr.	150	150
(iv)	Bills Payable A/c To N. Mehta A/c (Being the amount wrongly debited to N. Mehta cancelled)	Dr.	400	400
(v)	Ajit A/c Amrit a/c To Bad Debts Recovered A/c (Being the amount credited to Ajit account cancelled and credited to bad debts recovered)	Dr. Dr.	300 300	600
(vi)	Sales A/c To Karun A/c (Being wrong credit given to sales account cancelled)	Dr.	750	750

Illustration: 7

Following errors were detected in the Accounts of AA Ram and Sons for the year ended 30th June, 2015:

- A builder's bill for ₹2,700 for the erection of a small shed was debited to repairs account.
- A cheque for ₹300 received from Rahim Bux and Co. was dishonoured and debited to allowances account.
- Goods to the value of ₹150 returned by Chandmal Bros. were included in stock, but no entry was made in the books.
- Repairs to plant amounting to ₹567 had been charged to plant and machinery account
- Wages paid to the firm's own workmen for making certain additions to machinery amounting to ₹550 were posted to wages account.
- A cheque for ₹75 received from Lala Ram was credited to the account of Tika Ram and debited incorrectly to cash account.

- vii) A sum of ₹100 drawn by the proprietor for personal use was debited to travelling expenses account. Give journal entries to correct these errors. Which of these errors, if any, will cause disagreement of the trial balance? Give reasons for your answer.

Solution:

JURNAL ENTRIES

	Particulars		L.F.	Dr.(₹)	Cr.(₹)
(i)	Building A/c To Repairs A/c (Being a builder's bill for the erection of a small shed wrongly debited to Repairs Account, now corrected)	Dr.		2,700	2,700
(ii)	Rahim Bux & Co.A/c To Allowances A/c (Being a cheque received from Rahim Bux & Co. dishonoured was wrongly debited to Allowances Account, now rectified)	Dr.		300	300
iii)	Returns Inwards A/c To Chandmal Bros.A/c (Being goods returned by Chandmal Bros. omitted to be recorded, now recorded)	Dr.		150	150
iv)	Repairs A/c To Plant and Machinery A/c (Being repairs to plant and machinery wrongly debited to Plant and Machinery Account, now corrected)	Dr.		567	567
v)	Plant & Machinery A/c To Wages A/c (Being wages paid for making certain additions to machinery wrongly debited to Wags Account, now rectified)	Dr.		550	550
vi)	a) Tika RamA/c To Lala RamA/c (Being cheque received from Lala Ram wrongly credited to Tika Ram instead of to Lala Ram, now corrected)	Dr.		75	75
	b) Bank A/c To Cash A/c (Being cheque received from Lala Ram wrongly debited to Cash Account instead of to Bank A/c, now rectified)	Dr.		75	75
vii)	Drawings A/c To Travelling Expenses A/c (Being amount drawn by the proprietor wrongly debited to Travelling Expenses account, now corrected)	Dr.		100	100

Illustration: 8

On going through the Trial balance of Ball Bearings Co. Ltd. You find that the debit is in excess by `150. This was credited to "Suspense Account". On a close scrutiny of the books the following mistakes were noticed:

- 1) The totals of debit side of "Expenses Account" have been cast in excess by ₹50
- 2) The "Sales Account" has been totaled in short by ₹100.
- 3) One item of purchase of ₹25 has been posted from the day book to ledger as ₹250.
- 4) The sale return of ₹100 from a party has not been posted to that account through the Party's account has been credited.
- 5) A cheque of ₹500 issued to the Suppliers' account (shown under Trade payables) towards his dues has been wrongly debited to the purchases.



- 6) A credit sale of ₹50 has been credited to the Sales and also to the Trade receivables Account.
- Pass necessary journal entries for correcting the above;
 - Show how they affect the Profits; and
 - Prepare the "Suspense Account" as it would appear in the ledger.

Solution:

JURNAL ENTRIES

Particulars		L.F.	Dr.(₹)	Cr.(₹)
Suspense A/c To Expenses A/c (Being the mistake in totaling of Expenses A/c, rectified)	Dr.		50	50
Suspense A/c To Sales A/c (Being the mistake in totaling of Sales A/c, rectified)	Dr.		100	100
Supplier A/c To Sales A/c (Being the mistake in posting from Day Book to Ledger rectified)	Dr.		225	225
Sales Returns A/c To Suspense A/c (Being the sales return from a party not posted to "Sales Returns" now rectified)	Dr.		100	100
Trade Payable A/c To Purchases A/c (Being the payments made to supplier wrongly posted to purchases now rectified)	Dr.		500	500
Trade Receivables a/c To Suspense A/c (Being the sales wrongly credited to Customer's Account now rectified)	Dr.		100	100

Dr		Suspense Account		Cr	
Particulars	₹	Particulars	₹		
To Expenses A/c	50	By Difference in Trial balance	150		
To Sales A/c	100	By Trade payables	225		
To Balance c/d	425	By Sales Returns A/c	100		
		By Trade Receivables	100		
	575		575		
		By Balance b/d	425		

Since the Suspense Account does not balance, it is clear that all the errors have not been traced. As a result of the above corrections the Net Profit will be:

Particulars	₹	₹
Mistake in totaling in "Expenses"	50	
Mistake in totaling in "Sales"	50	
Mistake in posting from day book to Ledger under "Purchases"	500	
Omission in positing under "Sales Returns"		100
	650	100
Net Increase	550	

As a result of these adjustments, the Profits will be increased by ₹550. The books of accounts of A Co. Ltd. for the

Illustration: 9

The books of accounts of A Co. Ltd. for the year ending 31.3.2015 were closed with a difference in books carried forward. The following errors were detected subsequently:

- Return outward book was under cast by ₹ 100.
- ₹ 1,500 being the total of discount column on the credit side of the cash book was not posted.
- ₹ 6,000 being the cost of purchase of office furniture was debited to Purchase A/c.
- A credit sale of ₹ 760 was wrongly posted as ₹ 670 to the customers A/c. in the sales ledger.
- The Sales A/c. was under casted by ₹10,000 being the carry over mistakes in the sales day book.
- Closing stock was over casted by ₹10,000 being casting error in the schedule or inventory. Pass rectification entries in the next year.

Prepare suspense account and state effect of the errors in determination of net profit of last year.

Solution:

**In the Books of A Co. Ltd.
Journal**

Date 2015	Particulars	L/ F	Amount (₹)	Amount (₹)
(a) Apr1	Suspense A/c Dr.		100	
	To Profit & Loss Adjustment A/c			100
	(Returns outward book was under cast now rectified).			
(b)	Suspense A/c Dr.		1,500	
	To Profit & Loss Adjustment A/c			1,500
	(Discount received was not recorded, now rectified).			
(c)	Office Furniture A/c Dr		6,000	
	To Profit & Loss Adjustment A/c			6,000
	(Office furniture purchased wrongly debited to Purchase A/c. not rectified.)			
(d)	Debtors' A/c Dr.		90	
	To Suspense A/c.			90
	(Debtors account was posted ₹ 670 in place of ₹ 760, now rectified.)			
(e)	Suspense A/c. Dr.		10,000	
	To Profit & Loss Adjustment A/c.			10,000
	(Sales account was under casted, now rectified)			
(f)	Profit & Loss Adjustment A/c. Dr.		10,000	
	To Suspense A/c.			10,000
	(Closing Stock was overcastted, now rectified.)			

Dr.		Suspense Account		Cr.	
Date	Particulars	Amount(₹)	Date	Particulars	Amount(₹)
2015	To Profit & Loss Adj. A/c	100	2015	By Difference in Trial Balance	21,510
Apr.1	" "	1,500	Apr.1	₹ Debtors A/c.	90
	" " "	10,000			
	" " "	10,000			
		21,600			21,600

Particulars	Increase (+) ₹	Decrease (-) ₹
Item (a).....	-	100
(b).....	-	1,500



(c).....	-	6,000
(d) No effect	-	-
(e).....	-	10,000
(f).....	10,000	-
	10,000	17,600
Profit will be decreased by	7,600	-
	17,600	17,600

EXERCISE:

- How will you rectify the following errors discovered before preparation of the trial Balance?
 - ₹1,000 spent for repairs of buildings has been posted to building account
 - A sale of ₹730 to Mohinder Singh has been entered in the Sales Book as ₹370.
 - Goods worth ₹500 purchased from Bankey Lal have been omitted to be recorded in the books.
 - ₹400 paid as salary to a clerk has been debited to his personal account
 - ₹75 discount allowed by a creditor has been debited to Discount account
 - The Total of Sales Book has been added ₹100 too much.
 - Office furniture purchased for ₹1,800 has been passed through the Purchases Book.
- Write out the journal entries to rectify the following errors using a suspense account:
 - The total of discount allowed from the cash book for the month of December 2015 amounting to ₹350 was not posted
 - An amount of ₹175 entered in the sales return book has been posted to the debit of Ram, who had returned the goods.
 - Bad debts aggregating to ₹250 were written off during the year in the sales ledger, but were not adjusted in the general ledger
 - Goods of the value of ₹500 returned to Shyam were entered in the sales day book and posted there from to the credit of his account.
 - A sale of ₹800 made to Mohan was correctly entered in the sales day book but wrongly posted to the debit of Mahesh as ₹80.
- The debit side of the Trial Balance Showed ₹1,000 less than the credit side. The suspense account was debited with ₹1,000. Later on following errors were detected. Prepare suspense account passing the necessary rectification entries without giving narrations:
 - Goods return by a customer ₹300 entered in the customer's account but not entered in the sales returns account.
 - Goods sold to Mahesh on credit for ₹700 was entered in the sales book but not posted to his account.
 - 580 paid by Varsha traders was credited to their account ₹508.
 - ₹260 due from Dinesh was not entered in the schedule of S. Drs.
 - Purchases book was overcast by ₹188.

Ans: Total of suspense Account = ₹1,260

- Following mistakes were located in the books of a concern after its books were closed and a Suspense Account was opened in order to get the Trial Balance agreed:
 - Sales Day Book was overcast by ₹100
 - A sale of ₹50 to X was wrongly debited to the account of Y.
 - General expenses of ₹18 were posted in the general Ledger as ₹80
 - A bill receivable for ₹155 was passed through Bills Payable Book. The bill was given by P.

- v) Legal expenses of ₹119 paid to Mr. Duffry were debited to his personal account
- vi) Cash received from C. Dass has been debited to G. Dass ₹150.
- vii) While carrying forward the total of one page of the purchases book to the next, the amount of ₹1,235 was written as ₹1,325.

Find out the nature and amount of the Suspense Account and pass entries for the rectification of the above errors in the subsequent year's book.

Ans: Suspense Account Cr. Balance = ₹352

Multiple Choice Questions:

1. Whenever errors are noticed in the accounting records, they should be rectified ____
 (a) At the time of preparation of trial balance b) without waiting the accounting year to end (c) After the preparation of final accounts (d) in the next accounting year
2. A trial balance will not tally if __
 (a) correct journal entry is posted twice (b) credit purchase debited to purchases and credited to cash (c) 5000 cash paid to creditors is debited to creditors for 500 and credited to cash as 5000 (d) none of the above
3. Sales of shyam of 500 not recorded in the books would affect __
 (a) shyam's account (b) sales account (c) Sales account and shyam's account (d) cash account
4. Errors of carry forward from one year to another affects __
 (a) personal account (b) real account (c) nominal account (d) both a and b
5. Goods worth ₹272 returned by Lala passed through the books as ₹722. The rectification entry is
 (a) Lala will be debited by ₹450 (b) Lala will be debited by ₹272
 (c) Lala will be credited by ₹722 (d) Lala will be credited by ₹272
6. If a receipt of 200 from rajesh (debor) has not been recorded in the books the profits would show
 (a) An increase of ₹2,000 (b) A decrease of ₹200
 (c) Neither an increase nor a decrease (d) None of the above
7. A credit purchase of ₹950 from sudhir was recorded in purchases book as ₹590. The rectification entry is __
 (a) purchases account will be debited by ₹360 (b) sudhir will be credited by ₹590
 (c) purchases account will be debited by ₹950 (d) sudhir will be credited by ₹950
8. Which of these errors affect only one account
 (a) errors of casting (b) errors of carry forward (c) errors of posting (d) All the three
9. If goods worth ₹1750 returned to supplier is wrongly entered in sales returns book as ₹1570, then __
 (a) net profit will decrease by ₹3140 (b) Gross profit will increase by ₹3320
 (c) gross profit will decrease by ₹3500 (d) Gross profit will decrease by ₹3320
10. Which of the following is one sided error
 (a) ₹500 purchase of old equipment not recorded in the books of account at all
 (b) ₹500 being expense on travelling expense credited to travelling expenses (c) both (d) none
11. Which of the following errors affects the agreement of a trial balance?
 (a) Mistake in balancing an account (b) omitting to record a transaction entirely in the subsidiary books (c) recording of a wrong entry in the subsidiary books
 (d) Posting an entry on the correct side but in the wrong account
12. Which of the these errors affect only one account
 (a) errors of casting (b) errors of carry forward (c) errors of posting (d) All the three
13. Which of these errors affect two or more accounts
 (a) errors of complete omission (b) errors of principle (c) errors of posting to wrong account (d) all the three
14. Which of the following error is an error of principle
 (a) ₹5,000 received from sham credited to Ram A/c.
 (b) ₹5,000 incurred on installation of new plant debited to travelling expenses A/c



- (c) ₹500 paid for wages debited to salary A/c
 (d) ₹500 being purchase of raw material debited to purchase A/c ₹50
15. ₹200 paid as wages for erecting a machine should be debited to
 (a) repair account (b) Machine account (c) capital account (d) furniture account

Ans: 1.b 2.c 3.c 4.d 5.a 6.c 7.a 8.d 9.d 10.b 11.a 12.d 13.d 14.b 15.b

Fill in the blanks:

- Unintentional omission or commission of amounts and accounts in the process of recording transactions are known as ___ (errors.)
- In case trial balance does not agree difference is put to ____ (Suspense account.)
- If an effect of an error is cancelled by the effect of some other error, it is commonly known as ____ (Compensating errors)
- The equality of debts and credits can be tested periodically by preparing a ____ (trial balance).
- It is easy to detect ___ (error) than to ___ (frauds.)
- On purchase of old furniture, the amount spent on its repair should be debited to furniture ___ (account.)
- A credit sale wrongly passed through purchases book will ___ the trial balance. (Affect)
- Goods sold to sethi for ₹640 was recorded in his account as ₹460. In the rectifying entry, sethi's account will be debited with ____ (₹180)
- Casting errors is an error in ____ (totaling.)
- Goods sold to Busy & co on credit, worth ₹4,000 were not recorded in books. The rectification entry is ____ (sales account will be credited.)
- Treating revenue expenses as a capital expenditure is an example of ___ (principle) errors
- The difference in the trial balance is transferred to ____ account. (suspense)
- ₹ 200 received from smith whose account was written off as a bad debt should be credited to ____ (bad debts recovered account)
- ___ amount will be credited in Gopal Account when goods purchased from Gopal for ₹3,600 but way recorded as ₹6,300. (₹3,600)
- Rectified entries to be passed in ____ (journal proper)

True or false:

- Error of commission permit the trial balance to agree (FALSE)
- The discount column of the cash book is not posted is an example of error of omission (TRUE)
- Full omission do not affect trial balance (TRUE)
- An error in wrong casting of the sales day book will not affect the personal account of debtors (TRUE)
- Mistake in balancing an account will affect the agreement of a trial balance (TRUE)
- Total of purchase journal is short by ₹1,000 will not affect trial balance (FALSE)
- Recording a transaction in a wrong book of original entry with wrong amount will affect the trial balance (FALSE)
- Under casting or overcasting of a subsidiary book is an example of error of commission (TRUE)
- The mistake of treating a liability as on income or vice versa will affect the trial balance (FALSE)
- ₹ 500 purchase of old equipment not recorded in the books of account at all is an one sided error (FALSE)

Match the following:

Group A

1. Compensating errors	c	a) Not recording a business transaction
2. Error of omission	a	b) Charging a revenue item to capital
3. Error of principle	b	c) Writing a debit item on the credit side and vice versa.
4. Error of commission	e	d) Error in totaling
5. Error of omission	d	e) Errors which are not disclosed by trial balance

Group B

1. Clerical errors	c	a) If the transaction is recorded partly.
2. Error is made in carry forward	d	b) If the entry is recorded twice.
3. Error of commission	b	c) Errors raised due to negligence, overlook
4. Error of principle	e	d) Errors which are disclosed by trial balance
5. Error of omission	a	e) Errors which are not disclosed by trial balance

1.6 OPENING ENTRIES, TRANSFER ENTRIES, ADJUSTMENT ENTRIES, CLOSING ENTRIES

Opening Entries: The opening entry is an item which is passed in the Journal proper or General Ledger.

The purpose of passing this entry is to record the opening balances of the accounts transferred from the previous year to the New Year. The accounts which are appearing on the assets side of balance sheet are debited in the opening entry while which accounts are appearing in the liabilities side are credited.

At the end of each accounting period, the books of accounts need to be closed for preparation of final accounts. Also, in the beginning of the new accounting period, new books of accounts are to be opened. For this purpose, opening and closing entries need to be passed. These entries are passed in journal proper.

The entry can be given as:

All Asset A/c's	Dr
To All Liabilities A/c	
To Owners' Capital A/cs	

Illustration 31.

Consider the following balances in the Balance Sheet as on 31st March 2014. Pass the opening entry on 1st April 2015.

Subodh's Capital A/c	2,75,000
Loan from HH bank	4,25,000
Plant and machinery	3,30,000
Cash in hand	20,000
Balance at CC bank	1,75,000
Trade Debtors	3,55,000
Closing stock	1,35,000
Trade Payables	2,95,000
Outstanding Expenses	40,000
Prepaid Insurance	20,000

Solution:

The opening entry will be as follows:

Plant and machinery A/c	Dr	3,30,000	
Cash in hand A/c	Dr	20,000	



Balance at CC bank A/c	Dr	1,75,000	
Trade Debtors A/c	Dr	3,55,000	
Closing stock A/c	Dr	1,35,000	
Prepaid Insurance	Dr	20,000	
To Subodh's Capital A/c			2,75,000
To Loan from HH bank A/c			4,25,000
To Trade Payables A/c			2,95,000
To Outstanding Expenses A/c			40,000
(Being Opening entry)			

CLOSING ENTRIES: All the expenses and gains or income related nominal accounts must be closed at the end of the year. In order to close them, they are transferred to either Trading A/c or Profit and Loss A/c. Journal entries required for transferring them to such account is called a 'closing entry'.

The Closing Entries are passed on the basis of trial balance for transferring the balances to Trading and profit and loss A/c. These entries are mainly for:

a) For transferring purchases and direct expenses (goods related) to Trading A/c

Trading A/c	Dr
To Opening stock A/c	
To Purchases A/c	
To Factory expenses A/c	
To Freight & carriage inward A/c	

b) For transferring sales and closing stocks

Sales A/c	Dr
Closing Stock A/c	Dr
To Trading A/c	

c) For transferring gross profit or gross loss to P & L A/c

For Gross Profit

Trading A/c	Dr
To P & L A/c	

For Gross Loss

P & L A/c	Dr
To Trading A/c	

d) For transferring expenses

P & L A/c	Dr
To Respective expense A/c	

e) For transferring Incomes

Respective income A/c's	Dr
To P & L A/c	

f) For transferring Net profit or Net loss

For Net Profit

P & L A/c Dr
To Capital A/c

For Net Loss

Capital A/c Dr
To P & L A/c

Illustration 1

Pass closing entries for the following particulars as on 31st March 2015 presented by X Ltd.

Particulars	Amount (₹)
Opening stock	10,000
Purchases	50,000
Wages	5,000
Returns outward	5,000
Sales	1,00,000
Returns inward	10,000
Salaries	8,000
Insurance	1,000
Bad debts	3,000
Interest received	3,000
Discount allowed	4,000
Discount received	3,000
Closing stock	15,000

Solution:

**In the Books of X Ltd.
Journal**

Dr.	Cr.			
Date 2015 March 31st	Particulars	LF	Amount(₹)	Amount(₹)
	Trading A/c Dr.		75,000	
	To, Opening Stock A/c			10,000
	To, Purchases A/c			50,000
	To, Wages A/c			5,000
	To, Returns inward A/c			10,000
	(Transfer to balances for closing the latter accounts)			
	Sales A/c Dr		1,00,000	
	Returns outward A/c Dr.		5,000	
	Closing Stock A/c Dr.		15,000	
	To, Trading A/c			1,20,000
	(Transfer of balances for closing the former accounts)			
	Trading A/c Dr.		45,000	
	To, Profit and Loss A/c			45,000



	(Gross profit transferred)			
	Profit and Loss A/c Dr.		16,000	
	To, Salaries A/c			8,000
	To, Insurance A/c			1,000
	To, Bad Debts A/c			3,000
	To, Discount allowed A/c			4,000
	(Transfer of balances for closing the latter accounts)			
	Interest received A/c Dr.		3,000	
	Discount received A/c Dr.		3,000	
	To, Profit and Loss A/c			6,000
	(Transfer of balances for closing the former accounts)			
	Profit and Loss A/c Dr.		35,000	
	To, Capital A/c			35,000
	(Net profit transferred to Capital A/c)			

Transfer Entries: When it is necessary for an amount or balance of one account to be transferred to some other account, it is done by means of a transfer journal entry in the Journal Proper.

i.e., Amount withdrawn from Capital

Capital A/c Dr.
 To, Drawings A/c

Illustration 2

Following Balances appeared in the books of Patnayak on 31st March, 2014. Pass the necessary opening entry for 2014-15:

Credit balances: Capital ₹30,000; Bills Payable ₹5,000; Creditors ₹10,000

Debit balances: Furniture ₹4,000; Machinery ₹18,000; Debtors ₹12,000; B/R ₹9,000; Cash ₹2,000

SOLUTION:

OPENING ENTRY IN THE BOOKS OF PATNAYAK

Date	Particulars	L.F.	Dr. Amount ₹	Cr. Amount ₹
2012 Apr. 1	Furniture A/c Dr		4,000	
	Machinery A/c Dr		18,000	
	Debtors A/c Dr		12,000	
	Bills Receivable A/c Dr.		9,000	
	Cash A/c Dr.		2,000	
	To Capital A/c			30,000
	To Bills Payable A/c			5,000
	To Creditors A/c			10,000
	(Being opening entry)			
			45,000	45,000

ADJUSTMENT ENTRIES

Under accrual basis of accounting, incomes are recognized when these are earned and not when cash is actually received. Similarly, expenses are recognized when these are incurred and not when actual payments are made. This means at the end of the accounting year, there may be certain incomes earned but not received (i.e., accrued income) and incomes received but not earned (i.e. income received in advance). Similarly, there may be certain



To opening stock

By this entry, the opening stock account is closed and it has the effect of increasing the amount of purchases.

(ii) Closing stock AccountDr.

To purchases

This entry (ii) reduces the amount of purchases and opens a new account i.e. closing stock account. This closing stock account then appears in the trial balance. In such a case, closing stock will not appear in the trading account because purchases figure appearing in the trial balance stands adjusted for stocks and is called Adjusted purchases. This Adjusted purchases appear in the trading account and the closing stock will appear only in the balance sheet assets side.

2. Outstanding expenses:

These are the expenses like wages, salaries, rent etc. which have been incurred but not paid at the end of the year. For example, wages of ₹4,000 which have become due on 31st March but not paid in the financial year, is termed as outstanding wages. The adjustment entry is:

Wages AccountDr. 4,000	
To Wages outstanding Account		4,000

It will be added in wages shown in the trading Account and will also be shown as a liability in the balance sheet.

3. Prepaid or unexpired expenses

These are the expenses which are paid in the current accounting year but the benefit of this is to be received in the next accounting year. For example, insurance premium of ₹6,000 for one year is paid on 1st Jan. and the accounting year closes on 31st March. This means insurance premium for nine months i.e. for April 1st to Dec..., 31st amounting to ₹4,500 has been paid in advance i.e., prepaid. The adjustment entry is:

Prepaid Insurance AccountDr. 4,500	
To Insurance Account		4,500

As a result of this, ₹4,500 will be deducted from insurance premium of ₹6,000 in the Profit and Loss Account. It will also be shown as an asset in the Balance sheet at ₹4,500 as prepaid (or unexpired) Insurance Premium Account.

4. Accrued Income:

(Income earned but not received). This is the income which is earned during the current accounting year but is not received during that year. It may relate to incomes like rent, commission, interest etc. For example, if a business has purchased 8% Government Bonds of ₹ 1,00,000 on which interest is payable on 30th June and 31st Dec., then for the accounting year ending on 31st March, interest for three months i.e. Jan, Feb and March amounting to ₹2,000 will be taken as accrued interest because this amount has become due on 31st March but will be payable on 30th June. The following adjustment entry will be passed on 31st March.

Accrued Interest AccountDr. 2,000	
To Interest Account		2,000

Accrued interest will be shown on the credit side of profit and loss account and also on the assets side of the balance sheet.

5. Income Received in Advance:

(unearned Income): This is the income which has been received in the current year but against which services will be provided in the next accounting year. For example, rent of building let out has been received in advance for one year on 1st Jan. @ ₹5,000 per month i.e., ₹60,000. If accounting year ends on 31st March, then rent for 9 months i.e., from April 1 to Dec. 31 amounting to ₹45,000 has been received in advance. On 31st March, the adjustment entry to be passed is as follows:

Rent Received AccountDr. 4,5000	
To Rent Received in Advance Account		45,000

In the profit and Loss Account, this rent received in advance will be deducted from rent received on the credit side

and in the balance sheet rent received in advance will be shown as a liability.

6. Depreciation on Fixed Asset:

Depreciation has been discussed in detail in a separate chapter. The following entry is passed for depreciation:

Depreciation Account Dr.
 To Fixed Asset Account

Depreciation amount is shown as an expense on the debit side of the Profit and Loss Account and in the Balance Sheet, depreciation amount is deducted from the fixed asset.

7. Bad Debts:

When a business sell goods on credit basis, some of the customers may fail to pay. Bad debts represent that amount which is lost due to non-recovery from credit customers. In other words, losses on account of non-recoverable debts are called bad debts. Adjustment entry for recording bad debts is as under:

Bad debts Account Dr.
 To Debtors Account

In the Profit and Loss Account, bad debts is shown on the debit side and in the Balance Sheet, the amount of bad debts is deducted from debtors. When bad debts appear in the Trial Balance, it will be shown only in Profit and Loss Account as an expenses.

Sometimes bad debts written off are recovered in the subsequent accounting year. In such a case, the recovered amount is credited to Bad Debts Recovered Account and then shown in the credit side of Profit and Loss Account as this represents a gain.

8. Provision for Bad (and Doubtful) Debts:

As matter of principle, all bad debts should be debited to Profit and Loss account of the year in which the related credit sales take place. But this is very difficult because the actual writing off bad debts will be in some subsequent year. In order to ensure proper matching of revenues and expenses and calculate the true profit, it is necessary that a provision for the likely amount of bad debts is made at the end of the accounting year. Such a provision is to be created on the balance of debtors account as a fixed percentage which may be based on the past experience. The following journal entry is passed for creating a provision of bad and doubtful debts.

Profit and Loss Account Dr.
 To Provision for Bad (and Doubtful) Debts Account

This provision for bad debts is debited to Profit and Loss Account and in the Balance sheet, it is deducted from debtors.

Illustration 3

The following items appear in the Trial Balance as on 31st March, 2015.

	Dr. ₹	Cr. ₹
Sundry debtors	42,000	
Bad debts	3,500	

Adjustments:

1. After the trial balance was prepared, it was found that a debtor Z will not be able to pay ₹ 2,000 because of his insolvency.
2. Create 6% provision for bad debts.

Pass the necessary adjustment entries in journal and show how these would appear in the profit and loss Account and Balance sheet as on 31st March, 2015.

**Solution:**

Adjustment Entries

Date	Particulars	Dr. ₹	Cr. ₹
1	Bad debts AccountsDr To Z (Debtor) (Being the amount due for z became irrecoverable)	2,000	2,000
2	Profit and Loss AccountDr. To Provision for bad debts Account (Being 6% provision for bad debts on ₹ 40,000 i.e., 42,000-2,000)	2,400	2,400

Profit and loss Account
For the year ending 31st March, 2015

Particulars			Particulars	₹
To Bad debts (as given in trial balance)	3,500			
Add: Additional bad debts	2,000			
Add: provision for bad debts	2,400	7,900		

Balance Sheet
As on 31st March, 2015

Liabilities	₹	Assets		₹
		Sundry debtors	42,000	
		Less: Additional Bad debts	2,000	
			40,000	
		Less: provision for Bad debts	2,400	37,600

The provision for bad debts created is carried forward to the next accounting years. The bad debts that will arise in the next year will be met out of this provision. In other words, bad debts when written off will be debited to provision for bad debts where such a provision exists.

Illustration: 4

The following extracts from the trial balance as on 31st March, 2015 are given

Particulars	Dr. ₹	Cr. ₹
Sundry debtors	42,000	
Bad debts	3,500	
Provision for bad debts		3,800

Adjustments:

1. Additional bad debts ₹ 2,000
2. Maintain the provision for bad debts at 10% of debtors.

Show the relevant entries in the profit and Loss Account and Balance Sheet as on 31st March, 2015.

Solution:

Profit and Loss Account
For the year ending 31st March, 2015

Particulars		₹	Particulars	₹
To bad debts (as given in trial balance)	3,500			
Add: Additional bad debts	2,000			
	5,500			
Add: provision for bad Debts (New)	4,000			
	9,500			
Less: old provision for bad debts	3,800	5,700		

Balance Sheet as on 31st March 2015

Liabilities	₹	Assets		₹
		Sundry debtors	42,000	
		Less: bad debts	2,000	
			40,000	
		Less: New provision	4,000	36,000

Important Points:

- When bad debts are given as an adjustment outside the trial balance, then such an amount of bad debts is deducted from debtors (as given in the trial balance) and the provision for bad debts is calculated on the balance amount of debtors.
- Provision for bad debts account in the beginning of the year appears in the trial balance on the credit side. But the amount of bad debts in the trial balance appears on the debit side.

9. Provision for discount on debtors:

This provision is created for allowing discount to debtors to encourage prompt payments. The amount of this provision is calculated after deducting bad debts and provision for bad debts from the debtors.

Illustration 5

Debtors as per trial balance ₹ 31,000

Adjustments: Provide ₹1,000 for bad debts, Create 5% provision for bad debts and 2% provision for discount on debtors. Pass Journal entry for provision for discount on debtors and show how it will appear in the balance sheet.

Solution:

Debtors after providing for bad debts	=	₹ 31,000 - 1,000 = ₹30,000
Provision for bad debts	=	₹30,000 × 5% = ₹1,500.
Balance amount of debtors	=	₹30,000 - 1,500 = ₹ 28,500
Provision for discount on debtors	=	₹ 28,500 × 2% = ₹ 570

The following adjustment entry will be passed

Profit and Loss Account	...Dr.	570
To Provision for Discount on Debtors Account		

This amount of ₹ 570 appears on this debit side of Profit and Loss Account and in the Balance Sheet it is deducted from debtors as shown below:



Balance Sheet as on.....

Liabilities	₹	Assets	₹
		Debtors	31,000
		Less: Bad debts	<u>1,000</u>
			30,000
		Less: provision for	
		Bad debts	<u>1,500</u>
			28,500
		Less: provision for	
		Discount on debtors	<u>570</u>
			27,930

10. Provision for discount on creditors:

Similar to provision for discount on debtors, a firm may create provision for discount on creditors. For this the following adjustment entry is passed:

Provision for Discount on Creditors AccountDr.
To Profit and Loss Account

This provision appears on the credit side of the Profit and Loss Account and in the balance sheet it is deducted from creditors.

It is important to note that creating a provision for discount on creditors is against the accounting principle of conservatism. However, it is an accepted accounting practice.

11. Interest on Capital:

Sometimes interest on capital of proprietor or partners is to be provided and treated as business expense. For this, the following adjustment entry is passed.

Interest on Capital AccountDr.
To Capital A/c (of proprietor or partners)

This entry will have the effect of increasing the balance in capital account by the amount of interest as it appears in the balance sheet. In the Profit and Loss Account, interest on capital appears on the debit side as an expense.

12. Interest on drawings:

Drawings means the cash or goods withdrawn by the owner for his personal use. Sometimes, interest on such drawings is charged and treated as business income. For charging interest, the following entry is passed:

Capital A/c (of proprietor)
To Interest on drawings A/c

Interest on drawings is shown on the credit side of Profit and Loss Account and in the Balance Sheet it is deducted from the Capital Account of the proprietor or partner.

13. Interest on loan or deposit when rate of interest is given:

Sometimes, the trial balance includes Loan Account (Cr. Side) or Deposit Account (Dr. side) carrying a specific rate of interest. In such a case, one should check in the trial balance that interest at the rate given is shown as an expense or income, as the case may be. In case interest account does not appear, it means the entire interest should be treated as outstanding, even if problem is silent in this regard. If interest item appears in the trial balance, it should be checked that the interest is for the full period. In case, it is less, the remaining part should be treated as outstanding and if it is for more than, say 12 months the difference should be treated as prepaid. For example, trial balance shows the following:

	Dr. (₹)	Cr. (₹)
Loan @ 10% p.a.	-	60,000
Interest on loan (paid during the year)	4,500	-

Total interest for the full year is $60,000 \times 10\% = ₹6,000$. However, only ₹4,500 has been paid. The remaining ₹1,500 is due for payment at the end of the year i.e. it is outstanding. In the Profit and Loss Account and Balance Sheet it will appear as follows:

Profit and Loss Account

Dr.		Cr.
	₹	₹
To Interest on loan 4,500		
Add: outstanding 1,500		
	6,000	

Balance Sheet

	₹	₹
Loan 60,000		
Add: interest outstanding 1,500		
	61,500	

In case interest is on deposit or investment, it will appear in the credit side of P&L Account and in the assets side of balance sheet.

14. Manager's Commission:

Sometimes, the manager is entitled to a commission on profits at a fixed percentage. Such commission is calculated as follows:

(i) Commission on profits before charging such commission:

In such a case, commission is calculated as follows:

$$\text{Profit before commission} \times \frac{\text{Rate of Commission}}{100}$$

Suppose, profit before commission is ₹1,00,000 and commission is payable at 5%, then the amount of commission will be: ₹1,00,000 x 5% = ₹ 5,000.

Profit after commission will be ₹1,00,000 – 5,000 = 95,000

(ii) Commission on profits after charging such commission:

In this case, commission is calculated by the following formula:

$$\text{Profit before commission} \times \frac{\text{Rate of Commission}}{100 + \text{Rate of Commission}}$$

In the above example, commission will be:

$$\text{Rs. } 1,00,000 \times \frac{5}{100} = \text{Rs. } 4,762 \text{ (Approx.)}$$

Profit after commission will be ₹1,00,000 – 4,762 = ₹ 95,238

The following entry is passed (with the amount of commission):

Profit and Loss Account Dr.
 To Commission Outstanding Account

Commission payable is shown as an expense in Profit and Loss Account and in the balance sheet on the liability side.



15. Drawing of goods by proprietor for personal use:

When the proprietor takes away some goods from the business for his personal use, it should be treated as drawings and entered in his personal account. The adjustment entry is:

Drawing or Capital A/cDr.
 To Purchases A/c

As the goods are recorded at cost price, the amount is deducted from purchases in the trading account. It is also added in drawings account or deducted from capital in the balance sheet liabilities side.

16. Goods on sale or approval:

When the goods are sold subject to approval of the customer, there is a possibility that such goods are not approved and returned. In case such goods sold on approval basis are lying with the customers at the close of the accounting year but not yet returned, these should be treated as stock lying with customers. The following entries are passed.

1. Sales Account Dr
 To Debtors Account
 (This entry is at selling price of goods)
2. Stock Account Dr
 To Trading Account
 (This entry is at cost price)

How to show it in the final accounts

1. In the trading Account, it is deducted from sales at sale price and it is added in the closing stock at cost price.
2. In the balance sheet, it is deducted from debtors at sale price and added in closing stock at cost price.

Illustration 6

Pass the necessary entries to make the following adjustment as on 31st Dec. 2015

1. Stock on 31st Dec. 2015 was ₹ 12,000.
2. Depreciation at 10% on furniture valued at ₹ 4,500 and machinery valued at ₹ 50,000.
3. Interest accrued on securities ₹ 650.
4. Bad debts during the year amounted to ₹ 450.
5. Unexpired insurance as on 31st Dec. 2015 was ₹ 290.
6. Salaries outstanding on 31st Dec., 2015 were ₹ 600.
7. Make provision for discount on debtors and creditors @ 2.5%. The debtors and creditors at the end of the year were ₹ 35,000 and ₹ 24,000.

Solution:

Sl. No.	Particular	₹	₹
1	Stock AccountDr. To Trading Account (being the value of closing stock)	12,000	12,000
2	Depreciation Account Dr. To Furniture Account To Machinery Account (Being depreciation at 10% on furniture and machinery for the year)	5,450	450 5,000
3	Interest Accrued AccountDr. To Interest Account (being interest accrued on securities brought in to account)	650	650

Sl. No.	Particular	₹	₹
4	Bad debts AccountDr. To Debtors Account (being loss on account of non-recovery of debts debited to bad debts account)	450	450
5	Unexpired or prepaid Insurance Account .. Dr. To Insurance Account (Being the amount of the unexpired insurance as on the date of the balance sheet)	290	290
6	Salaries Account To Salaries outstanding Account (Being the amount of outstanding salaries brought into account)	600	600
7(a)	Profit and Loss AccountDr. To Provision for discount on debtors Account (Being provision made for discount on debtors @ 2.5%)	875	875
7(b)	Provision for discount of creditors Account... Dr. To Profit and Loss Account (Being provision made for discount on creditors @ 2.5)	600	600

17. Goods distributed as free samples:

When in order to promote sale of goods, free samples of goods are distributed to potential customers, the cost of free samples is charged to advertisement account. This will also reduce the stock of finished goods. In the final accounts, it is recorded as follows:

- In the Trading Account, cost of free samples is deducted from purchases.
- In the Profit and Loss Account, it is shown as Advertisement Expenses on the debit side.

The entry to record this adjustment is:

Advertisement Account Dr.
To Purchases Account

18. Loss of stock by fire, theft etc.

When some goods are lost by fire or theft etc., it is treated as abnormal loss. Such abnormal loss is recorded by the following entry:

Profit and Loss AccountDr.
To Trading Account

(It is recorded in Trading Account credit side and in the Profit and Loss Account on the debit side.)

When stock is insured. If the stock lost is insured, then the loss is fully or partly met by the insurance company. For example, if the loss is ₹ 35,000 and is fully recoverable from the insurance company, the journal entry will be:

Insurance Co. Account Dr. 35,000
To Trading Account 35,000

It will be shown on the credit side of Trading Account and on the assets side of the balance sheet as insurance claim. If loss of stock is partly accepted by insurance company, the journal entry will be (suppose, out of loss of ₹ 35,000 claim is accepted for only 25,000):

Insurance Co. Account Dr. 25,000
Profit and Loss Account Dr. 10,000
To Trading Account 35,000



In the trading Account credit side, it will show the full value of stock and in the profit and loss account debit side that part of loss which is not insured. That part of claim which is accepted by insurance company, it is shown on the assets side of the balance sheet.

1.7 BANK RECONCILIATION STATEMENTS

When an individual or a firm deposits any money into a bank or withdraw money by issuing a cheque from a bank, he/it records the transaction in the debit-side of the bank columns of the Cash Book for such deposits and credit side of the bank column of the Cash book for such withdrawals.

On the other hand, bank also records such transactions in its book i.e. credit such account for deposits and debit such account for any withdrawals. The Bank issues a book to the account holder after recording such transactions. The book which is prepared by the bank for accountholder is known as Pass Book. In case of Current Account, the bank issues Statements and not a Pass Book.

The statement is known as Bank Statement.

A Specimen of a Pass Book is presented below:

UNION BANK OF INDIA
NEW ALIPORE
A/c No. : 104922
Name: Mrs. Mathew

SAVINGS BANK ACCOUNT PASS BOOK

Date	Particulars	Cheque No.	Withdrawals (₹)	Deposits (₹)	Balance (₹)	Initials
20.03.15	Balance b/f	-	-		14,078.00	-
22.03.15	To CLG	210850	2,000.00		12,078.00	
23.03.15	To Self	210853	11,500.00		578.00	
24.03.15	By CLG			1,000.00	1,578.00	
28.03.15	To CLG	210854	700.00		878.00	
29.03.15	By Cash			1,000.00	1,878.00	
30.03.15	To CLG	210855	600.00		1,278.00	

Definition

A statement which is prepared to reconcile the causes of difference between Bank Balance as per Cash Book and Bank Balance as per Pass Book/ Bank Statement is known as a Bank Reconciliation Statement.

Features of a Bank Reconciliation statement

1. It is a statement.
2. It is not a part of the process of Accounts
3. It is prepared to reconcile the causes of difference between the Bank balance as per Cash Book and the Bank balance as per Pass Book
4. It can be prepared at any time during the financial year, as and when it is required.
5. Since it is prepared on a particular date, it is written as Bank Reconciliation statement as at/as on.....

It is necessary for a beginner to understand the mechanism of how to prepare the Bank Reconciliation statement. The first milestone on this journey is to understand the various reasons for differences between the two records.

Reasons for Differences between Cash Book and Pass Book

The differences are basically of two types:

- A. Items appear in Cash Book but not appearing in Pass Book and
- B. Items appear in Pass Book but not appearing in the Cash Book

Let us understand these reasons:

(A) Items not appearing in Bank Pass Book

(1) Cheques issued by business entity not debited by the Bank –

This may be because they might not have been Banked by the payee or it may still be under clearance. The entry in Cash Book will be made immediately when the cheque is issued thereby reducing the Bank balance in the books of entity's books of A/cs. Here, Bank balance as per Cash Book will be less, but as per Bank Pass Book it will be more. This is also termed as unrepresented cheques.

(2) Cheques deposited but not credited by the Bank –

The business entity may receive cheques or draft which is deposited into the Bank for collecting the payment. Again entry in Cash Book will be instant thereby increasing the balance. Here, Bank balance as per Cash Book will be more than the balance as per Bank passbook. This is also called as outstanding cheques.

(3) Errors –

The Bank may by mistake miss out entering the debit or credit which results in the difference.

(4) Standing Instructions –

The entity may give standing instruction to the Bank for certain regular payments like loan repayment installment, transfer of funds etc. This may get entered in the Cash Book immediately, but Pass Book entry may be delayed.

(B) Items not appearing in the Cash Book

(1) Bank interest, Bank charges etc. –

The Bank will charge interest on overdraft or also charges for services, issue of demand draft, pay orders etc. Here, being the source of transaction, the Bank will record in the Pass Book immediately and send the debit advice slips to the business entity. The entry in the Cash Book may be delayed. Similarly the Bank could credit interest on fixed deposits, which may get entered in business books at a later date.

2) Direct deposits in Bank account –

Sometimes customers or others may directly deposit an amount in the Bank for goods or services rendered. The Bank will enter it immediately, but entry in Cash Book will appear later.

(3) Bills for collection –

The Business Entity may send bills of exchange for collection. The Bank will collect the payment and credit the same in the passbook. The entry in Cash Book will be made only after receipt of information from the Bank.

(4) Errors – The records may be missed out by the book-keeper of the Business Entity.

Need of Bank Reconciliation Statement

1. It helps to understand the actual Bank balance.
2. It helps to identify the mistakes in the Cash Book and the Pass Book.
3. It helps to detect and prevent frauds and errors in recording the Banking transactions.
4. It helps to incorporate certain expenditures/income debited/credited by Bank in the books of accounts.

Methods of preparation of Bank Reconciliation Statement



1. Rules of Addition and Subtraction
2. Debit and Credit Method.

Steps in Preparing Bank Reconciliation Statement

One has to have a systematic approach towards preparation of the reconciliation. To avoid a lengthy reconciliation, one must ensure that the entries in the Cash Book are absolutely online. One also must obtain the Bank statements at regular intervals.

Once this checking is done, Bank reconciliation could be done by following these steps:

- (a) Identify the balances and the character thereof. Remember, a debit balance in Cash Book means asset where as a credit balance means a Bank overdraft. In Bank passbook, it's reverse. A debit balance in Pass Book means overdraft and a credit balance is a favourable balance. This must be carefully understood.
- (b) Based on the above, start with the balance (or overdraft) as per one book and arrive at the balance (or overdraft) as per the other book. The items of differences will be added to or deducted from the balance (or overdraft) with which the reconciliation is started.
- (c) The end result should be the balance (or overdraft) as per the other book e. g. if you start with balance as per Cash Book, then after adding or deducting items of differences, you should arrive at the balance (or overdraft) as per the Pass Book.
- (d) One has to make sure that all the items of differences from Cash Book as well as Bank book are taken into account in the reconciliation statement.
- (e) Whether the items of differences should be added or deducted will depend on the sequence you follow. This is shown in following table

When reconciliation is started with	Bal. as per CB	OD as per CB	Bal. as per PB	OD as per PB
Cheques deposited in Bank, but not cleared	Less	Add	Add	Less
Cheques issued, but not presented in Bank	Add	Less	Less	Add
Interest debited in PB only	Less	Add	Less	Add
Payments by Bank debited in PB only	Less	Add	Add	less
Direct payment by customer in PB only	Add	Less	Less	add
Bills discounted & dishonoured in PB only	Less	Add	Add	Less
Cheques deposited, dishonoured in PB only	Less	Add	Add	Less
Interest, Dividend, Commission collected by Bank not recorded in the Cash Book	Add	Less	Less	Add
Overcasting of payment side of Cash Book or Undercasting of Receipt side of Cash Book	Add	Less	Less	Add
Undercasting of Payment side of Cash Book or overcasting of Receipts side of Cash Book	Less	Add	Add	Less
Deposits recorded twice in the Cash Book or excess amount recorded in the Cash Book	Less	Add	Add	Less
Undercasting of credit side of the Pass Book or overcasting of the debit side of the Pass Book	Less	Add	Add	Less
Cheques deposited into Bank and credited without recording in the Cash Book	Add	Less	Less	Add
Wrong debit in the Pass Book for issue of cheque, Bank charges, etc.	Less	Add	Add	Less
Wrong credit in the Pass Book for deposit of cheque, interest, etc.	Add	Less	less	add
Cheques drawn but not actually issued to the suppliers/ creditors	Add	Less	Less	Add
Bank charges recorded twice in the Cash Book	Add	LESS	LESS	Add

Amount withdrawn from Bank not recorded in the Cash Book	Less	Add	Add	less
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Illustration 1.

On 31.12.14, P. Roy's Bank Balance as shown by the Cash Book was ₹ 75,000. On receipt of Bank Statement it was found that:

- (i) Three cheques of ₹3,000, ₹4,000 and ₹1,500 drawn in favour of suppliers respectively on 28th, 29th and 30th December, 2014 had been debited in the Bank Statement on 2nd January 2015.
- (ii) The Bank had credited ₹8,000 on 30th December, 2014, in respect of collection made by Bank directly from a customer, the intimation not having yet been received.
- (iii) Two cheques of ₹5,000 and ₹6,000 were deposited into Bank on 30th December, 2014 had been credited in the Bank statement on 4th January, 2015.
- (iv) The Bank had debited ₹30 as incidental charges on 30th December, 2014 but not entered in the Cash Book.

Show the reconciliation of the Bank Balance as per Cash Book with the Bank Balance as per Bank Statement as on 31st December, 2014.

Solution:

Bank Reconciliation Statement of Mr. P. Roy as on 31st December, 2014.

Particulars	Amount (₹)	Amount (₹)
Bank Balance as per Cash Book (Dr.)		75,000
Add:		
(i) Cheques issued but not presented for payment ₹3,000, ₹4,000 & ₹1,500 respectively.	8,500	
(ii) Collection by Bank from a Customer not recorded in the Cash Book	8,000	16,500
		91,500
Less:		
(i) Cheques deposited but not credited in the Pass Book on 31.12.14 ₹5,000 + ₹6,000 respectively.	11,000	
(ii) Bank charges not recorded in the C.B.	30	11,030
Balance as per Pass Book (Cr.)		80,470

Illustration 2

On 31-12-2015 your pass book showed a credit balance of ₹5,000. Before that date you had issued cheques worth ₹1,000 of which cheques worth ₹300 were not yet cashed. On 26th December, you deposited a cheque for ₹150 in the bank but you did not enter it in cash book. The pass book showed a credit of ₹40 for interest and a debit of ₹10 for bank charges and the cash book had not corresponding entries for them. A cheque for ₹1,200 deposited in your account No.2 was wrongly credited by the bank to this account. Dishonoured bill was debited in the pass book only ₹500. Cheques for ₹700 paid in to the bank were not yet credited in the pass book.

A wrong debit of ₹100 appears in the pass book. A cheque of ₹150 received from a customer was entered in the cash book in December, 2015 but the same was omitted to be paid in to the bank.

Determine the balance as per cash book as on that date.

Bank reconciliation statement as on 31-12-2015

	₹	₹
Credit Balance as per pass book		5,000
Add:	10	



(1) Bank charges not recorded in cash book	500	
(2) Dishonoured bill debited only in pass book	700	
(3) Cheques paid in to bank but not yet credited in pass book	100	
(4) Wrong debit in the pass book	150	1,460
(5) Cheque received but not presented with the bank		
		6,460
Less:		
(1) Cheques issued but not yet encashed (`1,000 – `700)	300	
(2) Cheque deposited but not recorded in cash book	150	
(3) Interest not recorded in cash book	40	
(4) A wrong credit appears only in pass book	1,200	
		1,690
Balance as per Cash Book (Dr.)		4,770

Illustration 3

The Bank Pass Book of Mr. Anil showed an overdraft of ₹6,000 on 31.12.2015. Prepare the Bank Reconciliation Statement based on the following details:

- (1) Cheques issued but not presented upto 31.12.2015, ₹5,500
- (2) Cheques deposited but not credited upto 31.12.2015, ₹9,000
- (3) Bank commission ₹30 was entered only in the Pass Book.
- (4) A cheque for ₹6,500 issued in settlement of a debt was encashed on 28.12.2015 but entered in the Cash Book as ₹8,500.

Solution:

Mr. Anil Bank Reconciliation Statement as on 31st December, 2015

Particulars	Amount (₹)	Amount (₹)
Overdraft as per Pass Book		6,000
Add:		
(i) Cheques issued but not presented for payment	5,500	
(ii) Cheque for `6,500 issued and encashed but entered in the Cash Book at `8,500 (8,500 - 6,500)		
2,000		
7,500		
		13,500
Less:		
(i) Cheques deposited but not credited	9,000	
(ii) Bank commission entered in the Pass Book only Overdraft as per Cash Book	30	9,030
Over Draft as per Cash Book (Cr.)		4,470

Illustration 4

From the following particulars of M/s Suresh enterprises, prepare a Bank reconciliation statement:

- (1) Bank overdraft as per Pass Book as on 31st March 2015 was ₹8,800
- (2) Cheques deposited in Bank for ₹5,800 but only ₹2,000 were cleared till 31st March
- (3) Cheques issued were ₹2,500, ₹3,800 and ₹2,000 during the month. The cheque of ₹5,800 is still with supplier.
- (4) Dividend collected by Bank ₹1,250 was wrongly entered as ₹1,520 in Cash Book.
- (5) Amount transferred from fixed deposit A/c into the current A/c ₹2,000 appeared only in Pass Book
- (6) Interest on overdraft ₹930 was debited by Bank in Pass Book and the information was received only on 3rd April 2015.

- (7) Direct deposit by M/s Rajesh Traders ₹400 not entered in Cash Book.
 (8) Corporation tax ₹1,200 paid by Bank as per standing instruction appears in PB onl

Solution:

Bank Reconciliation Statement as on 31st March, 2015

Particulars	Amount (₹)	Amount (₹)
Overdraft as per Pass Book		8,800
Add:		
(i) Cheques issued but not presented till 31st March	5,800	
(ii) Transfer from fixed deposit	2,000	
(iii) Direct deposit by M/s Rajesh Traders	400	8,200
		17,000
Less:		
(i) Cheques deposited but not cleared ₹(5,800 - 2,000)	3,800	
(ii) Dividend collected excess recorded in CB ₹ (1,520 - 1,250)	270	
(iii) Interest on overdraft debited in PB only	930	
(iv) Corporation tax paid appeared in PB only	1,200	6,200
Overdraft as per Cash Book		10,800

Amendment in Cash Book

Sometimes, in order to find out the correct balance at Bank or cash to amend the Cash Book before the preparation of Bank Reconciliation statement. In short, Bank Reconciliation Statement should be prepared by taking the balance shown by the amended Cash Book. The students should remember that usually two types of transactions are recorded in amended Cash Book i.e., (i) Items which were not at all recorded in Cash Book. (ii) Any error made by Cash Book. The transactions which are already recorded in Cash Book i.e., the rest of the transactions will go to Bank reconciliation statement.

But it must be remembered that preparation of amended Cash Book is possible only when the balance as per Cash Book is given.

Steps to be followed for preparation:

- Open the cash with the Balance as per Cash Book, whether favourable or unfavourable,
- Against the items (i.e., which are not recorded in Cash Book as any other error made by Cash Book.)
- Close the Cash Book and find out the balance,
- Prepare Bank Reconciliation Statement by taking the Cash Book balance and rest of the transaction which are not adjusted against amended Cash Book.

Illustration 5

The Bank Column of the Cash Book showed an Overdraft of ₹5,000 on 31.3.2015, whereas per Bank Statement the overdraft is ₹4,200. The following differences were noticed between the two records:

- Cheques of ₹2,400 issued but not encashed by customers
- Cheques deposited but not cleared ₹1,200
- Collection charges debited by Bank not recorded in CB ₹100
- Bank interest charged by the Bank not recorded in CB ₹ 300
- Cheques dishonoured debited by Bank not in CB ₹400
- Interest directly received by Bank not entered in CB ₹400

Prepare Bank reconciliation statement after amending the CB.

Solution:

Here, please note that amended CB is asked. What it actually means is to record all revenue (expense or income)



items of differences and those items that are recorded in PB only must first be recorded in the CB and then the reconciliation statement should be prepared by taking the revised balance as per CB. Here is the amended CB.

Cash Book (Bank column only)

Dr.		Cr.	
Particulars	Amount (₹)	Particulars	Amount (₹)
To Interest received	400	By Balance b/d (OD)	5,000
		By collection charges	100
		By Bank interest	300
To Balance c/d (OD)	5,400	By customer (chq dishonoured)	400
	5,800		5,800

Bank reconciliation statement as on 31-03-2015

Particulars	₹
Bank OD as per CB	5,400
Add: Cheques deposited, but not cleared	1,200
Less: cheques issued but not encashed	(2,400)
Bank OD as per PB	4,200

Illustration 6

The following is a summary from Cash Book of M/s Adarsh Trading for the month of Sept 2015

	₹		₹
Balance b/d	1,407	Payments	15,520
Receipts	15,073	Balance c/d	960
	16,480		16,480

On investigation it was found that

- Bank charges of ₹35 were not entered in the Cash Book
- A cheque of ₹47 issued to supplier was entered by mistake as a receipt in the Cash Book.
- A cheque of ₹18 was returned by the Bank marked as 'refer to drawer' but it's not entered in Cash Book.
- The balance brought forward in Sept 2015 should have been ₹1,470.
- Cheques paid to suppliers ₹214, ₹370 and ₹30 have not been presented for payment.
- Deposits of ₹1542 on 30th Sept were cleared by the Bank on 2nd October.
- The Bank charged a cheque wrongly to Adarsh trading ₹72.
- Bank statement shows overdraft of ₹124 as on 30th Sept 2015.

Show what adjustments will you make in the Cash Book and prepare a Bank reconciliation statement as on 30-09-2015.

Solution:

As we know, the errors in the Cash Book must first be corrected and entries that have been missed out in the CB

should be recorded.

Cash Book for Sept 2015

Dr.		Cr.	
Particulars	Amount (₹)	Particulars	Amount (₹)
To Original balance b/d	960	By Bank charges not recorded earlier	35
To Error in balance carried (1,470 - 1,407)	63	By Cheques issued recorded as receipt Now corrected (2×47)	94
		By Cheque returned	18
		By Revised balance c/d	876
	1,023		1,023

Now we can prepare the Bank reconciliation statement.

Bank Reconciliation from member as on 30.9.2015

Particulars	Amount (₹)	Amount (₹)
Balance as per Cash Book		876
Add: Cheques issued but not presented (214 + 370 + 30)		614
		1,490
Less: (i) Deposits not cleared	1542	
(ii) Cheques charged by mistake	72	1,614
Overdraft as per Pass Book		(124)

EXERCISE:

1. The Bank statement of Mr. J. White dated 31.12.2015 showed a balance with his Bank of ₹924, when checked with his Cash Book the following were noted:
 - (a) During December, the Bank had paid ₹200 for a yearly contribution of Mr. White, made to a local charity, as per his standing order. This amount appeared in the Bank statement but not in the Cash Book.
 - (b) The Bank had credited his account with ₹28 interest and had collected on his behalf ₹230 as dividends. No corresponding entries were made in the Cash Book.
 - (c) A cheque of ₹65 deposited into the Bank on 28.12.2015 was not cleared by the Bank till after 31.12.2015.
 - (d) A cheque of ₹150 deposited into and cleared by the Bank before 31.12.2015 was not entered in the Cash Book, through an oversight.
 - (e) Cheques drawn by and posted to parties by Mr. White on 31.12.2015 for ₹73, ₹119 and ₹46 were presented for payment to the Bank only on 3.1.2016.

Ans: Bank Balance as per Cash Book (Dr.) ₹543

2. Mr. Suresh request you to ascertain the Bank balance as per the Pass Book for January 2015, as his cash clerk reported a figure of ₹11,515 (credit) as on 31.1.2015. Scrutiny revealed the following discrepancies:
 - (i) Cheques issued and deposited by the cash clerk in January 2015, were ₹15,000 and ₹7,000 respectively. However, against the above, the Bank had paid out and debited cheques worth ₹9,000 only and cleared and credited cheques worth ₹4,000 only, by 31.1.2015.
 - (ii) A customer had paid in ₹6,400 directly into Suresh's Bank account, the effect of which was missing in the Cash Book
 - (iii) Bank commission of ₹45 charged and interest earned ₹1,400 on investments of Mr. Suresh, where only recorded in the Pass Book.
 - (iv) Total cash withdrawals of ₹3,000 by self and bearer cheques for office use, were recorded erroneously as ₹5,000 in the Cash Book.



Ans: Bank Balance as per Pass Book (Cr.) ₹1,240

3. Based on the following information prepare a Bank Reconciliation statement as on 31st December 2015 and find the balance as per pass book:
- Bank overdraft as per cash book on 31-12-2015 ₹6,340.
 - Interest on overdraft for 6 months ending 31-12-2015 ₹160 is entered in pass book.
 - Bank charges amounted to ₹30 for the above periods were entered in the pass book.
 - Cheques issued but not presented upto 31-12-2015 amounted to ₹1168
 - Cheques sent for collection to the bank but not collected up to 31-12-2015 amounted ₹2,170.
 - Interest on investments collected by the bank and entered in the pass book ₹1200.

Ans: Over Draft Balance as per Pass Book (Dr.) ₹6,332

4. The following is a summary from Cash Book of M/s Adarsh Trading for the month of Sept 2015:

Particulars	₹	Particulars	₹
Balance b/d Receipts	1,407	Payments	15,520
	15,073	Balance c/d	960
	16,480		16,480

On investigation it was found that:

- Bank charges of ₹ 35 were not entered in the cash book
- A cheques of ₹ 47 issued to supplier was entered by mistake as a receipt in the cash book.
- A cheques of ₹18 was returned by the bank marked as 'refer to drawer' but it's not entered in cash book
- The balance brought forward in Sept 2014 should have been ₹1470
- Cheques paid to suppliers ₹214, ₹ 370 and ₹ 30 have not been presented for payment.
- Deposits of ₹1542 on 30th Sept were cleared by the bank on 2nd October.
- The bank charged a cheque wrongly to Adarsh trading ₹ 72
- Bank statement shows overdraft of ₹124 as on 30th Sept 2015.

Show what adjustments will you make in the cash book and prepare a bank reconciliation statement as on 30-09-2015.

Ans: Revised Cash Book Balance (Dr.) ₹876

5. From the following extracts of Cash Book (Bank column only) and bank statement prepare a Bank Reconciliation Statement as at 30th April, 2015.

Cash Book

2015	Particulars	₹	2015	Particulars	₹
Apr. 1	To Balanced b/f	4,500	Apr. 1	By Salaries	2,400
2	To R.Rudra	450	3	By J Roy	720
5	To G.Saha	1,220	5	By Drawings	240
7	To A.Medda	2,400	7	By Khanna & CO.	940
12	To Ghose Bros.	970	10	By A.JaLil	670
14	To H.Raha & Co.	3,780	13	By Furniture	450
17	To S.Chand	870	19	By S.Manna	1,560
20	To A.Rana	640	20	By Nandi Bros.	800

24	To P.Sur	1,360*	23	By R.Chowdhury	570
27	To C.Munsi	480*	26	By F.Ahmed	1,400
30	To B.Haldar	590*	28	By P.Guha	320*
			30	By H.Bhatta	500*
			30	By Balance c/f	6,690
		17,260			17,260

PASS BOOK

Date	Particulars	Deposit	Withdrawal	Balance	Debit	Credit
2015						
May 1	Balance b/d					6,480
1	P.Sur	1,360*				
3	D.Singh		450			
4	F.Ahmed		1,400*			
4	Dividend	200				
5	C.Munis	480*				
	Exchange on C.Munisi's draft		2			
6	K Nagarajan	700				
	P.Guha		320*			
7	B.Haldar	590*				
	H.Bhatta		500*			

Multiple Choice Questions:

- When preparing a bank reconciliation statement, if you start with debit balance as per cash book cheques sent to bank but not collected should be
 (a) Added (b) Deducted (c) Not required to be adjusted (d) None
- Balance as per adjusted cash book ₹274. Cheques not yet presented ₹730. Cheques deposited not yet recorded by bank ₹477 balance as per pass book will be
 (a) ₹528 (b) ₹527 (c) ₹500 (d) none
- A debit balance in the depositor's cash book will be shown as
 (a) A debit balance on the bank statement (b) A credit balance on the bank statement
 (c) An overdrawn balance on bank statement (d) none of the above
- Which of these types of errors are not detected during bank reconciliation?
 (a) Cash embezzlement by the cashier (b) cheque deposited but not credited by bank
 (c) Casting mistakes in bank column of cash book
 (d) Interest or commission charged by the bank but not accounted for in cash book.
- Which of these documents is not required for bank reconciliation
 (a) bank column of cash book (b) bank pass book (c) bank statement (d) trial balance
- From the following details ascertain the adjusted bank balance as per cash book – overdraft as per cash book ₹80,000; cheque received entered twice in the cash book ₹5,000; credit side of bank column cast short by ₹500; bank charges amounting to ₹200 entered twice; cheque issued but dishonoured ₹2,000.
 (a) ₹80,500 (b) ₹85,500 (c) ₹85,000 (d) ₹85,300
- Which of these items are taken in to consideration for preparation of adjusted cash book
 (a) Mistake in cash book (b) mistake in pass book



- (c) Cheque issued but not presented for payment (d) cheques deposited but not cleared
8. When overdraft as per cash book is the starting point, a cheque of ₹500 deposited in to bank but not recorded in cash book will be:
(a) Added by ₹500 (b) deducted by ₹500 (c) added by ₹1000 (d) deducted by ₹1000
9. Bank has directly paid ₹1250 for rent as per standing instructions. In BRS starting with pass book overdraft
(a) ₹1250 will be added to pass book overdraft (b) ₹2500 will be added to pass book overdraft
(c) This amount will be ignored (d) ₹1250 will be deducted from pass book overdraft.
10. When credit balance as per pass book is the starting point bank charges are –
(a) Subtracted (b) Added (c) Neither of the two (d) None
11. The bank reconciliation statement is prepared
(a) to rectify the mistakes in the cash book (b) to arrive at the bank balance
(c) to arrive at the cash balance (d) to bring out the reasons for the difference between the balance as per cash book and the balance as per bank statement
12. Benefits of preparing bank reconciliation statement includes –
(a) it brings out any errors committed in preparation of cash book/ bank pass book
(b) highlights under delay in clearance of cheques deposited but not credited
(c) Help known actual bank balance (d) all the three
13. Debit balance as per bank pass book mean –
(a) surplus cash (b) bank overdraft (c) Terms deposits with bank (d) none of these
14. Debit side of bank pass book corresponds to –
(a) credit side of cash (b) debit side of cash book (c) debit side of trial balance
(d) credit side of balance sheet
15. Difference in bank balance as per pass book and cash book may arise on account of
(a) Cheque issued but not presented (b) cheque issued but dishonored
(c) cheque deposited and credited by bank (d) All of (a) and (b) above

Answers:

- 1.(b) 2.(b) 3.(b) 4.(a) 5.(d) 6.(d) 7.(a) 8.(b) 9.(d) 10.(b) 11.(d) 12.(d) 13.(b) 14.(a)
15.(d)

Fill in the blanks:

- (1) Bank reconciliation statement is a part of ___(cash book)
- (2) The debit side of the pass book was under-cast by ₹7,000. In the BRS, starting with cash book balance ___ (₹7,000 will be added to cash book balance.)
- (3) Unfavorable balance as per bank pass book means which of___(bank overdraft and debit balance in pass book.)
- (4) Overdraft as per cash book means ___(credit balance in bank column of the cash book.)
- (5) ___(Business enterprises) prepares bank reconciliation statement.
- (6) Bank balance shown in trial balance ___ (as per cash book)
- (7) A debit balance in the depositor's cash book will be shown as ___ (A credit balance on the bank statement)
- (8) The total of payment side of cash book is ₹700 short. If bank reconciliation statement is started with pass book over drafts balance then : ___(₹700 will be less.)
- (9) While preparing bank reconciliation statement from debit balance of cash book cheques paid into bank but not yet cleared are ___(deducted.)
- (10) Cheque of ₹6,250 deposited on 8.4.2015, realized on 14.4.2015. In the BRS as on 30.4.2015, starting with cash book balance, this item will be___ (ignored.)
- (11) Credit balance in the cash book means ___ (bank overdraft.)

- (12) When balance as per pass book is the starting point interest allowed by bank ____ (subtracted)
 (13) A bank reconciliation statement is prepared by ____ (the bank account holder)
 (14) Debit balance as per bank pass book means ____ (bank overdraft)
 (15) When debit balance as per cash book is the starting point unrepresented cheques are ____ (added)

True or False:

1. A credit balance in the pass book indicates excess of deposits over withdrawals (TRUE)
2. A bank reconciliation statement is a part of pass book (FALSE)
3. Bank charges increase debit balance as per bank pass book (TRUE)
4. Bank pass book is also known as bank statement (TRUE)
5. Reserve bank of India prepares bank reconciliation statement (FALSE)
6. Bank overdraft as per cash book means debit balance (FALSE)
7. The balance of cash book shows cash in hand (TRUE)
8. Cheque deposited and cleared on the same date will not affect bank and cash balance (TRUE)
9. Trial balance document is required for bank reconciliation (FALSE)
10. In arriving at adjusted cash balance errors in the pass book is not taken into account (TRUE)

Match the following:

GROUP-A

1. When cash book favourable balance given cheques issued but not yet presented for payment	c	(a) Credit side of pass book
2. Overcasting bank column of cash book will require adjustment of	d	(b) Is overdraft as per cash book
3. Credit balance in the bank column of the cash book	b	(c) Added
4. Debit balance of cash book is equal to	a	(d) Cash book
5. Cash book is prepared by	e	(e) Accountant

GROUP-B

1. Bank has directly paid ₹1250 for rent as per standing instructions. In BRS starting with pass book overdraft	c	(a) Subtracted
2. A debtor has directly deposited ₹350 in the bank Account. In BRS starting with pass book overdraft	e	(b) Memorandum statement
3. When favourable balance as per cash book is the starting point, wrong debit by the bank to the firm Will be	a	(c) ₹1250 will be deducted from pass book overdraft
4. Bank reconciliation statement is a	b	(d) Credit side of cash book
5. Debit balance of pass book is equal to	d	(e) ₹350 will be added to pass book overdraft



Study Note: 2

Accounting for Special Transactions

THIS STUDY NOTE INCLUDES:

2.1 Bills of Exchange

2.2 Consignment (cost price, invoice price, commission & valuation of stock)

2.3 Joint Venture

2.1 BILLS OF EXCHANGE

Introduction

In India, the Negotiable Instruments Act 1881 governs the provisions for bills of exchange. As per this act, the bill of exchange is defined as "an instrument in writing containing an unconditional order signed by the maker, directing a certain person to pay a certain some of money only to the order of the certain person or to the bearer of the instrument"

Advantages:

- Proof of debt.
- Easily transferred.
- Safely transferred.

Based on this definition the following features of a bill of exchange are noticed:

- (a) It's an instrument in writing;
- (b) It contains an unconditional order;
- (c) It's signed by the maker;
- (d) It's drawn on a specific person ;
- (e) There is an order to pay a specific sum of money;
- (f) It must be dated and stamp;
- (g) It must bear revenue stamp;

Stamp	Address of Drawer
	Date
Three months after date pay to a sum of ₹ 50,000 (Fifty Thousands only) for the value received.	
To B accepted	
(B's signature & stamp)	A (Drawer)

Specimen of a bill of exchange:

Parties to Bill of Exchange

The parties involved in transaction that uses bill of exchange as a mode of settlement are:

- (a) **Drawer:** He is a person who draws the bill. Typically, he is the seller or a creditor.
- (b) **Drawee:** He is the person on whom the bill is drawn. Normally, he is the buyer or debtor. He has to pay the

amount of the bill to the drawer on the due date.

- (c) **Payee:** He is the person to whom the amount of bill is payable. He may be the drawer himself or the creditor of the drawer.
- (d) **Endorser:** Person who transfers rights of payment.
- (e) **Endorsee:** He is the person in whose favour the bill is endorsed by the drawer. He is usually the creditor of the drawer.
- (f) **Bearer:** Person in possession of bearer bill.

Dishonour of Bill

Dishonour of a Bill means that the acceptor refuses to honour his commitment on due date and for this, payment of the bill on presentation does not take place. To provide a legal evidence of dishonour, the fact of dishonour is to be noted on the bill by 'Notary Public'. The fact of dishonour which he is recording is called 'noting' and the amount charged by him for his services are called 'noting charges'. These charges are to be paid by the holder of the bill on the date of default. Actually the acceptor of the bill is liable for the dishonour, the noting charges paid by the holder are to be reimbursed by the acceptor.

The Journal Entries for dishonor of a bill are as follows:

(a) When bill is retain till due date:

Books of Drawer	Books of Acceptor
Acceptor A/c Dr. To Bills Receivable A/c To Cash A/c (Acceptor account is debited with the amount of the bill and the amount of noting charges paid in cash).	Bills Payable A/c Dr. Noting Charges A/c Dr. To Drawer A/c (Drawer account is credited with the amount of the bill and the amount of the noting charges to be reimbursed through the drawer).

Discounting of Bills

If the holder of a bill receivable cannot wait till the date of maturity of the bill and needs cash before the date due, then he can get the bill discounted from the bank. At the time of discounting it, the bank pays cash after deducting the discount from the value of the bill. The discount which is to be deducted depends upon the rate of interest and the remaining period of the bill and is calculated as follows.

$$\text{Discount} = \text{Amount of the bill} \times \text{Remaining period to maturity} \times \text{Rate of interest}$$

Discount is an expense for the holder receiving the payment and gain to the bank. Journal Entries in the books of drawer and drawee at the time of discounting and payment on due date are as under:

Books of Drawer	Books of Drawee
1. At the time of cash received from Bank on discounting of bills: Bank(or Cash) A/c Dr. Discount A/c Dr. To Bills Receivable A/c (For bills, discounted from bank)	Discounting of bill: No entry is passed in the books of Drawee for discounting of the bill.
2. Payment of bill by drawee to Bank on due date: No entry is passed in the books of the drawer because the bill is duly honoured by the drawee.	Payment of the bill on due date : Bills Payable A/c Dr. To, Cash (or Bank) A/c (For payment of the bill to bank)



3. Transfer of discount to Profit and Loss Account: Profit & Loss A/c To Discount A/c Dr.	No entry
--	----------

Tenure, Days of Grace and Date of Maturity or Due Date of Bills:

Tenure

The bill is payable at sight, on demand after sight, after date etc. The period between the date of drawing of the bill and the period it becomes due is called Tenure of the Bill.

Days of Grace

In case the bill is payable on demand, it becomes due immediately on presentation for payment. In the same way if the bill is not payable on demand becomes due on the third day from the date of maturity. These three days are called Days of Grace. For example, if a bill is drawn on 1.4.2015 for 4 months, the due date or date of maturity will be 4.8.2015. The same can be computed as under:

Example

Date of Drawing	1.4.2015
Add: Period/Tenure	4 months
1.8.2015	
Add: Days of Grace	3
Due Date / Date of Maturity	4.8.2015

Date of Maturity

Date of Maturity is also known as Due Date. The date on which the amount of the bill becomes payable is called 'Due Date' or 'Date of Maturity'. To compute due date, three days (called Grace Period) are included to the date of maturity of the period of the bill.

The date of maturity of the period of bills depends on whether (a) the bill is payable on date or bill is payable on sight. If the bill is payable on date, the date of maturity is computed by including tenure of bill to the making of the bill.

Date of maturity can be understood with the help of the following example:

Date of Drawing	12.12.2013
Tenure	<u>+3 Months</u>
	<u>12.03.2014</u>

Types of Bills of Exchange

(a) **Trade bill:** This bill is drawn to settle a trade transaction.

(b) **Accommodation bill:** This bill is used without a trade transaction and is for mutual benefit.

If Mr. X is in need of money, he draws a bill on his friend Mr. Y who accepts it. This bill is then discounted with bank (bank will pay money before due date) and the money is shared between X and Y. On the due date, Y will pay to the bank and X will pay Y his share. Law generally does not recognise such bills.

Accounting Treatment

Let us see what accounting entries are passed in the books of the drawer, drawee and the endorsee. These entries may be thoroughly understood. Here entries only regarding bill transactions are listed. The trade transaction that precedes the bill of exchange will be accounted for in the usual manner, hence the entries are not given here.

(a) When the drawer retains the bill till maturity**(b)**

Situations	Drawer's books	Drawee's books	Endorsee's books
Drawing of a bill	B/R A/c Dr. To, Drawee A/c	Drawer A/c Dr. To, B/P A/c	Not applicable
Payment on due date	Bank A/c / Cash A/c Dr. To, B/R A/c	B/P A/c Dr. To, Bank A/c/ Cash A/c	Not applicable
Dishonoured on due date	Drawee A/c Dr. To, B/R A/c To, Bank A/c/Cash A/c (for noting charges)	B/P A/c Dr. Noting Charges A/c Dr. To, Drawer A/c	Not applicable

(b) When the drawer discounts the bill with bank before maturity

Situations	Drawer's books	Drawee's books
Drawing of a bill	B/R A/c Dr. To, Drawee A/c	Drawer A/c Dr. To, B/P A/c
Discounting with bank	Bank A/c Dr. Discount A/c Dr. To, B/R A/c	No Entry
Payment due date	No Entry	B/P A/c Dr. To, Bank A/c
Dishonoured on due date	Drawee A/c Dr. To, Bank A/c (bill + noting charges)	B/P A/c Dr. Noting Charges A/c Dr. To, Drawer A/c

Treatment of Discount in the Books of the Bank

The following entries are recorded in the books of the bank:

(a) When the bill is discounted:

Bill Discounted A/c Dr.
To, Customer's Current A/c
To, Discounting on Bill A/c

(b) When amount is received from the drawee:

Cash A/c Dr.
To, Bills Discounted A/c

(c) When the drawer endorses the bill to a person before maturity

Situations	Drawer's books	Drawee's books	Endorsee's books
Drawing of a bill	B/R A/c Dr. To, Drawee A/c	Drawer A/c Dr. To, B/P A/c	Not applicable
Endorsement	Endorsee A/c Dr. To, B/R A/c	No Entry	B/R A/c/cash A/c Dr. To Drawer A/c
Payment on due date	No Entry	B/P A/c Dr. To, Bank A/c/cash	Bank A/c Dr. To, B/R A/c
Dishonoured on due date	Drawee A/c Dr. To, Endorsee A/c (bill + noting charges)	B/P A/c Dr. Noting Charges A/c Dr. To, Drawer A/c	Drawer A/c Dr. To, B/R A/c To, Bank A/c (noting charges)



(a) **When the drawer sends the bill to bank for collection before maturity**

Situations	Drawer's books	Drawee's books
Drawing of a bill	B/R A/c Dr. To, Drawee A/c	Drawer A/c Dr. To, B/P A/c
Sending for collection	Bill for Collection Dr. To, B/R A/c	No Entry
Payment on due date	Bank A/c Dr. Collection Charges A/c Dr. To, Bill for Collection	B/P A/c Dr. To, Bank A/c
Dishonoured on due date	Drawee A/c Dr. To, Bill for Collection A/c To, Bank A/c (bill & noting charges)	B/P A/c Dr. Noting Charges A/c Dr. To, Drawer A/c

Retiring a Bill under Rebate:

Sometimes the acceptor of the bill desires to make its payment before its due date, he will do so if he is given some rebate or discount by the holder of the bill on earlier payment. This rebate is like discount and is calculated at agreed rate for the period between the date of earlier payment and the due date of the bill. Thus, if a bill is paid before its due date and some rebate or discount is allowed by the holder to the acceptor, it is said to be retired under rebate. The following are the accounting entries in connection with retiring a bill under rebate:

Entries in Holder's Books:

Cash A/c Dr.
Rebate or Discount A/c Dr.
To Bills Receivable A/c

(Being bill retired under rebate, rebate given for the unexpired period of bill debited being loss to the holder)

Entries in Acceptor's Books:

Bills Payable Account Dr.
To Cash A/c
To Rebate or Discount A/c

(Being bill retired under rebate, rebate granted for the unexpired period credited being gain to the acceptor)

Renewal of Bills

Sometimes the drawee of a bill is not able to meet the bill on due date. He may request the drawer to draw a new Bill for the amount due. Sometimes he pays a certain amount out and accepts a first bill for the balance for which he has to pay a certain amount of interest which is either paid in cash or is included with the fresh bill. This bill is known as Renewal of Bills. That, the amount of the new bill will be face value of the original bill minus cash payment, if any, plus interest for the renewed period.

Entries in the books of Drawer and Drawee are shown below:

Transactions	Entries in the books of Drawer	Entries in the books of Drawee
(a) For dishonor of Bills	Usual entry	Bills Payable A/c Dr. To Drawer A/c
(b) For interest on renewed period	Drawee A/c Dr. To, Interest A/c	Interest A/c Dr. To Drawer A/c
(c) If interest is paid in Cash	Cash A/c Dr. To Interest A/c	Interest A/c Dr. To Cash A/c
(d) For fresh Bill	Bills Receivable A/c Dr. To Drawee A/c	Drawer A/c Dr. To Bills Payable A/c

Illustration 1

Mohan sold goods to Sohan for ₹50,000. On 1st Jan 2015, Mohan drew a bill for three months on Sohan who accepted the same. Pass necessary journal entries in the books of Mohan and Sohan in following situations:

- The bill is retained by Mohan till 31st March and Sohan paid it on that day upon presentation.
- Bill is discounted with the bank and the bank pays ₹ 49,000 to Mohan. Sohan paid the bill on due date.
- Mohan endorsed the bill to Rohan (his creditor) in settlement of his claim for ₹ 51,000. The bill is settled on the due date.
- Mohan sent the bill to the bank for collection on due date. The bank collected bill amount and after deducting collection charges of ₹100 paid the balance to Mohan.

Solution:

Entries in the books of Mohan

(a) Bill is retained by Mohan:

	Particulars	L.F.	Dr. (₹)	Cr. (₹)
On getting Sohan's acceptance	B/R A/c Dr. To, Sohan's A/c (Being the bill accepted by Sohan)		50,000	50,000
On payment on 31-03-15	Bank A/c / cash A/c Dr. To, B/R A/c (Being the payment received against the B/R)		50,000	50,000

(b) Bill is discounted by Mohan:

	Particulars	L.F.	Dr. (₹)	Cr. (₹)
On getting Sohan's acceptance	B/R A/c Dr. To, Sohan's A/c (Being the bill accepted by Sohan)		50,000	50,000
On discounting 31-03-15	Bank A/c Dr. Discount A/c To B/R A/c (Being bill discounted with bank)		49,000 1,000	50,000

On the date of maturity, as the bill is settled by Sohan to bank, there will be no entry in Mohan's books.

(c) Bill is endorsed to Rohan by Mohan:

	Particulars	L.F.	Dr. (₹)	Cr. (₹)
On getting Sohan's acceptance	B/R A/c Dr. To, Sohan's A/c (Being the bill accepted by Sohan)		50,000	50,000
On endorsement 31-03-15	Rohan A/c Dr. To, B/R A/c To discount (Being bill endorsed and discount received from Rohan in full settlement))		51,000	50,000 1,000



(d) Bill is sent for collection to bank by Mohan:

	Particulars	L.F.	Dr. (₹)	Cr. (₹)
On getting Sohan's acceptance	B/R A/c Dr. To, Sohan's A/c (Being the bill accepted by Sohan)		50,000	50,000
On sending bill of collection	Bill for Collection A/c Dr. To, B/R A/c (being bill sent to bank for collection)		50,000	50,000
On payment on due date	Bank A/c Dr. Collection Charges A/c Dr. To, Bills for Collection A/c (being payment received on bill collected).		49,900 100	50,000

Entries in the books of Sohan

In all four situations, since the bill was honoured, the entries will be same as below.

	Particulars	L.F.	Dr. (₹)	Cr. (₹)
On acceptance of bill drawn by Mohan	Mohan's A/c Dr. To, B/P A/c (Being the bill of Mohan accepted)		50,000	50,000
On payment on due date	B/P A/c Dr. To, Bank A/c / cash (Being payment of bill)		50,000	50,000

Illustration 2

Sunil owed Anil ₹ 80,000. Anil draws a bill on Sunil for that amount for 3 months on 1st April 2015. Sunil accepts it and returns it to Anil. On 15th April 2015, Anil discounts it with CD Bank at a discount of 12% p.a. On the due date the bill was dishonoured, the bank paid noting charges of ₹100. Anil settles the bank's claim along with noting charges in cash. Sunil accepted another bill for 3 months for the amount due plus interest of ₹ 3,000 on 1st July 2015. Before the new bill became due, Sunil retires the bill with a rebate of ₹ 500. Show journal entries in books of Anil.

Solution

Date	Particulars	L.F.	Dr. (₹)	Cr. (₹)
2015 April 1	Bills Receivables A/c Dr. To Sunil's A/c (Being acceptance by Sunil)		80,000	80,000
2015 April 15	Bank A/c Dr. Discount A/c Dr. To, Bills Receivables A/c (Being discounting of the bill @ 12% p.a. & discounting charges for 2.5 months)		78,000 2,000	80,000
2015 June 30	Sunil's A/c Dr. To, Bank A/c (Being dishonour of the bill & noting charges paid by bank)		80,100	80,100
2015 June 30	Bank A/c Dr. To, Cash A/c (Being cash paid to bank)		80,100	80,100

2015 July 1	Sunil's A/c To, Interest A/c (Being interest due from Sunil)	Dr.		3,000	3,000
2015 July 1	Bills Receivables A/c Dr. To, Sunil's A/c (Being new acceptance by Sunil for ₹80,100 & interest of ₹3,000)			83,100	83,100
2015 July 1	Bank A/c Rebate A/c To, Bills Receivables A/c (Being the amount received on retirement of the bill)	Dr. Dr.		82,600 500	83,100

Illustration 3

On 1st April 2015 Mr. Bala draws a bill of ₹ 1,20,000 on Mr. Lala for the amount due for 4 months. On getting acceptance, on 5th April 2015, Bala endorses it to Mr. Kala in full settlement of his claim of ₹ 1,40,000 by paying the difference in cash. Lala approached Bala on 25th July saying that he needed to renew the bill for a further period of 4 months at an interest of 12% p.a. which Bala accepted. A fresh bill including interest was accepted by Lala on 1st August 2015. Bala settled his liability to Kala by cheque. This was duly settled on the due date. Pass journal entries in the books of Bala and Lala. Also show Bills Receivables Account and Bills Payable Account.

Solution:

Date	Particulars	L.F.	Dr. (₹)	Cr. (₹)
2015 April 1	Bills Receivables A/c Dr. To Mr. Lala's A/c (Being acceptance by Lal)		1,20,000	1,20,000
2015 April 15	Kala's A/c To Cash A/c To, Bills Receivables A/c (Being bill endorsed to Kala & cash payment made to him)		1,40,000	20,000 1,20,000
2015 July 25	Lala's A/c Dr. To, Kala's A/c (Being cancellation of bill for renewal)		1,20,000	1,20,000
2015 July 25	Lala's A/c Dr. To, Interest A/c (Being interest due from Lala)		4,800	4,800
2015 July 25	Kala's A/c Dr. To, Bank A/c (Being claim of Mr. Kala settled)		1,20,000	1,20,000
2015 August 1	Bills Receivables A/c Dr. To Lala's A/c (Being acceptance by Lala with interest) of ₹ 3,000)		1,24,800	1,24,800
2015 November 30	Bank A/c Dr. To Bills Receivables A/c (Being payment received on due date)		1,24,800	1,24,800



Bills Receivable Account

Dr. Cr.

Date	Particulars	Amount (₹)	Date	Particulars	Amount (₹)
1-Apr-15	To Lala A/c	1,20,000	5-Apr-15	By Kala A/c	1,20,000
	To Lala A/c	1,24,800	30-Nov-15	By Bank A/c	1,24,800
1-Aug-15		2,44,800			2,44,800

Journal entries in the Books of Lala

Date	Particulars	L.F.	Dr. (₹)	Cr. (₹)
2015 April 1	Bala's A/c Dr. To Bills Payable A/c (Being acceptance of Bala's bill)		1,20,000	1,20,000
2015 July, 25	Bills Payable A/c Dr. To Bala's A/c (Being cancellation of the bill for renewal)		1,20,000	1,20,000
2015 August 1	Interest A/c Dr. To Bala's A/c (being interest due to Bala)		4,800	4,800
2015 August, 1	Bala's A/c Dr. To Bills Payable A/c (Being Bala's bill accepted with interest)		1,24,800	1,24,800
2015 Nov. 30	Bills Payable A/c Dr. To Bank A/c (Being settlement of the bill due)		1,24,800	1,24,800

Bills Payable Account

Dr. Cr.

Date	Particulars	Amount (₹)	Date	Particulars	Amount (₹)
2015 July, 25	To Bala A/c	1,20,000	2015 April, 1	By Bala A/c	1,20,000
2015 Nov. 30	To Bank A/c	1,24,800	2015 August, 1	By Bala A/c	1,24,800
		2,44,800			2,44,800

Illustration 4

On 1st January, 2015, P draws three months bill of exchange for ₹30,000 on his debtor, Q who accepts it on the same date. P discounts the bill on 4th January, 2015 with his bankers, the discount rate being 6% p.a. On the due date, the bill is dishonored, the noting charges being ₹200. Q immediately makes an offer to P to pay him ₹ 10,000 cash on account and to settle the balance by agreeing to accept one bill of exchange for ₹ 12,000 at one month and the other for the balance at three months, the latter including at 12% p.a. for both the bills. P accepts the arrangement. The bill for ₹ 12,000 is met on the due date, but the other bill is dishonored. Show Q's Account and Bills Receivable Account in the books of P.

Solution:

**In the books of P
Q's Account**

Dr.			Cr.		
Date	Particular	Amount (₹)	Date	Particulars	Amount (₹)
2015 Jan 1	To, Balance b/d	30,000	2015 Jan 1	By ,Bills Receivable A/c	30,000
Apr 4	To, Bank A/c (dishonor +noting charge)	30,200	Apr 4	By, Bank A/c	10,000
Apr 4	To, Interest A/c	366	Apr 4	By ,Bills Receivable A/c	12,000
July 7	To, Bills Receivable A/c	8,566		By, Bills Receivable A/c (8,200+366)	8,566
			July 7	By, Balance c/d	8,566
		69,132			69,132
July 8	To, Balance b/d	8,566			

Bills Receivable Account

Dr.			Cr.		
Date	Particular	Amount (₹)	Date	Particulars	Amount (₹)
2015 Jan 1	To Q' A/c	30,000	2015 Jan 4	By, Bank A/c	29,550
Apr 4	To Q' A/c	12,000		By, Discount A/c (30,000 x 6/100 x 3/12)	450
	To Q' A/c	8,566	May 7	By, Bank A/c	12,000
			July 7	By, Q' A/c	8,566
		50,666			50,666

Calculation of Interest

On ₹ 12,000 for 1 month @ 12%: $(12,000 \times 12\% \times 1/12)$ = ₹120
 On ₹ 8,200 for 3 month @ 12%: $(8,200 \times 12\% \times 3/12)$ = ₹246
₹366

Illustration 5

X bought goods from Y for ₹4,000. Y draws a bill on 1.1.2015 for 3 months which was accepted by X for this purpose. On 1.3.2015, X arranged to retire the bill at a rebate of 12% p.a. Show the entries in the books of X and Y.

Solution:

**In the books of Y
Journal**

Date	Particular	L.F.	Dr. (₹)	Cr. (₹)
2015 Jan 1	X A/c To, Sales A/c (Goods sold to X)	Dr.	4,000	4,000
Jan 1	Bills Receivable A/c To, X A/c (Bills drawn for 3 months)	Dr.	4,000	4,000



March 1	Cash A/c Rebate Allowed A/c To, Bills Receivable A/c (Bills retired under a rebate of 12% p.a.)	Dr. Dr.		3,954 46	4,000
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Rebate = ₹4,000 × 12/100 × 35/365 (1st March to 4th April) = ₹46.

**In the books of X
Journal**

Date	Particular	L.F.	Dr. (₹)	Cr. (₹)
2015 Jan 1	Purchase A/c To, Y A/c (Goods purchased from Y)	Dr.	4,000	4,000
Jan 1	Y A/c To, Bills Payable A/c (Bills accepted for 3 months)	Dr.	4,000	4,000
March 1	Bills Payable A/c To, Cash A/c To, Rebate Received A/c (Bills retired under a rebate of 12% p.a.)	Dr.	4,000	3,954 46

Illustration 6

Mohan sold goods to Gupta on 1st September, 2015 for ₹1,600. Gupta immediately accepted a three months bill. On due date Gupta requested that the bill be renewed for a fresh period of two months. Mohan agrees provided interest at 9% was paid immediately in cash. To this Gupta was agreeable. The second bill was met on due date. Give journal entries in the books of Mohan.

Solution:

2015	Particulars		Dr. (₹)	Cr. (₹)
Sept. 1	Gupta A/c To Sales A/c (sales of goods to Gupta as per Invoice No....)	Dr.	1,600	1,600
	Bills Receivable A/c To Gupta A/c (3 months acceptance received from gupta for the amount due from him)	Dr.	1,600	1,600
Dec. 4	Gupta A/c To Bill Receivable A/c (Gupa's acceptance cancelled because of renewal)	Dr.	1,600	1,600
	Gupta A/c To Interest A/c (interest @ 9% on ₹1,600 due form Gupta for 2 months because of renewal)	Dr.	24	24
	Bills receivable A/c Cash A/c To Gupta A/c (New acceptance for 2 months for ₹1,600 and cash (for interest) received from Gupta}	Dr. Dr.	1,600 24	1,624
2012 Feb. 7	Cash A/c To Bills Receivable A/c (Cash received against Gupta's second acceptance)	Dr.	1,600	1,600

EXERCISE:

- Pass journal entries in the books of Hema for the following transactions:
 - Hema's acceptance to Nanda for ₹5000 renewed for 3 month with interest at 10% p.a.
 - Nalini's acceptance to Hema was for ₹10000 was retired one month before due date at a discount of 12% p.a.
 - Discounted Natasha's acceptance to Hema for ₹4000 with the bank for ₹3920.
 - Neela requests Hema to renew her acceptance for ₹3500 for 3 months. Hema accepted on the condition that interest of ₹100 was paid in cash which Neela did.
- Mohan sold goods on 1st September, 2014 for ₹2,00,000/- to Sohan. Sohan immediately accepted a 3 months bill. On the due date Sohan requested for the renewal of the bill for a further period of two months. Mohan agrees to pay interest @ 9% per annum to be included in the new bill. Determine the amount of the new bill.

Ans: ₹2,03,000

- On 1-4-15, Mr. A draws a bill for ₹ 6,000 for 7 months on Mr. B who returned the bill to Mr. A after acceptance. On 10-4-15, Mr. A endorsed the bill in favour of Mr. C who endorsed the bill on 15-4-15 in favour of Mr. D. On 1-5-2015, Mr. D discounted the bill at 10%. On maturity, the bill was dishonoured and banker paid ₹ 50 towards noting charges. Pass necessary journal entries in the books of Mr. D
- Mr. A draws on Mr. B a bill of exchange for ₹ 5,000 on 1st Jan, 2015. Mr. A endorses the bill in favour of Mr. C Before maturity, Mr. B approaches Mr. A with the request that the bills be renewed for a further period of 3 months at fifteen percent interest per annum. Mr. A pays the sum to Mr. C on due date and agrees to the proposal of Mr. B pass the journal entries in the books of Mr. A assuming that the second bill is duly met.

Multiple choice questions:

- The person other than the original creditor to whom the amount in the bill is made payable to is known as the ___ of the bill.
 - holder
 - payee
 - drawer
 - endorser
- Payment of Bills of exchange is received
 - by drawer
 - by holder in due course of due date
 - by endorsee
 - by bank
- Retirement of bill means:
 - making payment before the due date
 - cancellation of the bill
 - sending the bill for collection
 - endorsing the bill in favour of third party
- At the time of retirement of a bill, the acceptor debits:
 - bills receivable account
 - bill payable account
 - discount
 - none of the above
- The party who is ordered to pay the amount is known as
 - payee
 - Drawer
 - drawee
 - endorsee
- In which of these ways a bill of exchange cannot be disposed of
 - discounting with bank
 - retain till maturity
 - endorsement to creditors
 - destroyed
- Bills receivable book is a part of the
 - ledger
 - balance sheet
 - journal
 - profit and loss account
- X Sold goods to Y for ₹30,00,00. ½ of the amount will be received in cash and the balance through a B/R for what amount X should draw a bill Y
 - 150000
 - 300000
 - 100000
 - 120000
- A person who endorses a bill is called
 - drawer
 - drawee
 - Bank
 - endorser
- At the time of dishonor of an endorsed bill which one or these accounts would be credited by the drawee
 - bill payable account
 - drawer
 - Bank
 - Bill dishonored account
- Date on which the payment of the bill is to be made
 - public holiday
 - date of grace
 - due date
 - date of bill+ 3 days



12. Kuntal draws a bill on shyam for ₹ 3000 kuntal endorsed it to Ram. Ram endorsed it to Rahim. The payee of the bill will be:
(a) kuntal (b) Ram (c) Shyam (d) Rahim
13. If the due date is a public holiday what will be the due date of the bill
(a) following day (b) preceding day (c) the same day only (d) one month later
14. On 1-8-15, X draws a bill on Y for 30 days after sight The date of acceptance is 8-8-15. The due date of the bill will be
(a) 8-9-15 (b) 10-9-15 (c) 11-9-15 (d) 9-9-15
15. If bill drawn on 3rd July 2015 for 40 days payment must be made on
(a) 16th August, 2006 (b) 15th August, 2006 (c) 12th August, 2006 (d) 14th August, 2006

Ans:

- 1. (b) 2.(b) 3.(a) 4.(b) 5.(c) 6.(d) 7.(c) 8. (a) 9.(d) 10.(b) 11.(c) 12.(d) 13.(b) 14.(b) 15.(d)**

Fill in the blanks:

1. When a B/R is endorsed by the drawer what entry is passed by the drawee _____ (No entry at all)
2. Negotiable instrument act was enacted in the year _____ (1881)
3. The debtor on whom a bill of exchange is drawn is called (Drawee)
4. _____ is the date on which a bill falls due for payment (maturity date)
5. X-draws a trade bill of ₹25000 for 6 months on Y. After holding the bill for 1.5 months, X-discounts the bill with bank @ 10% p.a. the amount of discount on bill is _____ (₹938).
6. A promissory note contains an _____ to pay (undertaking or promise)
7. A bill of exchange is a _____ of indebtedness of the purchaser of goods or services on credit (conclusive proof)
8. Amount ordered to be paid by the drawer in a bill must be _____ (certain and unconditional)
9. Renewal of a bill includes interest for the _____ period (extended period)
10. When the drawer discounts the bill with bank before maturity the drawee passes _____ entry in his (no entry)
11. Rebate is given in case of _____ of a bill (retirement)
12. Bills receivable account is a _____ account (personal account)
13. Bills of exchange is a _____ (negotiable) instrument
14. The cash allowance provided by the drawer to the drawee for the pre-payment of the bill is known as _____ (rebate)
15. M sold goods worth ₹50,000 to N on 1.1.15. N immediately accepted a three months bill on due date N requested that the bill be renewed for a fresh period of 3 months. N agrees to pay interest @ 18% p.a. in cash. How much interest to be paid in cash by N? _____ (2250)

True or false:

1. Oral bill of exchange is also valid (FALSE)
2. Creditors can draw a bill on debtors (TRUE)
3. Bank will draw a bill on customer at the time of overdraft (FALSE)
4. Retirement of bill means sending the bill for collection (FALSE)
5. A person by whom the bill is endorsed is called endorser (TRUE)
6. Foreign trade is facilitated with the help of foreign bills of exchange (TRUE)
7. If the bill is assigned by the drawer it is invalid (FALSE)
8. In case of endorsement of bill endorser debits endorsee and credits B/R account (TRUE)
9. Endorser or drawer credits endorsee when the payment is received (FALSE)
10. When a bill is retired under rebate the holder of a bill debits B/R account (FALSE)

Match the following:

Group A

1. Grace days	g	a) honour before due date
2. Accommodation bills	f	b) includes interest
3. Promissory note	d	c) Unconditional
4. Bill of exchange	c	d) 2
5. Rebate of bill	e	e) loss of interest for drawer
6. Retirement	a	f) kite bills
7. Renewal of bill	b	g) 3

Group B

1. Dishonour of a bill	g	a) drawee has no entry
2. Bill sent to bank collection	a	b) holder credits B/R account
3. Retiring a bill	b	c) drawer
4. Promissory note	h	d) Endorser
5. Maker of bill	c	e) conclusive proof
6. Person endorses a bill	d	f) foreign trade
7. Bills of exchange	e	g) drawer debits drawee account
8. Foreign bill of exchange	f	h) Indian currency

2.2 CONSIGNMENT (COST PRICE, INVOICE PRICE, COMMISSION & VALUATION OF STOCK)

Wholesalers and Manufactures find it quite convenient and profitable to sell goods, through the medium of an agent at home and abroad. An agent sells the goods on behalf of sender of goods and charges commission. The knowledge of the agent regarding local conditions proves quite useful for increasing the sales. The person who sells the goods is called 'consignor' or 'principal', the person to whom the goods are sent is termed as 'consignee' or 'agent' and the shipment of the goods is known as consignment. Thus, a consignment may be defined as shipment of goods by a manufacturer or wholesale dealer to an agent for sale on commission basis. An agent sells the goods on account of consignor and risk is borne by the consignor. It is not transfer of ownership of goods, but only sending of goods by one person to another at a different place to be sold by the latter on behalf of the former. When the goods are sent by the consignor, it is known as outward consignment. To the consignee, it is an inward consignment. Consignee does not become the debtor for the goods received on consignment. The relationship between both the parties is that of an agent and a principal only. The goods consigned to the agent are treated as sales only when these are sold by the consignee and he becomes entitled to be reimbursed for the expenses incurred on behalf of consignor and is also entitled to receive commission for the goods sold by him.

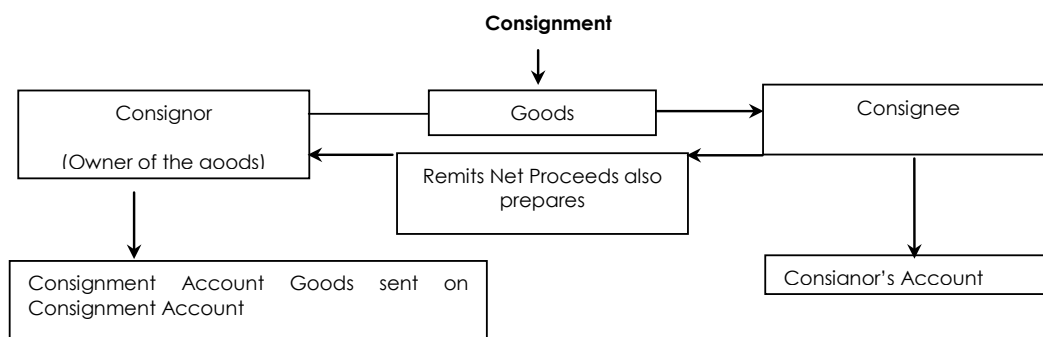
Consignment and Sale – Distinction:

The following are the main points of difference between consignment and sale of goods:

- (i) In case of consignment, legal ownership of goods rests with the consignor. It is only the possession of goods which is transferred to the consignee. In case of sale, the legal ownership of goods is transferred immediately from the seller to the buyer of goods.
- (ii) In case of consignment the relationship between the consignor and consignee is that of principal and an agent and continue till terminated, while in case of sale, the relationship between the two parties is that of buyer and seller and terminate as soon as payment is made and goods are transferred.

- (iii) In case of consignment, the risk of loss or damage to the goods remains with the consignor till the goods consigned are sold by the consignee. In case of sale, risk attached to the goods passes along with ownership to the buyer of goods.
- (iv) In consignment, the consignor usually bears the expenses incurred by the consignee in connection with the goods consigned to him. In case of sale, expenses incurred by the buyer, after its completion, will be borne by him.
- (v) In consignment, 'Account Sales' is required to be submitted periodically by the consignee to the consignor. But in case sale, no 'Account sales' is required to be submitted by the buyer to the seller.
- (vi) In consignment, goods are sold by the consignee against commission, while in case of sale, goods are sold against price.
- (vii) In consignment, unsold goods with the consignee can be returned at any time if he feels that goods cannot be sold except at a loss, while in case of sale, the goods cannot be returned by the buyer after the sale is complete.

Diagrammatic representation:



Nature of a Consignment

- If the owner of the goods does not have retail outlets, he can consign the goods to an agent.
- The agent will sell the goods for him and receive a commission in return.

Main Terms of Consignment

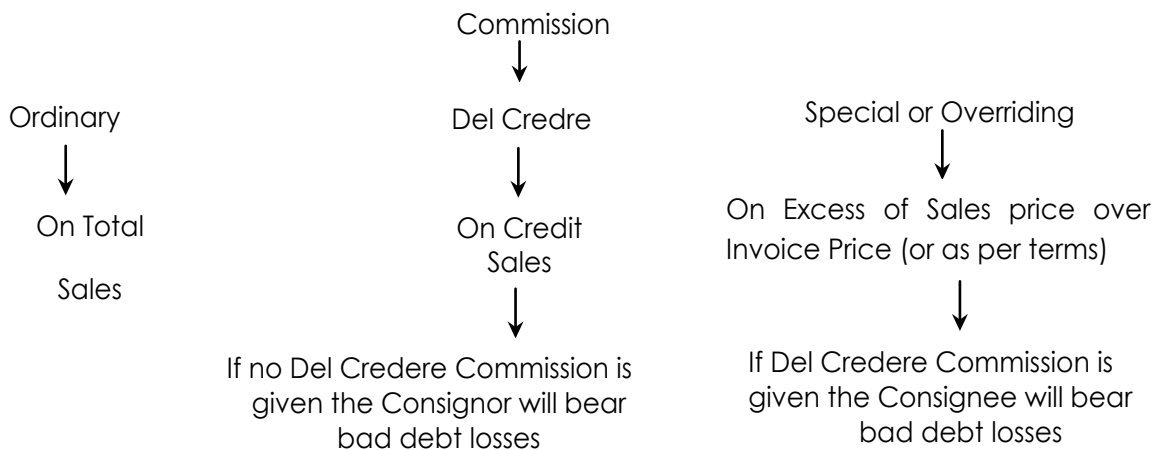
Trade Consignor – He is the person who sends goods to agents e.g. a manufacturer or wholesaler.

Consignee – He is the agent to whom goods are sent for selling.

Ordinary Commission – This is a fee payable by consignor to consignee for sale of goods when the consignee does not guarantee the collection of money from ultimate customer. The % of such commission is generally lower.

Del Credre Commission – This is additional commission payable to the consignee for taking over additional responsibility of collecting money from customers. In case, the customers do not pay of the consignee takes over the loss of bad debts in his books. Although it's paid for taking over risk of bad debts that arise out of credit sales only, this commission is calculated on total sales and not on credit sales.

Commission table:



Account Sales – This is a periodical statement prepared by consignee to be sent to the consignor giving details of all sales (cash and credit), expenses incurred and commission due for sales, destroyed-in-transit, or in godown and deducting the amount of advance remitted by him.

Proforma Invoice:

When the goods are sent by consignor to the consignee, consignor sends a 'proforma Invoice' in the form of an invoice to the consignee, 'proforma Invoice' contains information related to the nature of goods, number and/ or quantity, weights, other measurements related to the goods and marked price, etc. It is to be noted that proforma invoice is only in the nature of memorandum invoice and not a regular invoice, so it does not make the consignee accountable to pay the amount mentioned therein. Generally, the price shown in such invoice is not the cost price but it is sometimes the selling price and sometimes the cost price plus an arbitrary percentage of profit.

Operating Cycle of Consignment Arrangement

- (i) Goods are sent by consignor to the consignee
- (ii) Consignee may pay some advance or accept a bill of exchange
- (iii) Consignee will incur expenses for selling the goods
- (iv) Consignee maintains records of all cash and credit sale.
- (v) Consignee prepares a summary of results called as Account sales
- (vi) Consignor pays commission to the consignee

sometimes, the consignor may send the goods at a price higher than cost so that the consignee gets no knowledge of the real cost of goods which is confidential for the consignor.

Accounting for Consignment Business

The consignor and consignee keep their own books of accounts. The consignor may send goods to many consignees. Also, a consignee may act as agent for many consignors. It is appropriate that both of them would want to know profit or loss made on each consignment. There are certain new accounts that are to be opened in addition to regular accounts as cash or bank. Let us see the entries in the books of consignor as well as consignee.

Situations	Consignor's books	Consignee's books
On sending goods	Consignment A/c Dr To Goods Sent on Consignment	No Entry



On expenses for sending goods	Consignment A/c Dr To Cash/ Bank A/c	No Entry
On consignee accepting bill of exchange	Bill Receivables A/c Dr To Consignee's Personal A/c	Consignor's Personal A/c Dr To Bills Payable A/c
On expenses incurred by consignee	Consignment A/c Dr To Consignee's Personal A/c	Consignor's Personal A/c Dr To Cash/ Bank A/c
On consignee reporting sales	Consignee's Personal A/c Dr To Consignment A/c	Cash/ Bank A/c Dr To Consignor's Personal A/c
For commission	Consignment A/c Dr To Consignee's Personal A/c	Consignor's Personal A/c Dr To Commission A/c
On closing stock	Stock on Consignment A/c Dr To Consignment A/c	No Entry

Credit Sales Accounting in books of Consignor

In case consignee sales goods on cash and credit both, the responsibility of collection from customers may be either with consignee or consignor. The risk of non-collection is usually borne by the consignor. If consignor want this to be shouldered by the consignee, additional commission in the form of 'Del Credere' commission is payable. It may be noted that in case of credit sales, the personal accounts of debtors are to be maintained by the consignor and not the consignee. The entry for credit sales will be:

Consignment Debtors A/c Dr
To Consignment A/c

Del Credere Commission and Bad Debts

Sometimes the consignor allows an extra commission to the consignee in order to cover the risk of collection from customer. On account of credit sales which is known as Del Credere Commission. Naturally, if debt is found to be irrecoverable the same must be borne by the consignee. There will be no effect in the books of consignor. In short, credit sales will be treated as cash sales to consignor. If no Del credere commission is given by the consignor to the consignee, the amount of Bad debts must be borne by the consignor.

Entries in the Books of Consignor

(a) When Del Credere Commission is given

i)	For Credit Sales Consignee's Personal A/c To, Consignment A/c	Dr.
ii)	For Bad Debts No Entry	
iii)	For Del Credere Commission Consignment A/c To, Consignee's Personal A/c	Dr.

(b) When Del Credere Commission is not given

i)	For Credit Sales Consignment Debtors A/c To, Consignment A/c	Dr.
ii)	For Bad Debts Consignment A/c To, Consignment Debtors A/c	Dr.

iii)	a) For realization of Cash		
	Cash A/c		Dr.
	To, Consignment Debtors A/c if collected by Consignor		
	(b) Consignee's Personal A/c		Dr.
	To, Consignment Debtors A/c if collected by Consignee		

Entries in the Books of Consignee

(a) When Del Credere Commission is given

i)	For Credit Sales		
	Consignment Debtors A/c		Dr.
	To, Consignor A/c		
ii)	For Bad Debts		
	Bad Debts A/c		Dr.
	To, Consignment Debtors A/c		
iii)	For realization of cash from cash from Debtors		
	Cash/ Bank A/c		Dr.
	To, Consignment Debtors A/c		
iv)	For Closing Bad Debts A/c		
	Commission Received A/c		Dr.
	To, Bad Debts A/c		

(b) When Del Credere Commission is not given

There will be no entry against a bad debts entry in the books of consignee

Valuation of Stock

- If there are unsold goods on consignment at the end of the accounting period, the value of the unsold stock will be carried down to the following period.
- Unsold stock on consignment should properly value; otherwise final accounts cannot be prepared.
- Usually, unsold stock on consignment is value at (Consignor's Cost + Consignee's Expenses)
- Alternatively, total cost of goods plus total expenses incurred by the consignor plus total non recurring expenses of the consignee are to be added and stock should valued on the basis of proportionate unsold goods.

The entry will be:

Stock on Consignment A/c Dr.
 To, Consignment A/c

(Unsold stock on consignment will appear in the asset side of Balance Sheet.)

Invoice Price higher than cost price:

Sometimes, the consignor does not want to reveal actual price of the goods to the consignee so that he may not know the actual profit or loss being made by him on these goods. Therefore, the consignor sends the goods at a price higher than cost price, known as proforma invoice price. The consignor adds some profit margin to the cost price of the goods and prepare an invoice showing the invoice price of the goods. Thus, consignment account stands debited with the invoice price of the goods. Therefore, some adjustments are required at the end of each balancing period to ascertain the correct profit or loss on consignment. Hence, the following journal entries are required to be passed in the books of consignor.

(i) Goods sent on consignment Account Dr.
 To Consignment Account

(Being the excess of invoice price of goods sent on consignment adjusted)



The entry is made with the amount difference between cost price and invoice price of the goods sent. If some goods remain unsold with the consignee, then also the adjustment is required to nullify the effect of higher price and show the stock on cost price. The journal entry being passed

(a) Consignment Account Dr.
 To Consignment Stock Reserve Account

(Being the excess of invoice value over cost price adjustment to show the unsold stock at cost price).

Illustration 1

Ram & Co. of Calcutta consigned 50 cases of goods at ₹200 each to Nathan of Bombay. The consignor pays ₹200 for insurance and for freight ₹300. Nathan sent an account sales showing the gross proceeds at ₹24,000. The expenses paid by Nathan were dock dues ₹20, carriage ₹50 warehousing expenses ₹130. He sent the amount due to the consignor after deducting 4% commission. Give journal entries in the books of both the parties.

Solution:

In the Books of Ram & Co. Journal Entries

Consignor's books	₹	₹
Consignment A/c Dr. To Goods Sent on Consignment A/c (Being the cost of 50 cases of goods @ ₹200 each consigned to consignee)	10,000	10,000
Consignment A/c Dr. To Cash A/c (Being ₹200 for Insurance and ₹300 for freight paid)	500	500
Nathan's A/c Dr To Consignment A/c (Being the sales proceeds at ₹24,000)	24,000	24,000
Consignment A/c Dr To Nathan's A/c (Being expenses paid by Nathan i.e. dock dues ₹20, carriage ₹50 and warehousing expenses ₹130)	200	200
Consignment A/c Dr To Nathan's A/c (Being the commission payable to Nathan @4% on ₹24,000)	960	960
Consignment A/c Dr To Profit and Loss A/c (Being the profit on consignment transferred to Profit and loss A/c)	12,340	12,340
Cash A/c Dr To Nathan's A/c (Being the amount due from Nathan received)	22,840	22,840
Goods Sent on Consignment A/c Dr To Trading A/c (Being the transfer of goods sent on consignment account to Trading A/c)	10,000	10,000

In the Books of Nathan Journal Entries

Ram & co. A/c To Cash A/c (Being various expenses paid on goods on consignment)	Dr	200	200
Bank A/c To Ram & Co. A/c (Being goods sold on behalf of Ram & Co.)	Dr	24,000	24,000
Ram & Co. A/c To Commission A/c (Being the commission due on sale proceeds paid to Ram & co.)	Dr	960	960
Ram & co. A/c To Bank A/c (Being amount due on consignment remitted to Ram & Co.)	Dr	22,840	22,840

Illustration 2

The Bombay Mills Ltd. of Bombay consign to their Calcutta agent ₹10,000 worth of piece goods, drawing on Calcutta for the amount. They pay charges freight and insurance on the consignment amounting to ₹650 and discount the bill which costs ₹200. The goods were received in Calcutta and in due course the account Sales was received as follows:

Account sales of 200 bales of piece goods from Bombay Mills Ltd. of Bombay.

	₹	₹
200 Bales of piece goods at		14,000
Less:		
Delivery charges etc.,	500	
Godown rent	70	
Insurance	80	
Sundry charges	18	
Commission	700	1,368
		12,632
Draft paid		10,000
Balance herewith		2,632

Enter these particulars in the ledger of the consignor and complete the transaction showing final profit or the loss on the consignment.

Solution:

**In the Books of Bombay Mills Ltd.
CONSIGNMENT ACCOUNT**

Dr.	Particulars	Amount (₹)	Amount (₹)	Cr.
	To Goods sent on Consignment A/c		10,000	By Agent (Sales) 14,000
	To Cash (Freight & Insurance)		650	
	To Agent:			
	Delivery charges etc.	500		
	Godown rent	70		
	Insurance	80		
	Sundry charges	18		



Commission	700	1,368		
To Profit & Loss a/c		1,982		
		14,000		14,000

Agent Account

Dr. Cr.

Particulars	Amount (₹)	Particulars	Amount (₹)
To Consignment A/c	14,000	By Bills Receivable A/c	10,000
		By Consignment A/c	1,368
		By Bank A/c	2,632
	14,000		14,000

Goods sent on Consignment Account

Dr. Cr.

Particulars	Amount (₹)	Particulars	Amount (₹)
To Trading A/c	10,000	By consignment A/c	10,000
	10,000		10,000

Bills Receivable Account

Dr. Cr.

Particulars	Amount (₹)	Particulars	Amount (₹)
To Agent A/c	10,000	By Bank	9,800
		By Discount	200
	10,000		10,000

Illustration 3

'A' sends goods worth ₹50,000 to 'B' for sales for 5% commission. He incurs ₹1,500 for Freights and ₹500 for Insurance. The goods are sold for ₹60,000, consignee incurs ₹500 unloading expenses and ₹500 rent. B sends a draft after deducting his expenses and commission.

Prepare necessary accounts in the books of A.

Solution:

**In the books of A
Consignment Account**

Dr. Cr.

Particulars	Amount (₹)	Particulars	Amount (₹)
To Goods Sent on Consignment A/c	50,000	By B's A/c Sale	60,000
To Cash A/c (Freight)	1,500		
To Cash A/c (Insurance)	500		
To B's A/c			
-Unloading Expenses	500		
- Rent	500		
To B's A/c -Commission (60,000 x 5%)	3,000		
To Profits and Loss A/c (Profit on Consignment)	4,000		
	60,000		60,000

B's (Consignee's) Account

Dr.		Cr.	
Particulars	Amount(₹)	Particulars	Amount(₹)
To Consignment A/c- Sale	60,000	By Consignment A/c – (Unloading Expenses)	500
		By Consignment A/c (Rent)	500
		By Consignment A/c (Commission)	3,000
		By Bank A/c	56,000
	60,000		60,000

Goods Sent on Consignment Account

Dr.		Cr.	
Particulars	Amount (₹)	Particulars	Amount (₹)
To Trading A/c (Balancing Figure)	50,000	By Consignment A/c	50,000
	50,000		50,000

Illustration 4

Usha sent goods costing ₹75,50,000 on consignment basis to Gayathri on 1.2.2015 @8.5% commission, ₹8,25,000 was spent on transportation by Usha. Gayathri spent ₹5,25,000 on unloading. 80% of the goods received were sold for ₹90,00,000, 10% of the goods for ₹10,00,000 and the balance was taken over by Gayathri @10% below the cost price. She has sent a demand draft to Usha for the amount due show in Usha's Books.

- (i) Consignment Account
(ii) Gayathri's Account.

Solution:

**In the Books of Usha
Consignment Account**

Dr.		Cr.	
Particulars	Amount (₹)	Particulars	Amount (₹)
To Goods sent on Consignment A/c	75,50,000	By Gayathri A/c (W.N.- 1)	1,01,35,900
To Bank A/c – Transportation	8,25,000		
To Gayathri A/c – Unloading Expenses	5,25,000		
To Gayathri A/c –Commission (W. N.- 2)	8,61,551		
To Profit and Loss on Consignment A/c	3,74,349		
	1,01,35,900		1,01,35,900

Gayathri's Account

Dr.		Cr.	
Particulars	Amount (₹)	Particulars	Amount (₹)
To Consignment A/c	1,01,35,900	By Consignment a/c -Expenses	5,25,000
		By Consignment a/c –Commission	8,61,551
		By Bank a/c (Balancing Figure)	87,40,349
	1,01,35,900		1,01,35,900

Working Note:

1. Computation of Amount of Sales by Gayathri

Goods Sent on consignment Basis	75,50,000
88% of the Goods Received, Sold for	90,00,000
10% of the Goods Received, Sold for	10,00,000



2% of the goods Received Taken Over ($\text{₹}75,50,000 \times 2\%$) $\times 90\%$	1,35,900
Total Amount of Sales	1,01,35,900

2. Computation of Commission

Commission = Total Sales Proceeds \times Rate of Commission = $1,01,35,900 \times 8.5\% = \text{₹}8,61,551$

Illustration 5

Sree Traders of Gujrat purchased 10,000 sarees @ ₹ 100 per saree. Out of these 6,000 sarees were sent on consignment to Nirmala Traders of Kolkata at the selling price of ₹ 120 per saree. The consignor paid ₹ 3,000 for packing and freight. Nirmala Traders sold 5,000 sarees @ ₹ 125 per saree and incurred ₹ 1,000 for selling expenses and remitted ₹ 5,00,000 to Gujrat on account. They are entitled to a commission of 5% on total sales plus a further of 25% commission on any surplus price realized over ₹ 120 per saree. 3,000 sarees were sold at Gujrat @ ₹ 110 per saree. Owing to fall in market price, the value of stock of saree in hand is to be reduced by 5%. You are required to prepare (i) Consignment Account, and (ii) Nirmala Traders Account.

Solution:

i)

In the books of Sree Traders Consignment Account

Dr.		Cr.	
Particulars	Amount (₹)	Particulars	Amount (₹)
To, Goods Sent on Consignment A/c (6,000 \times ₹ 100)	6,00,000	By Nirmala Traders A/c : Sale proceeds (5,000 \times ₹ 125)	6,25,000
To, Bank A/c (Packing and Freight)	3,000	By, Stock on Consignment A/c (W.N.2)	90,250
To, Nirmala Traders A/c			
- Selling Expenses	1,000		
- Commissions (W.N.1)	37,500		
To, Profit & Loss A/c (Profit on Consignment)	73,750		
	7,15,250		7,15,250

Note:

3,000 sarees which were sold at Gujrat @ ₹110 per saree are not to be taken into consideration since it is not a consignment transaction and hence the same is extended from Consignment Account.

Although the consignor purchased 10,000 sarees, only 6,000 sarees are related to consignment transaction, balance is not to be taken into Consignment Account at all.

(ii)

Nirmala Traders Account

Dr.		Cr.	
Particulars	Amount (₹)	Particulars	Amount (₹)
To Consignment A/c:		By, Bank A/c (Advance)	5,00,000
Sales Proceeds	6,25,000	By, Consignment A/c (Exp. + Com.)	38,500
		By, Balance c/d	86,500
	6,25,000		6,25,000

Workings:**1. Calculation of Commission payable to Nirmala Traders:**

	(₹)
Total Sales @ ₹ 125 per saree	6,25,000
Less: Amount ₹ 120 per saree	6,00,000
Surplus Price Realised	25,000
Less: @ 5% on total Sales (₹ 6,25,000 × 5%)	31,250
Add: 25% on ₹ 25,000	6,250
	37,500

2. Valuation of Unsold Stock:

Since market price has fallen by 5%, valuation of unsold stock on consignment will be calculated as under:

Particulars	(₹)
Total Cost (1,000 × ₹ 100) (without Considering expenses)	1,00,000
Less: 5% in reduction	5,000
	95,000
Less: Consignee's Com. @ 5%	4,750
Estimated Selling Price	90,250

Losses on Consignment

There are two types of losses which may arise in case of a consignment transaction, viz.

- (a) Normal Loss, and
(b) Abnormal Loss

(a) Normal Loss – Normal Losses arise as a result of natural causes, e.g. evaporation, leakage, breakage etc., and they are inherent in nature. Since normal loss is a charge against gross profit no additional adjustment is required for this purpose. Moreover, as the same is a part of cost of goods, when valuation of unsold stock is made in case of consignment account the quantity of such loss (not the amount) should be deducted from the total quantity of the goods received by the consignee in good condition. Thus,

Value of closing stock will be

$$= \text{Total Value of goods sent} \times \frac{\text{Unsold Quantity}}{\text{Good Quantity Received by Consignee}}$$

Illustration 6

Ram of Patna consigns to Shyam of Delhi for sale at invoice price or over. Shyam is entitled to a commission @ 5% on invoice price and 25% of any surplus price realized. Ram draws on Shyam at 90 days sight for 80% of the invoice price as security money. Shyam remits the balance of proceeds after sales, deducting his commission by sight draft. Goods consigned by Ram to Shyam costing ₹20,900 including freight and were invoiced at ₹28,400. Sales made by Shyam were ₹26,760 and goods in his hand unsold at 31st Dec, represented an invoice price of ₹6,920. (Original cost including freight ₹5,220). Sight draft received by Ram from Shyam upto 31st Dec was ₹6,280. Others were in-transit. Prepare necessary any Ledger Accounts.

Solution:

**In the books of Ram
Consignment to Delhi Account**

Dr.		Cr.	
Particulars	Amount(₹)	Particulars	Amount(₹)
To, Goods Sent on Consignment A/c	28,400	By, Goods Sent on Consignment A/c (Loading) ₹(28,400- 20,900)	7,500
To, Y A/c – Commission	2,394	By, Shyam A/c – Sale proceeds	26,760



To, Stock Reserve A/c ₹(6,920 – 5,220)	1,700	By, Stock on Consignment A/c	6,920
To, Profit and Loss A/c-Profit on consignment transferred	8,686		
	41,180		41,180

Shyam Account

Dr.		Cr.	
Particulars	Amount(₹)	Particulars	Amount(₹)
To, Consignment to Delhi A/c	26,760	By, Bills Receivable A/c	22,720
To, Balance c/d (₹ 6,920 × 80%)	5,536	By, Consignment to Delhi A/c	2,394
		- Commission	
		By, Draft A/c	6,280
		By, Draft- in- Transit A/c	902
	32,296		32,296

Goods sent on Consignment Account

Dr.		Cr.	
Particulars	Amount (₹)	Particulars	Amount (₹)
To, Consignment to Delhi A/c	7,500	By, Consignment to Delhi A/c	28,400
To, Trading A/c (bal.fig)	20,900		
	28,400		28,400

Workings:

Calculation of Commission:	(₹)
Invoice value of goods	28,400
Less: Unsold stock	6,920
Invoice value of goods sold	21,480
Total sale proceeds	26,760
Less: Invoice value of goods sold	21,480
Surplus price	5,280
Commission @ 5% on ₹21,480	1,074
Add: @ 25% on ₹5,280	1,320
	2,394

Illustration 7

Ashok sends goods on consignment basis to Srinivas. The terms are that Srinivas will receive the 10% commission on Invoice price and 20% on price realized over and above the Invoice price. Srinivas will meet his expenses himself. Ashok sent goods whose cost was ₹16,000 at a proforma Invoice price cost plus 25% and spent ₹1,500 on freight charges. Srinivas accepted a bill for 16,000 immediately on receiving the consignment. His expenses were ₹200 as rent and ₹100 as insurance. Srinivas sold ¾ of goods for ₹19,500. Part of sales were on credit and one customer failed to pay ₹400. Pass journal entries in the books of Ashok.

Solution:**Journal entries in the books of Ashok**

	Particulars	(₹)	(₹)
1	Consignment a/c Dr. To goods sent on consignment A/c (Being the invoice value of the goods sent on consignment)	20,000	20,000
2	Consignment A/c Dr. To Bank A/c (Being the expenses incurred on consignment)	1,500	1,500
3	Bill Receivable A/c Dr. To srinivas A/c (being the bill drawn as an advance)	16,000	16,000
4	Srinivas A/c Dr. To consignment A/c (being the sales made by srinivas)	19,500	19,500
5	Consignment A/c Dr. To Srinivas A/c (being the commision due to srinivas)	2,400	2,400
6	Consignment stock A/c Dr. To consignment A/c (Being the value of $\frac{1}{4}$ of the goods left unsold)	5,375	5,375 ²
7	Goods sent on consignment A/c Dr. To consignment A/c (Being the excess of invoice price over cost price in stock adjusted)	4,000	4,000
8	Consignment A/c Dr. To consignment stock suspense A/c (Being the excess of invoice price over cost price in stock adjusted)	1,000	1,000
9	Consignment A/c Dr. To Srinivas A/c (Being the bad debts on the credit sale made by srinivas)	400	400
10	Consignment A/c Dr. To profit and loss A/c (Being the profit on consignment transferred to p & L A/c)	3,575	3,575
11.	Goods sent on consignment A/c Dr. To trading A/c (being the transfer of goods sent on consignment account)	16,000	16,000

Working Notes:**1. Calculation of commission**

10% on invoice price	
(i.e., 10% on 15,000 \times 3/5)	1,500
20% on excess of invoice price	
(i.e., 20% on 19,500 – 15,000)	<u>900</u>
Total commission	<u>2,400</u>



2. Closing stock:

Invoice price of $\frac{1}{4}$ of the goods	
Left unsold, i.e., $\frac{1}{4} \times 20,000$	5,000
Add: $\frac{1}{4}$ of freight $\frac{1}{4} \times 1,500$	<u>375</u>
	<u>5,375</u>

EXERCISE:

1. On 1st July, 2006 Radio House of Delhi consigned 200 Radios to Banerjee Bros. of Calcutta. The cost of each radio was ₹400. Radio House paid ₹5,000 for freight and insurance. On 7 July, 2006 Banerjee Bros. accepted a 3 month bill drawn upon them by Radio House for ₹50,000. Banerjee Bros. Paid ₹2,200 as rent and ₹1,300 for advertisement and upto 31st December, 2006 (on which date Radio House close their books) they sold 180 radios at ₹500 each. Banerjee Bros. were entitled to a commission of 5% on sales. Give Journal entries and prepare necessary accounts to record the above transactions in the books of the parties.

Ans: Profit = ₹5,500, Value of Stock = ₹8,500, Balance due from Banerjee = ₹32,000

2. A of Sonepat consigned 500 bicycles to B of Cochin to be sold on his account and at his risk. The cost of one bicycle was ₹200. A paid ₹5,500 as freight and insurance and received ₹40,000 as advance from B. B paid ₹1,000 as octroi and carriage, ₹1,500 as rent and ₹1,200 as insurance. 410 bicycles were sold by B for ₹1,10,000. B was entitled to a commission of 5% on sale @₹250 per bicycle and 25% of any surplus price realized. Give journal entries in the books of A and B.

Ans: Profit = ₹12,970, Value of Stock = ₹19,170, Commission = ₹7,000, Balance due from B = ₹59,300

3. H Ltd. Forwarded on 1.7.2006, 100 bicycles to Vasu of Hyderabad to be sold on behalf of H Ltd. The cost of each bicycle was ₹150 but the invoice price was ₹200. H Ltd. incurred ₹1,000 on freight and insurance. Vasu received the consignment on 14.7. 2006 and accepted a three months draft drawn upon him by H Ltd. For ₹10,000. Vasu paid ₹400 as rent and ₹250 as insurance and by 31.12.2006 had disposed of 80 bicycles at ₹205 each. Vasu is entitled to a commission of 5% on sales including del credere commission of 1%. Vasu sold 20 bicycle on credit and was not able to recover sales proceeds of 5 bicycles because of insolvency of the debtor. Give journal entries to record the above transactions in the books of H Ltd. and Vasu.

Ans: Profit = ₹2,130, Value of Stock at invoice price= ₹4,200

Multiple Choice Questions:

- Which of these is/are recurring (indirect expenses)?
(a) Transit insurance and freight (b) octroi
(c) loading and unloading (d) godown rent and insurance
- On receipt of goods the consignee debits which of these accounts
(a) purchase account (b) goods account (c) consignor's account (d) none of these
- X sends out goods to Y, costing ₹1,50,000. Goods are to be sold at cost +33 $\frac{1}{3}$ %. The consignor asked consignee to pay an advance for an amount equivalent to 60% of sales value. The amount of advance will be
(a) 1,20,000 (b) 1,00,000 (c) 1,50,000 (d) none
- Goods of the invoice value of ₹ 2,40,000 sent out to consignee at 20% profit on cost the loading amount will be
(a) ₹ 40,000 (b) ₹ 48,000 (c) ₹ 50,000 (d) none
- Goods sent on consignment account is of the nature of
(a) personal account (b) nominal account (c) Real account (d) sales account
- Out of the given option which cannot be treated as part of cost of purchase for valuing stock on hand
(a) packing (b) octroi (c) Delivery charges (d) freight
- X sends out 100 bags to Y costing ₹ 1000 each. 60 bags were sold at 10% above cost price. Sale value will be
(a) 66,000 (b) 65,000 (c) 60,000 (d) 65,500

8. The consignment accounting is made on the following basis
(a) Accrual Basis (b) realization basis (c) cash basis (d) All of above
9. Which of the following term is true above consignment?
(a) sale of goods (b) hypothecation of goods (c) shipment of goods (d) mortgage of goods
10. Which of these accounts are not opened in the books of consignor?
(a) consignment account (b) commission account
(c) Goods sent on consignment account (d) consignee's personal account
11. For closing stock held by consignee which account must be debited
(a) consignment stock account (b) sales account (c) consignee account (d) consignment account
12. X of Kanpur sends out 1000 boxes to Y Delhi costing ₹ 200 each at an invoice price of ₹ 220 each goods sent out on consignment to be credited in general trading will be
(a) ₹ 2,00,000 (b) ₹ 2,40,000 (c) ₹ 40,000 (d) None
13. A proforma invoice is sent by
(a) consignee to consignor (b) consignor to consignee
(c) debtor to consignee (d) debtor to consignor
14. Commission will be shared by
(a) consignor and consignee (b) only consignee (c) only consignor (d) third party
15. X of Mumbai sends out certain goods at cost +25%. Invoice value of the goods is ₹2,00,000. 4/5th of the goods were sold by consignee at ₹1,76,000. Commission 2% upto invoice value and 10% of any surplus above invoice. The amount of commission will be.
(a) 4800 (b) 5200 (c) 3200 (d) 1600

Answers:

1. (d), 2.(d), 3. (a), 4. (a), 5.(c), 6.(c), 7. (a), 8.(a), 9.(c), 10.(b),11. (a), 12. (a), 13. (b), 14. (b) , 15.(a).

Fill in the blanks:

1. The person who sends the goods for sale on fixed commission basis is __ (consignor)
2. When the consignor sends goods to consignee he prepares a ____ (proforma invoice)
3. A periodic statement furnished by the consignee to consignor is ____ (account sales)
4. Del credere commission is allowed to cover the risk of ____ (bad debts)
5. Where goods are sent on consignment, credit is given to ____ (Goods sent on consignment account) in the books of consignor.
6. Goods costing ₹2,00,000 sent out to consignee at cost +25%. Invoice value of the goods will be ____ (₹2,50,000.)
7. Stock reserve is created to adjust ____ (valuation of closing stock to cost.)
8. Goods of the invoice value of ₹1,20,000 sent out to consignee at 20% profit on cost. The loading amount will be ____ (₹20,000.)
9. Extra commission given to the consignee, for making him responsible for bad debts this extra commission is known as ____ (del credere commission.)
10. Balance in consignment account shows ____ (profit or loss on consignment)
11. 'X' of Kolkata sends out certain goods to Y of Mumbai at cost + 25%. 1/2 of the goods received by Y is sold at ₹1,76,000 at 10% above lp. Invoice value of goods sent out is ____ (₹3,20,000.)
12. X of Kolkata sends out 400 bags to Y on Delhi costing ₹ 200 each consignor expenses ₹2,000. Y expenses non selling ₹ 2,000 selling 1000. 300 bags were sold by y. Value of consignment stock will be ____ (₹ 21000.)
13. The balance of consignment stock is shown on the ____ side of the balance sheet. (asset)



14. Consignment account is ___Account.(nominal)
15. Goods costing ₹1,80,000 sent out to consignee to show a profit of 20% on the invoice price. Invoice price of the good will be ___(2,25,000.)

True or false:

1. Goods sent on consignment account is of the nature of real account (TRUE)
2. Goods valued at invoice price refers to valued at lower price than its original cost (FALSE)
3. Balance in consignment account shows profit and loss on consignment (TRUE).
4. Profit and loss on consignment is retained / borne by consignor (TRUE).
5. Commission will be shared between only consignee (TRUE).
6. The details contained in account sales are unsold stock left with the consignee (FALSE)
7. All proportionate consignee's expenses will be added up for valuation of consignment stock (FALSE)
8. In consignment, the goods are dispatched on the basis that the goods will be sold on behalf of and at the expenses of and at the risk of the consignee (FALSE)
9. Cost of the goods include all expenses incurred till the goods reach the premises of the consignee's godown (TRUE)
10. Accounts sales is a statement furnished by consignor to consignee (FALSE)

Match the following:

Group- A

1. Ownership right of the consignment stock is always with the	c	a) loss which is uncertain
2. Consignment stock account is a	e	b) 2,50,000
3. Goods sent to consignment at cost +33 1/3 %. The Percentage of loading on invoice price will be	d	c) consignor
4. Goods costing ₹ 2,00,000 sent out to consignee at Cost +25% invoice value of the goods will be	b	d) 25%
5. Main objective of sending goods at invoice at invoice Price is to	f	e) real account
6. Normal loss in case of consignment means	a	f) keep the real profit a secret

Group – B

1. Del. credere commission is calculated on	b	a) consignor account
2. Closing stock with consignee is shown in the balance sheet of Consignor which account should be credited.	d	b) total sales
3. On receipt of advance from consignee in books of	e	c) original cost plus non-recurring (direct) expense incurred by both Consignor and consignee
4. Account sales indicate	f	d) Consignor
5. The unsold stock on consignment is valued at Price is to	c	e) Consignee
6. On earning the commission on sales, the consignee Debits in his books	a	f) The net amount due by consignee to consignor

2.3 JOINT VENTURE

Introduction

Joint Venture is a temporary form of business organization. There are certain business activities or projects that may involve higher risks; higher investments and even they demand multi-skills. In such cases, an individual person may not be able to muster all resources. Hence two or more people having requisite skill sets come together to form a temporary partnership. This is called a Joint Venture. There is a Memorandum of Undertaking (MOU) signed for this purpose.

- The business activities for which Joint Ventures (JV) are formed could be :-
 - Construction of dams, bridges, roads etc.
 - Buying & selling of goods for a particular season
 - Producing a film
 - Purchasing land selling plots
- The basic features of a Joint Venture business are :
 - (i) It is done for a specific purpose and hence has a limited duration.
 - (ii) The partners are called co-venturers
 - (iii) The profit or loss on joint venture is shared between the co-venturers in the agreed ratio.
 - (iv) The co-venturers may or may not contribute initial capital.
 - (v) The JV is dissolved once the purpose of the business is over.
 - (vi) The accounts of the co-venturers are settled immediately on dissolution.
 - (vii) A joint venture has no name.

Difference between Joint Venture and Consignment:

Sl. No.	Point of Distinction	Joint Venture	Consignment
1	Relation between parties.	Is that of owners	Is that of the principal and the agent.
2	Methods of keeping accounts.	Four methods of keeping accounts.	Is only one
3	Continuity of Relationship between parties.	Is terminated as soon as the venture is over	Will be there even after one transaction
4	Ownership of goods.	Is that of co-venturers	Remains with the consignor though possession of goods passes from the consignor to the consignee
5	Profit earned	Belongs to the co-venturers	Belongs to the consignor and not to the consignee
6	Account Sales	Is not sent by one co-venturer to another	Is sent by the consignee to the consignor
7	Management	The co-venturers enjoy full powers to manage the business & contribute funds for the business	The consignee being an agent has no powers except that he has simply to obey instructions of his principal
8	Finance	Money is contributed by all co-venturers in a certain proportion	All money invested by the consignor
9	Risk	Risk is shared between venturers	Sales are made at consignor's risk

Difference between Joint Venture and Partnership:

The following are differences between Joint Venture and Partnership:

Sl. No.	Point of Distinction	Joint Venture	Partnership
1	Name of the firm.	It is carried on without a firm's name.	It is carried on with firm's name.
2	Co-venturers/ Partners	Parties are called co-venturers.	Parties are called partners.
3	Continuity	Temporary partnership and comes to an end after the completion of a particular venture.	Continuous and does not end after the completion of a particular venture.
4	Liability	Limited to the adventure concerned for which they agree to contribute capital and share profits or losses.	Unlimited to the extent of their business and private estate.
5	Location of Business	It is generally local.	It may be located at different places.
6	Position of a Minor	In it, minor is generally not admitted.	A minor, can be admitted only for benefits.
7	Application of the Act	No enactment is applicable.	Indian Partnership Act, 1932 is applicable.
8	No. of Partners/ Members	No limit in it	Limited to 20 in ordinary trade and 10 in banking business.

Accounting Entries

There may be three ways of maintaining the books of account for the joint venture business. They are:

- Where separate books of accounts are maintained
- Where no separate books of accounts are maintained
- Memorandum Joint Venture

(a) When Separate Books are Maintained

As the business duration is short, the books of accounts are not very comprehensive. The basic purpose is to know profit or loss on account of the joint venture.

- Like a normal P & L A/c, a "Joint Venture A/c" is opened which records all transactions related to the activities carried out. The net result of this account will be either profit or loss.
- To record cash/bank transactions a "Joint Bank A/c" is maintained. This could take a form of cash book with cash and bank column. It will record, the initial contributions made by each co-venturer, proceeds of sales, expenses and distribution of net balances among co-venturers on dissolution of the venture.
- To record transaction related to co-venturers, "Co-Venturers' personal A/cs" are also maintained.

The accounting entries are normally as follows:

No.	Transaction	Entry
1	Contribution of co-venturers	Joint Bank A/c Dr. To, Co-Venturers A/c
2	Goods sent by co-venturer out of his own stock	Joint Venture A/c Dr. To, Co-Venturers A/c
3	Expenses paid by co-venturers	Joint Venture A/c Dr. To, Co-Venturers A/c
4	Materials purchased out of joint venture funds	Joint Venture A/c Dr. To Joint Bank A/c

5	For expenses out of joint bank A/c	Joint Venture A/c To Joint Bank A/c	Dr.
6	For goods sold for cash	Joint Bank A/c To Joint Venture A/c	Dr.
7	Contract / sale price received in form of shares / cash	Joint Bank A/c Shares A/c To Joint Venture A/c	Dr. Dr.
8	Commission / salary to co-venturers	Joint Venture A/c To Co-Venturers A/c	Dr.
9	Unsold goods taken over by co-venturers	Co-Venturers A/c To Joint Venture A/c	Dr.
10	Shares taken over by co-venturers	Co-Venturers A/c To Shares	Dr.
11	If shares are sold in open market	Joint Bank A/c To Shares	Dr.
12	For profit on joint venture	Joint Venture A/c To Co-Venturers A/c	Dr.
13	For loss on joint venture	Co-Venturers A/c To Joint Venture A/c	Dr.
14	For final distribution of funds	Co-Venturers A/c To Joint Bank A/c	Dr.

Illustration 1

Aditya and Amit entered into a joint venture to buy and sale Ganesh idols for the Ganesh festival. They opened a Joint Bank Account. Aditya deposited ₹2,00,000 and Amit ₹1,50,000. Aditya supplied Ganesh idols worth ₹ 25,000 and Amit supplied decoration material worth ₹15,000. The following payments were made by the venture:

(a) Cost of Ganesh idols purchased ₹2,50,000

(b) Transportation charges ₹12,000

(c) Advertising ₹7,500 and Sundry Expenses ₹2,500. They sold idols for ₹ 4,00,000 for cash. Aditya took over some idols for ₹30,000 and Amit took over remaining for ₹10,000. The profit or losses were to be shared equally between co-venturers. Prepare Joint Venture Account, Joint Bank Account and each Co-Venturer's Account.

Solution:

Joint Venture Account

Dr.		Cr.	
Particulars	Amount (₹)	Particulars	Amount (₹)
To Aditya A/c (Materials)	25,000	By Joint Bank A/c –sales	4,00,000
To Amit A/c (Materials)	15,000	By Aditya A/c	30,000
To Joint Bank A/c (Materials Purchased)	2,50,000	By Amit A/c	10,000
To Joint Bank A/c (Transport)	12,000		
To Joint Bank A/c (Advertising)	7,500		
To Joint Bank A/c (Sundry Exp.)	2,500		
To Profit on Venture A/c :			
Aditya	64,000		
Amit	64,000		
	4,40,000		4,40,000



Joint Bank Account

Dr.		Cr.	
Particulars	Amount (₹)	Particulars	Amount (₹)
To Aditya A/c (Contribution)	2,00,000	By Joint Venture A/c : (Material purchase)	2,50,000
To Amit A/c (Contribution)	1,50,000	By Joint Venture A/c :(Transport)	12,000
To Joint venture A/c (Sales)	4,00,000	By Joint Venture A/c : (Advertising)	7,500
		By Joint Venture A/c : (Sundry)	2,500
		By Aditya A/c : (Closing)	2,59,000
		By Amit A/c : (Closing)	2,19,000
	7,50,000		7,50,000

Dr.

Aditya's Account

Cr.

Particulars	Amount (₹)	Particulars	Amount (₹)
To Joint Venture A/c – (materials)	30,000	By, Joint Bank	2,00,000
To Joint Bank A/c – (closing)	2,59,000	By, Joint Venture – (materials)	25,000
		By, Joint Venture – (profit)	64,000
	2,89,000		2,89,000

Dr.

Amit's Account

Cr.

Particulars	Amount (₹)	Particulars	Amount (₹)
To Joint Venture A/c – (materials)	10,000	By, Joint Bank	1,50,000
To Joint Bank A/c – (closing)	2,19,000	By, Joint Venture A/c – (materials)	15,000
		By, Joint Venture A/c – (profit)	64,000
	2,29,000		2,29,000

Illustration 2

Prabir and Mihir doing business separately as building contractors undertake jointly to build a skyscraper for a newly started public limited company for a contract price of ₹1,00,00,000 payable as ₹80,00,000 in cash and the balance by way of fully paid equity shares of the new company. A Bank Account was opened for this purpose in which Prabir paid ₹25,00,000 and Mihir ₹15,00,000. The profit sharing ratio was agreed as 2:1 between Prabir and Mihir.

The transactions were:

- Advance received from the company ₹50,00,000
- Wages to contractors ₹10,00,000
- Bought materials ₹60,00,000
- Material supplied by Prabir ₹10,00,000
- Material supplied by Mihir ₹15,00,000
- Architect's fees paid from Joint Bank Account ₹21,00,000

The contract was completed and the price was duly paid. The joint venture was duly closed by Prabir taking all the shares at ₹18,00,000 and Mihir taking over the balance material for ₹3,00,000. Prepare the Joint Venture Account, Joint Bank Account, Co-venturer's Accounts and Shares Account.

Solution:

Dr.		Joint Venture Account		Cr.	
Particulars	Amount (₹)	Particulars	Amount (₹)		
To, Joint Bank A/c – (wages)	10,00,000	By, Joint Bank A/c – (advance)	50,00,000		
To, Joint Bank A/c – (materials)	60,00,000	By, Joint Bank A/c – (balance) price	30,00,000		
To, Joint Banks A/c – (Architect)	21,00,000	By, Shares A/c – (received)	20,00,000		
To, Prabir A/c – (materials)	10,00,000	By, Mihir A/c – (stock taken)	3,00,000		
To, Mihir A/c – (materials)	15,00,000	By, Prabir A/c – (2/3rd loss)	10,00,000		
To, Shares A/c – (loss)	2,00,000	By, Mihir A/c – (1/3rd loss)	5,00,000		
	1,18,00,000		1,18,00,000		

Dr.		Joint Bank Account		Cr.	
Particulars	Amount (₹)	Particulars	Amount (₹)		
To, Prabir A/c	25,00,000	By, Joint Venture A/c – (wages)	10,00,000		
To, Mihir A/c	15,00,000	By, Joint Venture A/c – (materials)	60,00,000		
To, Joint Venture A/c – (advance)	50,00,000	By, Joint Venture A/c – (Architect)	21,00,000		
To, Joint Venture A/c – (balance)	30,00,000	By, Prabir A/c – (balance paid)	7,00,000		
		By, Mihir A/c – (balance paid)	22,00,000		
	1,20,00,000		1,20,00,000		

Dr.		Prabir's Account		Cr.	
Particulars	Amount (₹)	Particulars	Amount (₹)		
To, Shares A/c – (taken)	18,00,000	By, Joint Bank A/c	25,00,000		
To, Joint Venture A/c – (loss)	10,00,000	By, Joint Venture A/c – (material)	10,00,000		
To, Joint Bank A/c – (balance paid)	7,00,000				
	35,00,000		35,00,000		

Dr.		Mihir's Account		Cr.	
Particulars	Amount (₹)	Particulars	Amount (₹)		
To, Joint Venture A/c – (stock taken)	3,00,000	By, Joint Bank A/c	15,00,000		
To, Joint Venture A/c – (loss)	5,00,000	By, Joint Venture A/c – (material)	15,00,000		
To, Joint Bank A/c – (balance paid)	22,00,000				
	30,00,000		30,00,000		

Dr.		Shares Account		Cr.	
Particulars	Amount (₹)	Particulars	Amount (₹)		
To, Joint Venture A/c	20,00,000	By, Prabir A/c	18,00,000		
		By, Joint Venture A/c – (loss)	2,00,000		
	20,00,000		20,00,000		

(b) When no Separate Books of Accounts are Maintained

The co-venturers may decide not to keep separate books of account for the venture if it is for a very short period



of time. In this case, all co-venturers will have account for the transactions in their own books. Here no Joint Bank Account is opened and the co-venturers do not contribute in cash. Goods are supplied by them from out of their stocks and expenses for the venture are also met by them. Each co-venturer will prepare a Joint Venture A/c and the other Co-Venturer's A/c in his books. Naturally, the profit or loss is separately calculated by each co-venturer. Each co-venturer will take into A/c all transactions i.e. done by himself and by his co-venturer as well.

In books of Co-venturer A	In books of co-venturer B
When goods are supplied and expenses paid by A	
Joint Venture A/c Dr. To, Goods A/c To, Cash / Bank A/c	Joint Venture A/c Dr. To, A's A/c
When goods are supplied by B and expenses paid by B	
Joint Venture A/c Dr. To, B's A/c	Joint Venture A/c Dr. To, Goods A/c To, Cash / Bank A/c
When advance is given by A to B or bill accepted by A	
B's A/c Dr. To, Cash / Bank A/c To, B/P A/c	Cash / Bank A/c Dr. B/R A/c Dr. To, A's A/c
When sale proceeds are received by A	
Cash / Bank A/c Dr. To, Joint Venture A/c	A's A/c Dr. To, Joint Venture A/c
When sale proceeds are received by B	
B's A/c Dr. To, Joint Venture A/c	Cash / Bank A/c Dr. To, Joint Venture A/c
For unsold goods taken over by A	
Goods A/c Dr. To Joint Venture A/c	A's A/c Dr. To Joint Venture A/c
For unsold goods taken over by B	
B's A/c Dr. To, Joint Venture A/c	Goods A/c Dr. To, Joint Venture A/c
For profit on joint venture business	
Joint Venture A/c Dr. To, B's A/c To, P & L A/c	Joint Venture A/c Dr. To, A's A/c To, P & L A/c
For loss on joint venture business	
B's A/c Dr. P & L A/c Dr. To, Joint Venture A/c	A's A/c Dr. P & L A/c Dr. To, Joint Venture A/c

Illustration 3

Ram, Mohan and Rahim were partners in a joint venture, each contributing ₹ 5,000. Ram purchased goods for ₹ 13,000 and also supplied goods worth ₹ 1,000 from his stock, Rahim also supplied goods to the value of ₹ 1,500 from stock and his expenses in connection with the supplying of goods on account of joint venture amounted to ₹ 50. Ram paid ₹ 250 for expenses in connection with the joint venture. There was a sale of ₹ 20,800 by Ram. Ram was entitled to a commission of 5 per cent on sales. Unsold goods amounting to ₹ 500 were taken over by Mohan. Ram settled accounts of Mohan and Rahim by Bank draft.

Records these transactions in Ram's journal and also prepare Joint venture account and Rohan and Rahim accounts in ram's books.

Solution:

Rama's Journal

Particulars	Dr. (₹)	Cr.(₹)
Bank A/c Dr. To Mohan A/c To Rahim A/c (Being amount received from Mohan and Rahim for joint venture)	10,000	5,000 5,000
Joint Venture A/c Dr. To Bank A/c (Being goods purchased on account of joint venture)	13,000	13,000
Joint Venture A/c Dr. To Goods A/c (Being goods supplied out of stock for joint venture)	1,000	1,000
Joint Venture A/c Dr To Rahim A/c (Being goods for ₹ 1,500 supplied for joint venture and expenses ₹ 50 incurred by Rahim)	1,550	1,550
Joint Venture A/c Dr. To Bank A/c (Begin expenses incurred in connection with joint venture)	250	250
Bank A/c Dr. To Joint Venture A/c (Being goods sold on account of joint venture)	20,800	20,800
Joint Venture A/c Dr. To Commission A/c (Being 5% commission on sale of ₹ 20,800 on account of joint venture)	1,040	1,040
Mohan A/c Dr. To Joint Venture A/c (Being unsold goods taken by Mohan)	500	500
Joint Venture A/c Dr. To Profit and Loss A/c To Mohan A/c To Rahim A/c (Being profit on joint venture transferred)	4,460	1,486 1,487 1,487
Mohan A/c Dr Rahim A/c Dr To Bank A/c (Being amount remitted to mohan and rahim in settlement of their accounts)	5,987 8,037	14,024

Dr		Joint Venture Account		Cr	
		₹			₹
To Bank Account (purchase)		13,000	By Bank Account (Sale)		20,800
To Goods Account (Goods Supplied)		1,000	By Mohan (unsold goods taken)		500
To Rahim (goods and expenses)		1,550			
To Bank Account (expenses)		250			
To Commission Account (5%)		1,040			
To Profit on joint venture transferred to:					
Profit & Loss Account	1,486				
Mohan	1,487				



Rahim	1,487	4,460	
		21,300	21,300

Dr		Mohan Account		Cr	
	₹			₹	
To Joint Venture Account	500	By Bank Account		5,000	
To Bank Account	5,987	By Joint Venture Account (profit)		1,487	
	6,487			6,487	

Dr		Rahim Account		Cr	
	₹			₹	
To Bank Account	8,037	By bank account		5,000	
		By joint venture Account		1,550	
		By joint venture Account (profit)		1,487	
	8,037			8,037	

Illustration 4

John and Smith entered into a joint venture business to buy and sale garments to share profits or losses in the ratio of 5:3. John supplied 400 bales of shirting at ₹500 each and also paid ₹ 18,000 as carriage & insurance. Smith supplied 500 bales of suiting at ₹ 480 each and paid ₹ 22,000 as advertisement & carriage. John paid ₹50,000 as advance to Smith. John sold 500 bales of suiting at ₹ 600 each for cash and also all 400 bales of shirting at ₹650 each for cash. John is entitles for commission of 2.5% on total sales plus an allowance of ₹2,000 for looking after business. The joint venture was closed and the claims were settled. Prepare Joint Venture Account and Smith's Account in the books of John and John's Account in the books of Smith.

Solution:

Books of John

Dr.		Joint Venture Account		Cr.	
Particular	₹	Particular	₹		
To, Goods A/c - shirting (400x500)	2,00,000	By, Cash A/c – sales			
To, Bank A/c - carriage & insurance	18,000	shirting (500 x 600)		3,00,000	
To, Smith A/c - suiting (500x480)	2,40,000	suiting (400 x 650)		2,60,000	
To, Smith A/c - Advt & Carriage	22,000				
To, Commission A/c - 2.5%	14,000				
To, Allowance A/c	2,000				
To, P & L A/c (5/8th share)	40,000				
To, Smith A/c (3/8th share)	24,000				
	5,60,000			5,60,000	

Dr.		Smith's Account		Cr.	
Particular	₹	Particular	₹		
To, Cash A/c – advance	50,000	By, Joint Venture A/c – suiting		2,40,000	
To, Cash A/c - balance paid	2,36,000	By, Joint Venture A/c – Expenses		22,000	
		By, Joint Venture A/c - profit		24,000	

	2,86,000		2,86,000
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Books of Smith

Dr. John's Account Cr.

Particular	₹	Particular	₹
To, Joint Venture A/c – sales	5,60,000	By, Cash A/c – advance	50,000
		By, Joint Venture A/c – shirting	2,00,000
		By, Joint Venture A/c – expenses	18,000
		By, Joint Venture A/c – commission	14,000
		By, Joint Venture A/c – allowance	2,000
		By, Joint Venture A/c – profit	40,000
		By, Cash A/c - balance paid	2,36,000
	5,60,000		5,60,000

(a) Memorandum Joint Venture Account

When all the parties keep accounts, the method adopted for recording the transactions relating to joint venture, is called Memorandum Joint venture method. Here each Co-Venturer records only those joint venture transactions which are affected by him with the help of a personal account designed as 'Joint Venture with.....(Name of the other Co-Venturer).....Account'. It is debited with the amount of purchases/supplies made and expenses incurred by the Venturer. Each Co-Venturer sends a periodic statement of joint venture transactions effected by him only, to the other Co-Venturer and on receipt of the aforesaid statement, each Co-Venturer prepares Memorandum Joint Venture Account in order to ascertain the profit/loss on Joint Venture transactions. Since this account is in fact, not a part and parcel of double entry system the word 'memorandum' is prefixed.

Journal Entries:

The journal entries which may be required at any point of time, are summarized below:

1.(a) On receipt of any amount / Bills Receivable from other Co-Venturer:	
Cash/Bank/Bills Receivable A/c Dr.	
To, Joint Venture withA/c	
1.(b) On discounting Bills Receivable:	
Bank A/c Dr.	(with net proceeds)
Joint Venture withA/c Dr.	(with discount)
To, Bills Receivable A/c	(with total)
2. On purchase of goods:	
Joint Venture withA/c Dr.	(with total)
To, Cash/Bank A/c	(with cash purchase)
To, Supplier's A/c	(with credit purchase)
3. On making payment to supplier	
Supplier's A/c Dr.	(with total)
To, Cash/Bank/Bills Payable A/c	(with payment made)
To, Joint Venture withA/c	(with discount received)
4. On supply of goods out of own stock:	
Joint Venture withA/c Dr.	(if supplies at cost)
To, Purchases/Goods sent on Joint Venture A/c	(if supplies at profit)
To, Sales A/c	
5. On payment of expenses:	



Joint Venture withA/c Dr.	(with total)
To, Cash/Bank A/c	(with cash expenses)
To, Creditor's A/c	(with outstanding expenses)
6. On sale of goods:	
Cash/Bank A/c Dr.	(with cash sales)
Customer's A/c Dr.	(with credit sales)
To, Joint Venture withA/c	(with total)
7. On receiving payment from a customer:	
Cash/Bank A/c Dr.	(with the payment received)
Joint Venture withA/c Dr.	(discount allowed/bad debt)
To, Customer's A/c	(with the payment received)
8. On taking away of unsold goods:	
Goods Sent on Joint Venture A/c Dr.	
To, Joint Venture withA/c	
9. On considering some commission/salary to the Co-Venturer:	
Joint Venture withA/c Dr.	
To, Commission/Salary A/c	
10. On recording the share of Profit/Loss:	
(a) When profit-	
Joint Venture withA/c Dr.	
To, Profit & Loss A/c	
(b) When loss-	
Profit & Loss A/c Dr.	
To, Joint Venture withA/c	
11. On settlement of balance of Joint Venture with.....A/c:	
(a) When there is a debit balance:	
Cash/Bank A/c Dr.	
To, Joint Venture withA/c	
(b) When there is a credit balance:	
Joint Venture withA/c Dr.	
To, Cash/Bank A/c	

Illustration 5

Bharat and Sujit joined together as co-ventures for equal share in profits through sale of television cabinets. On March 31, 2015, Bharat purchased 2,000 cabinets at ₹1,250 each for cash and sent 1,500 of these to Sujit for sale, the selling price of each being ₹1,300. All the cabinets were sold by April 30, 2015 by both and the proceeds collected. Each venturer recorded in his books only those transactions concluded by him, final profit and loss being ascertained through a Memorandum joint venture Account.

The expenses met by the venturer were:

	₹
Bharat: Freight and insurance	12,000
Selling expenses	5,000
Sujit: Clearing charges	1,000
Selling expenses	12,000

Final settlement between the venturers took place on May 31, 2015. You are required to show:

- joint venture with Sujit A/c in the books of Bharat
- Joint venture with Bharat A/c in the books of Sujit; and
- Memorandum joint venture Account.

Solution:

Bharat's books
Joint venture with Sujit Account

Dr.			Cr.		
Date	Particulars	₹	Date	Particulars	₹
2015 Mar. 31	To purchases – 2,000 television cabinets @ ₹ 1,250	25,00,000	April. 30	By cash- sale proceeds of 500 @ cabinets ₹ 1,300 each	6,50,000
April, 30	To cash – expenses: Freight & Insurance	12,000	May 31	By cash (settlement of accounts)	19,02,000
	Selling Expenses	5,000			
May 31	To profit & loss Account ½ share of profit	35,000			
		25,52,000			25,52,000

Sujit's books
Joint venture with Bharat Account

Dr.			Cr.		
Date	Particulars	₹	Date	Particulars	₹
2010 Mar.31	To cash – expenses: Clearing charges	1,000	2010 April 30	By cash- sale proceeds of 1,500 cabinets at ₹ 1,300 each	19,50,000
	Selling expenses	12,000			
May 31	To profit & loss A/c ½ share of profit	35,000			
May 31	To cash (settlement)	19,02,000			
		19,50,000			19,50,000

Memorandum joint venture account

Dr.			Cr.		
Date	Particulars	₹	Date	Particulars	₹
2010 Mar.31	To purchases: Bharat 2,000 Television cabinets at ₹ 1,250 each	25,00,000	2007 April 30	By sales : Bharat	6,50,000
April,30	To expenses: Bharat (12,000 + 5,000)	17,000		Sujit	19,50,000
	Sujit (1,000 + 12,000)	13,000			
May 31	To Net profit: Bharat (1/2) 35,000 Sujit (1/2) 35,000	70,000			
		26,00,000			26,00,000

Illustration 6

M and N decided to work in partnership with the following scheme, agreeing to share profits as under :

M — ¾th share.

N—¼th share.

They guaranteed the subscription at par of 10,00,000 shares of ₹1 each in U Ltd. And to pay all expenses up to allotment in consideration of U Ltd. issuing to them 50,000 other shares of ₹1 each fully paid together with a commission @ 5% in cash which will be taken by M and N in 3 : 2. M and N introduced cash as follows:



M— Stamp Charges, etc.,	4,000
Advertising Charges	3,000
Printing Charges	3,000
N— Rent	2,000
Solicitor's Charges	3,000

Application fell short of the 10,00,000 shares by 30,000 shares and N introduced ₹30,000 for the purchase of those shares. The guarantee having been fulfilled, U Ltd. handed over to the venturers 50,000 shares and also paid the commission in cash. All their holdings were subsequently sold by the venturer N receiving ₹18,000 and M ₹50,000. Write-up necessary accounts in the books of both the parties on the presumption that Memorandum Joint Venture Account is opened for the purpose.

Solution:

Dr.		Memorandum Joint Venture Account		Cr.	
Particulars	Amount(₹)	Amount(₹)	Particulars	Amount(₹)	
To, N : Cost or Shares		30,000	By M : Commission (3/5)	30,000	
To, M : Stamp Charges etc.,	4,000		N : Commission (2/5)	20,000	
Advertising Charges	3,000		By M : Sale Proceeds	50,000	
Printing Charges	3,000	10,000	N : Sale Proceeds	18,000	
To, N : Rent	2,000				
Solicitor's Charges	3,000	5,000			
To, Profit on Venture :					
To M — $\frac{3}{4}$	54,750				
To N — $\frac{1}{4}$	18,250	73,000			
		1,18,000			1,18,000

**In the books of M
Joint Venture with N**

Dr.		Cr.	
Particulars	Amount(₹)	Particulars	Amount(₹)
To, Bank : Stamp, Adv. & Printing Charges	10,000	By, Bank : Commission	30,000
To, Share of Profit	54,750	By, Bank : Sale Proceeds	50,000
To, Bank (Remittance)	15,250		
	80,000		80,000

**In the books of N
Joint Venture with M**

Dr.		Cr.	
Particulars	Amount (₹)	Particulars	Amount (₹)
To, Bank : Cost of Shares	30,000	By, Bank : Commission	20,000
To, Bank : Rent and Solicitor's Charges	5,000	By, Bank : Sale Proceeds	18,000
To, Share of Profit	18,250	By, Bank (Remittance)	15,250
	53,250		53,250

Joint Venture Business on Consignment Principle

The co-venturers may decide to appoint an agent for selling goods on their behalf on consignment basis. He is allowed expenses and commission on sales. The agent would remit the cash to co-venturers. In such case in addition to Joint Venture A/c and the co-venturer's A/c a separate Account is maintained for the agent as well. The Agent's A/c is debited with the sales proceeds received by him and credited with the expenses incurred and commission payable to him. Hence additional entries are:

(I) Goods sold by the agent

Agent's A/c Dr.
 To, Joint Venture A/c

(II) Expenses & commission entitled to agent

Joint Venture A/c Dr.
 To, Agent's A/c

(III) Payment received from agent

Bank A/c Dr.
 To, Agent's A/c

(IV) Cash paid by agent to co-venturers

Co-Venturers' A/c Dr.
 To, Agent's A/c

Illustration 7

A and B enter into joint venture sharing profit 3/5ths and 2/5ths. A is to purchase timber in Madhya Pradesh and forward it to B in Delhi. A purchases timber worth ₹10,000 and pays ₹1,000 as expenses. B received the consigned and immediately accepted A's draft for ₹8,000. A gets discounted for ₹7,850. B sold the timber for ₹16,000. He had to spend ₹350 for fire insurance and ₹300 for other expenses. Under the agreement he is entitled to a commission of 5% sales.

Give ledger accounts in the books of A and B.

Solution:

In the books of 'A'			
Joint Venture Account			
Dr.		Cr.	
Particulars	₹	Particulars	₹
To Bank: (purchase of timber)	10,000	By B's A/c (Sales)	16,000
To Bank (Expenses)	1,000		
To Bills Receivable A/c (Discount)	150		
To B's A/c:			
Fire Insurance	350		
Expenses	300		
Commission	800		
To Profit & Loss A/c	2,040		
To B's A/c	1,360		
	16,000		16,000



Dr.		B's Account		Cr.	
Particulars	₹	Particulars	₹		
To Joint Venture A/c	16,000	By Bills Receivable A/c	8,000		
		By Joint Venture A/c (Expenses & Commission)	1,450		
		By Joint Venture A/c (profit)	1,360		
		By Bank A/c	5,190		
	16,000		16,000		

**In the books of 'B'
Joint Venture Account**

Dr.		Cr.	
Particulars	₹	Particulars	₹
To A's A/c: Purchase of timber	10,000	By bank A/c (sales)	16,000
Expenses	1,000		
B/R (discount)	150		
To Bank: Fire Insurance	350		
Expenses	300		
To Commission	800		
To A's A/c (profit)	2,040		
To P. & L. A/c	1,360		
	3,400		
	16,000		16,000

Dr		A's Account		Cr	
Particulars	₹	Particulars	₹		
To Bills Payable A/c	8,000	By Joint Venture A/c	11,150		
To Bank A/c	5,190	By Joint Venture A/c (profit)	2,040		
	13,190		13,190		

EXERCISE:

1. A and B were participants in a joint venture, sharing profits and losses in the proportion of 10:9 respectively. Each party maintains a complete record in his own books. A supplies goods to the value of ₹25,000 and incurs an expenditure of ₹500 on them; and B supplies goods to the extent of ₹21,000 and his expenses thereon amounted to ₹1000. A sells all the goods for ₹70,000 for which he is entitled to receive a commission at 5 percent. Accounts are settled by bank draft. Give journal entries and prepare necessary accounts in the books of both parties.
Ans: Profit = ₹19,000, Amount Paid to B = ₹31,000

2. Dilip and Raj are doing business separately engineering contractors. They undertake jointly to build and install new machinery for a company for a contract price of ₹1,34,000. ₹84,000 payable in installments in cash and the balance as fully paid share in the new company. A bank account is opened in joint names. Dilip paying ₹45,000 and Raj 20,000. They agree to share profits and losses in the proportion of 3/5 and 2/5 respectively. The transactions were as follows:

Particulars	₹
Amount advance to suppliers for supply of materials	52,000
Value of materials supplied by suppliers	89,000
Balance amount paid to suppliers in full and final settlement	35,500
Paid wages	36,000

Materials purchased in cash	2,500
Engineering consultant's fee paid	3,250
Materials supplied by Dilip from stock	9,250
Value of stocks lost by fire and not covered by insurance	3,500

The contract was completed and price duly received.

Dilip took all the shares at an agreed value of ₹47,000 and Raj took the balance stock of materials work ₹3,500 at an agreed value of ₹2,750.

Show the necessary ledger accounts assuming a separate set of books is opened.

Ans: Loss of Joint Venture = ₹2,750, Final settlement Dilip- ₹5,600, Raj - ₹16,150 Discount allowed by the supplier - ₹1,500

3. Das, Bose and Gupta undertake to erect a five storied mansion for National Housing Trust Ltd. The contract price is agreed at ₹25,00,000 to be paid in cash ₹22,00,000 by four equal installments and the balance amount in 8% Debentures of the company. They agree to share equally the profit or loss.

They opened a Joint Banking Account with cash contributed as stated below; Das ₹3,00,000: Bose: ₹3,75,000: Gupta ₹2,00,000 Das arranges the preparation of building plans, etc., and pays ₹32,000 as architect's fees. Bose brings a concrete mixer and other implements valued at ₹80,000 and Gupta brings a motor lorry valued at ₹75,000.

They paid in cash for the following;

	₹
Materials	12,26,800
Wages	7,33,200
Sundry expenses	20,000
Plant	60,000

On completion of the venture concrete mixer is sold ₹50,000 and plant and other implements are sold as scrap for ₹10,000. Gupta takes back the motor lorry at ₹40,000.

Subsequently Das took over the Debentures issued by the company at a valuation of ₹2,80,000.

Show the necessary ledger accounts for the joint venture.

Ans: ₹3,54,000, Amount paid to Das ₹1,70,000, Bose ₹5,73,000 Gupta = ₹3,53,000

4. A and B decided to work on a joint venture to sale electric motors. On 21th May 2014. A purchased 200 electric motors at ₹ 1,750 each and dispatched 150 motors to B incurring ₹ 10,000 as freight and insurance. 10 motors got damaged in transit. On 1st Feb 2015, insurance company paid ₹ 5,000 to A in full settlement of the claim. On 15th March, 2015, A sold 50 motors at ₹ 2,250 each. He received ₹ 1,50,000 from B on 1st April 2015.

On 25th May 2015, B took delivery of motors and paid ₹ 1700 for clearing, repairs ₹ 3,000 and rent of ₹ 6,000. B sold motors as on 1st Feb 2015 – 10 damaged motors at ₹ 170 each, on 15th March 2015 – 40 motors at ₹ 2,000 each, on 1st April 2015 – 20 motors at ₹ 3150 each and on 1st April 2015, 80 motors at ₹ 2,500 each. It was agreed that they would be entitled for a commission of 10% on the respective sales made by them and that the profit or losses will be shared by A & B in the ratio of 2:1.

On 30th April 2015, B remits the cash to A to close the venture Prepare "Joint venture with B A/c" in the books of A and the memorandum joint venture A/c.

Ans: Profit A - ₹39,700, B- ₹19,850, Balance received from B - ₹1,43,450



Multiple Choice Questions:

1. Joint venture account is of the nature of
(a) Personal A/c (b) Nominal A/c (c) Real A/c (d) Suspense account
2. A and B purchased a piece of land for ₹40,000 and sold it for ₹ 60,000 in 2015. Originally A had contributed ₹ 24,000 and B ₹ 16,000. What will be the profit on venture?
(a) ₹ 20,000 (b) ₹16,000 (c) ₹30,000 (d) Nil
3. A, for joint venture with B, Purchased goods costing ₹2,00,000. B sold 80% of the goods for ₹ 2,50,000. Balance of goods were taken over by B at cost less 25%. Find out profit on venture?
(a) ₹80,000 (b) ₹90,000 (c) ₹50,000 (d) None of these
4. If unsold goods costing ` 20,000 is taken over by venture at ` 15,000 the Joint venture A/c will be credited by
(a) ₹ 20,000 (b) ₹ 15,000 (c) ₹ 5,000 (d) Nil
5. Memorandum joint venture account is
(a) personal account (b) real account (c) nominal account (d) none of the above
6. A purchased goods costing ` 42,500. B sold goods of ₹ 40,000 at ₹ 50,000. Balance goods were taken over by A at same gross profit percentage as in case of sale. The amount of goods taken over will be.
(a) ₹ 3,125 (b) ₹ 2,500 (c) ₹ 3,000 (d) None
7. What is the nature of joint venture with co-venture account
(a) Nominal account (b) Real account (c) Personal account (d) None of these
8. 'M' and 'N' enter into joint venture where 'M' supplies goods worth ₹6,000 and spend ₹100 on various expenses. 'N' sells the entire lot for ₹7,500 meeting selling expenses amounted to ₹200 profit sharing ratio equal. N remits M the amount due. The amount of remittance will be
(a) ₹6,700 (b) ₹7,300 (c) ₹6,400 (d) ₹6,100
9. A and B purchased a piece of land for ₹ 20,000 and sold it for ₹ 60,000 in 2015. Originally A had contributed ₹ 12,000 and B ₹ 8,000. The profit on venture will be :
(a) ₹ 40,000 (b) ₹ 20,000 (c) ₹ 60,000 (d) Nil
10. A and B enter in to joint venture sharing profit and loss in the ratio 1:1 A purchased goods costing ₹20,000. B sold the goods for ₹ 25,000. A is entitled to get 1% commission on purchase and B is entitled to get 5% commission on sales the profit will be
(a) ₹ 3,550 (b) ₹ 3,600 (c) ₹3,400 (d) ₹3,800
11. Goods costing ₹ 10,000 destroyed by an accident, insurance claim nil
(a) ₹ 10,000 will be credited to joint venture account
(b) No entry will be made in the books of joint venture
(c) ₹ 10,000 will be debited in Joint venture account as loss
(d) ₹ 8,000 will be credited in joint venture account
12. Which of the following statement is true?
(a) There is no difference between joint venture and partners
(b) Consignment and joint venture is same
(c) There is not separate act for joint venture
(d) In case of joint venture, the number of third party is none only
13. Which of the following accounts are maintained in the joint venture when separate set of books are maintained
(a) Joint bank A/c (b) Joint venture A/c (c) Co-ventrueer A/c (d) All of these
14. If A co-venturer takes away goods under memorandum joint venture method then he will debit these goods in his books to
(a) Joint venture account (b) personal account (c) Purchases account (d) sales account
15. For opening joint bank account, in case of separate sets of books:
(a) Ventrue a/c will be debited and ventures A/c will be credited
(b) Joint Bank A/c is debited and ventures capital A/c is credited

- (c) Joint venture A/c is debited and joint Bank A/c will be credited
 (d) Joint Bank A/c will be debited and joint venture A/c will be credited

Ans: 1.b 2.a 3.a 4.b 5.c 6.c 7.c 8.a 9.a 10.a 11.b 12.c 13.d 14.c 15.b

Fill in the blanks:

- The account opened in the bank in joint name of the co-ventures is ___ (Joint bank account)
- Partners of Joint venture business are called ___ (Co-venturers)
- Under Memorandum Joint venture, each co-venturer opens only one account which is in the nature of a ___ (personal account)
- When goods are sold for the joint venture the account to be credited in separate set of books ___ (Joint venture account.)
- The accounts to be credited for transferring profit on Joint venture in the books of the co-venturer maintaining accounts regarding joint venture are ___ (profit and loss account and other party account)
- Generally, when the size of the venture is ___ the co-venture keep separate set of books of account for the joint venture. (Big)
- ___ is the concept which the joint venture accounting does not follow. (Going concern)
- ___ is credit balance of joint venture account. (Profit)
- ___ is not a part of double entry system. (Memorandum)
- When co-venture initially contribute for a joint venture ___ account should be debit in the case when separate set of books are maintained. (Joint bank)
- Maximum number of members in joint venture business ___ (Unlimited.)
- Memorandum Joint-venture account is prepared to find out ___ in venture (profit or loss)
- Joint venture does not follow ___ basis of accounting. (Accrual)
- When separate set of books is maintained expenses paid by venture will be ___ to joint venture account. (debited)
- Co-ventruer account is ___ account. (personal)

True or False:

- Expenses incurred by co-venture are debited in joint venture account (TRUE)
- The profit to be shared between the venture in agreed ratio (TRUE)
- In joint venture, provisions of partnership act applies (FALSE)
- The transactions regarding transfer of goods from one venturer to another venturer will affect book-keeping entries (FALSE)
- If goods costing Rs. 10,000 destroyed by an accident, insurance claim nil then no entry will be made in the books of joint venture (TRUE)
- Joint venture has a definite life (TRUE)
- Joint venture agreement must be registered (FALSE)
- Memorandum joint venture account is a real account (FALSE)
- Contract money received is credited to Joint venture account (TRUE)
- Joint bank account is a Nominal account (FALSE)

Match the following:

Group – A

1. Memorandum joint venture account	d	a) Co-venturers
2. Joint venture account is	c	b) Memorandum account
3. Partners of joint venture business	a	c) Nominal account
4. Under joint bank account method which Account is not opened	b	d) to find out profit or loss
5. The account opened in the bank in Joint name of the co-ventures	e	e) joint bank account



Group – B

1. The nature of joint venture with co-venture A/c	c	a) Memorandum A/c
2. Expenses incurred by co-venture are debited to	d	b) Profit
3. The account is not a part of double entry system	a	c) personal account
4. Memorandum joint venture account is	e	d) joint venture
5. Credit balance of joint venture account	b	e) Nominal account

STUDY NOTE : 3

PREPARATION OF FINAL ACCOUNTS:

THIS STUDY NOTE INCLUDES:

3.1 Profit making concern (for sole proprietorship concern)

3.2 Not-for- Profit making concern

3.1 PROFIT MAKING CONCERN (FOR SOLE PROPRIETORSHIP CONCERN)

The most important function of an accounting system is to provide information about the profitability of the business. A sole trader furnishes a Trading and Profit and Loss Account which depicts the result of the business transactions of the sole trader. Along with the Trading and Profit and Loss Account he also prepares a Balance Sheet which shows the financial position of the business.

Steps in the Process of Finalization of Accounts

A. For Trading Concerns:

1. Trading Account.
2. Profit and Loss Account.
3. Balance Sheet.

B. For Manufacturing and Trading Concerns:

1. Manufacturing Account.
2. Trading Account.
3. Profit and Loss Account.
4. Balance Sheet.

Profitability Statement –

This statement is related to a complete accounting period. It shows the outcome of business activities during that period in a summarized form. The activities of any business will include purchase, manufacture, and sell.

Balance Sheet –

Business needs some resources which have longer life (say more than a year). Such resources are, therefore, not related to any particular accounting period, but are to be used over the useful life thereof. The resources do not come free. One requires finance to acquire them. This funding is provided by owners through their investment, bank & other through loans, suppliers by way of credit terms. The Balance Sheet shows the list of resources and the funding of the resources i.e. assets and liabilities (towards owners and outsiders). It is also referred as sources of funds (i.e. liabilities & capital) and application of funds (i.e. assets). Let us discuss these statements in depth.

Trading Account:

It is an account which is prepared by a merchandising concern which purchases goods and sells the same during a particular period. The purpose of it to find out the gross profit or gross loss which is an important indicator of business efficiency.

The following items will appear in the debit side of the Trading Account:

**(i) Opening Stock:**

In case of trading concern, the opening stock means the finished goods only. The amount of opening stock should be taken from Trial Balance.

(ii) Purchases:

The amount of purchases made during the year. Purchases include cash as well as credit purchase. The deductions can be made from purchases, such as, purchase return, goods withdrawn by the proprietor, goods distributed as free sample etc.

(iii) Direct expenses:

It means all those expenses which are incurred from the time of purchases to making the goods in suitable condition. This expenses includes freight inward, octroi, wages etc.

(iv) Gross profit:

If the credit side of Trading A/c is greater than debit side of Trading A/c gross profit will arise.

The following items will appear in the credit side of Trading Account:

(i) Sales Revenue:

The sales revenue denotes income earned from the main business activity or activities. The income is earned when goods or services are sold to customers. If there is any return, it should be deducted from the sales value. As per the accrual concept, income should be recognized as soon as it is accrued and not necessarily only when the cash is paid for. The Accounting standard 7 (in case of contracting business) and Accounting standard 9 (in other cases) define the guidelines for revenue recognition. The essence of the provisions of both standards is that revenue should be recognized only when significant risks and rewards (vaguely referred to as ownership in goods) are transferred to the customer. For example, if an invoice is made for sale of goods and the term of sale is door delivery; then sale can be recognized only on getting the proof of delivery of goods at the door of customer. If such proof is pending at the end of accounting period, then this transaction cannot be taken as sales, but will be treated as unearned income.

(ii) Closing Stocks:

In case of trading business, there will be closing stocks of finished goods only. According to convention of conservatism, stock is valued at cost or net realizable value whichever is lower.

(iii) Gross Loss:

When debit side of Trading A/c is greater than credit side of Trading A/c, gross loss will appear.

Dr.		Trading Account for the year ended		Cr.	
Particulars	Amount	Particulars	Amount		
Opening Stock:		Sales			
Finished goods		Less : Sales return			
Purchases		Closing stock			
Less : Purchase returns		Finished goods			
Gross Profit (transferred to P&L A/c)		Gross Loss (transferred to P&L A/c)			
Total		Total			

Preparation of Trading Account

Illustration 1.

Following are the ledger balances presented by M/s. P. Sen as on 31st March 2015.

Particulars	Amount	Particulars	Amount
Stock (1.4.2014)	10,000	Sales	3,00,000
Purchase	1,60,000	Return Inward	16,000
Carriage Inwards	10,000	Return Outward	10,000
Wages	30,000	Royalty on Production	6,000
Freight	8,000	Gas and Fuel	2,000

Additional Information:

- (1) Stock on 31.3.2015: (i) Market Price ₹ 24,000; (ii) Cost Price ₹ 20,000;
- (2) Stock valued ₹ 10,000 were destroyed by fire and insurance company admitted the claim to the extent of ₹ 6,000.
- (3) Goods purchased for ₹ 6,000 on 29th March, 2015, but still lying in-transit, not at all recorded in the books.
- (4) Goods taken for the proprietor for his own use for ₹ 3,000.
- (5) Outstanding wages amounted to ₹ 4,000.
- (6) Freight was paid in advance for ₹ 1,000.

Solution:

**In the books of M/s. P. Sen
Trading Account
For the year ended 31st March, 2015**

Dr.	Particulars	Amount	Amount	Particulars	Amount	Amount	Cr.
	To Opening Stock		10,000	By Sales	3,00,000		
	To Purchase	1,60,000		Less: Return Inward	16,000	2,84,000	
	Less: Return Outward	10,000		By Closing Stock	20,000		
		1,50,000		Add: Stock Destroyed	10,000		
	Less: Goods taken by Proprietor	3,000			30,000		
		1,47,000		Add: Goods-in-Transit	6,000	36,000	
	Add: Goods-in-transit	6,000	1,53,000				
	To Wages	30,000					
	Add: Outstanding	4,000	34,000				
	To Carriage Inwards		10,000				
	To Freight	8,000					
	Less: Prepaid	1,000	7,000				
	To Gas & Fuel		6,000				
	To Profit & Loss A/c (Gross Profit transferred)		98,000				
			3,20,000				3,20,000

Note:

- (a) Stock should be valued as per cost price or market price whichever is lower.
- (b) The claim which was admitted by insurance company and the loss of stock, will not appear in Trading Account.



Profit and Loss Account:

The following items will appear in the debit side of the Profit & Loss A/c:

(i) Cost of Sales:

This term refers to the cost of goods sold. The goods could be manufactured and sold or can be directly identified with goods.

(ii) Other Expenses:

All expenses which are not directly related to main business activity will be reflected in the P&L component. These are mainly the Administrative, Selling and distribution expenses. Examples are salary to office staff, salesmen commission, insurance, legal charges, audit fees, advertising, free samples, bad debts etc. It will also include items like loss on sale of fixed assets, interest and provisions. Students should be careful to include accrued expenses as well.

The following items will appear in the credit side of Profit & Loss A/c:

(i) Revenue Incomes:

These incomes arise in the ordinary course of business, which includes commission received, discount received etc.

(ii) Other Incomes:

The business will generate incomes other than from its main activity. These are purely incidental. It will include items like interest received, dividend received, etc. The end result of one component of the P&L A/c is transferred over to the next component and the net result will be transferred to the balance sheet as addition in owners' equity. The profits actually belong to owners of business. In case of company organizations, where ownership is widely distributed, the profit figure is separately shown in balance sheet.

Dr. **Profit and Loss Account for the year ended** Cr.

Particulars	Amount	Particulars	Amount
Gross Loss (transferred from Trading A/c)		Gross Profit (transferred from Trading A/c)	
Administrative expenses		Other Income	
Office salaries		Interest received	
Communication		Commission received	
Travel & Conveyance		Profit on sale of assets	
Office rent		Rent received	
Depreciation of office assets		Net loss	
Audit fees		Total	
Insurance			
Repairs & maintenance			
Selling & Distribution expenses			
Advertising			
Salesmen commission			
Delivery van expenses/Depreciation on delivery vans/Bad debts			
Financial expenses			
Bank charges			
Interest on loans			
Loss on sale of assets			
Net profit			
Total			

Trading and Profit and Loss Account (Vertical Format)

Particulars	Schedule	Amount
Income		
Sales and operating income	1	XXXX
Other income	2	XXXX
Total		XXXXX
Expenditure		
Cost of goods sold	3	XXXX
Operating and other expenses	4	XXXX
Depreciation / Amortisation		XXXX
Interest		XXXX
Total		XXXXX
Add /Less: Exceptional Items		XXXX
Profit /(Loss) before Tax		XXXXX
Less: Tax		XXXX
Profit/ (Loss) after Tax		XXXXX

Illustration 2.

Indicate where the following items will be shown in various components of Trading Account and P & L Account:

(1) Wages	(2) Salaries to office staff
(3) Depreciation on office car	(4) Power & fuel
(5) Repairs to machinery	(6) Maintenance of office building
(7) Purchase returns or return outwards	(8) Closing stock of WIP
(9) Opening stock of finished goods	(10) Interest received
(11) Commission paid	(12) Telephone
(13) Travel & conveyance	(14) Insurance
(15) Audit fees	(16) Carriage inward
(17) Freight outward	(18) Bad debts
(19) Provision for outstanding rent	(20) Return inwards or sales returns
(21) Discount earned	(22) Depreciation on delivery van
(23) Printing and stationery	(24) Sales

Solution:

Item	Treatment	Where
Wages	Trading A/c	Dr
Salaries to office staff	P & L A/c	Dr.
Depreciation on office car	P & L A/c	Dr.
Power & fuel	Trading A/c	Dr.
Repairs to machinery	P & L A/c	Dr
Maintenance of office building	P & L A/c	Dr
Purchase returns or return outward	Trading A/c	Dr less from purchases
Closing stock of WIP	Trading A/c	Cr
Opening stock of finished goods	Trading A/c	Dr
Interest received	P & L A/c	Cr



Commission paid	P & L A/c	Dr
Telephone	P & L A/c	Dr
Travel & conveyance	P & L A/c	Dr
Insurance	P & L A/c	Dr
Audit fees	P & L A/c	Dr
Carriage inward	Trading A/c	Dr
Freight outward	P & L A/c	Dr
Bad debts	P & L A/c	Dr
Provision for outstanding rent	P & L A/c	Dr
Return inwards or sales returns	Trading A/c	Cr less from sales
Discount earned	P & L A/c	Cr
Depreciation on delivery van	P & L A/c	Dr
Printing and stationery	P & L A/c	Dr.
Sales	Trading A/c	Cr.

Preparations of Profit & Loss Account

Illustration 3.

From the following particulars presented by Sri Tirlhankar for the year ended 31st March 2015, Prepare Profit and Loss Account.

Gross Profit ₹ 1,00,000, Rent ₹ 22,000; Salaries, ₹ 10,000; Commission (Cr.) ₹ 12,000; Insurance ₹ 8,000; Interest (Cr.) ₹ 6,000; Bad Debts ₹ 2,000; Provision for Bad Debts (1.4.2012) ₹ 4,000; Sundry Debtors ₹ 40,000; Discount Received ₹ 2,000; Plant & Machinery ₹ 80,000.

Adjustments:

- Outstanding salaries amounted to ₹ 4,000;
- Rent paid for 11 months;
- Interest due but not received amounted to ₹ 2,000
- Prepaid Insurance amounted to ₹ 2,000;
- Depreciate Plant and Machinery by 10% p.a.
- Further Bad Debts amounted to ₹ 2,000 and make a provision for Bad Debts @5% on Sundry Debtors.
- Commissions received in advance amounted to ₹ 2,000.

Solution:

**In the Books of Sri Tirlhankar
Profit and Loss Account
for the year ended 31st March 2015**

Dr.			Cr.		
Particulars	Amount (₹)	Amount (₹)	Particulars	Amount (₹)	Amount (₹)
To, Rent	22,000		By Trading A/c (Gross Profit)		1,00,000
Add: Outstanding	2,000	24,000	By Commission	12,000	
To, Salaries	10,000		Less: Received in advance	2,000	10,000
Add: Outstanding	4,000	14,000	By Interest	6,000	
To, Insurance	8,000		Add: Accrued Interest	2,000	8,000
Less: Prepaid	2,000	6,000	By Discount received		2,000
To, Bad Debts	2,000		By Provisions for Bad Debts	4,000	
Add: further Bad Debts	2,000	4,000	Less: New Provision @ 5% on (₹ 40,000 – ₹ 2,000)	1,900	2,100
To, Depreciation on Plant & Machinery @10% on ₹ 80,000		8,000			

To, Capital A/c (Net Profit Transferred)		66,100		
		1,22,100		1,22,100

Profit and Loss Appropriation Account:

We know that the net profit or loss is added to or deducted from owner's equity. The net profit may be used by the business to distribute dividends, to create reserves etc. In order to show these adjustments, a P & L Appropriation A/c is maintained. Distribution of profits is only appropriation and does not mean expenses. After passing such distribution entries, the remaining surplus is added in owner's equity. The format of P & L Appropriation A/c is given below:

Dr.		Profit and Loss Appropriation Account for the year ended		Cr.
Particular	Amount	Particulars	Amount	
To Proposed Dividend		By Net profit transferred from P&L A/c		
To Transfer to General Reserve				
To Surplus carried to Capital A/c				
Total		Total		

Illustration 4.

X, Y and Z are three Partners sharing profit and Losses equally. Their capital as on 01.04.2014 were: X ₹80,000; Y ₹60,000 and Z ₹50,000. They mutually agreed on the following points (as per partnership deed) (a) Interest on capital to be allowed @ 5% p.a. (b) X to be received a salary @ ₹500 p.m. (c) Y to be received a commission @ 4% on net profit after charging such commission. (d) After charging all other items 10% of the net profit to be transferred General Reserve. Profit from Profit and Loss Account amounted to ₹66,720. Prepare a Profit and Loss Appropriation Account for the year ended 31st March, 2015.

Solution:

Particulars	Amount(₹)	Amount (₹)	Particulars	Amount(₹)	Amount(₹)
To, Interest on Capital:			By, Profit and Loss A/c		66,720
X	4000				
Y	3000				
Z	2500				
“ Salaries		9,500			
X : (₹500 x 12)					
“ Commission		6,000			
Y					
“ General Reserve		1970 ¹			
“ Net Divisible Profit		4,925			
X	14,775				
Y	14,775				
Z	14,775				
		44,325			
		66,720			66,720

Workings:

1. Net Profit before charging Y's Commission = ₹ (66,720 – 15,500) = ₹ 51,220 Less: Y's Commission @ 4% i.e.

(4/104 × ₹ 51,220) = ₹ 1,970

2. Transfer to General Reserve = ₹ 49,250 × 10% = ₹ 4,925

Balance Sheet: Horizontal format of Balance Sheet is also used by the business other than company



A. Liabilities

(a) Capital:

This indicates the initial amount the owner or owners of the business contributed. This contribution could be at the time of starting business or even at a later stage to satisfy requirements of funds for expansion, diversification etc. As per business entity concept, owners and business are distinct entities, and thus, any contribution by owners by way of capital is liability.

(b) Reserves and Surplus:

The business is a going concern and will keep making profit or loss year by year. The accumulation of these profit or loss figures (called as surpluses) will keep on increasing or decreasing owners' equity. In case of non-corporate forms of business, the profits or losses are added to the capital A/c and not shown separately in the balance sheet of the business.

(c) Long Term or Non-Current Liabilities:

These are obligations which are to be settled over a longer period of time say 5-10 years. These funds are raised by way of loans from banks and financial institutions. Such borrowed funds are to be repaid in installments during the tenure of the loan as agreed. Such funds are usually raised to meet financial requirements to procure fixed assets. These funds should not be generally used for day-to-day business activities. Such loan are normally given on the basis of some security from the business e.g. against a charge on the fixed assets. So, long term loan are called as "Secured Loan" also.

(d) Short Term or Current Liabilities:

A liability shall be classified as Current when it satisfies any of the following:

- It is expected to be settled in the organisation's normal Operating Cycle,
- It is held primarily for the purpose of being traded,
- It is due to be settled within 12 months after the Reporting Date, or
- The organization does not have an unconditional right to defer settlement of the liability for at least 12 months after the reporting date (Terms of a Liability that could, at the option of the counterparty, result in its settlement by the issue of Equity Instruments do not affect its classification) Current liabilities comprise of :

(i) Sundry Creditors –

Amounts payable to suppliers against purchase of goods. This is usually settled within 30-180 days.

(ii) Advances from customers –

At times customer may pay advance i.e. before they get delivery of goods. Till the business supplies goods to them, it has an obligation to pay back the advance in case of failure to supply. Hence, such advances are treated as liability till the time they get converted to sales.

(iii) Outstanding Expenses:

These represent services procured but not paid for. These are usually settled within 30–60 days e.g. phone bill of Sept is normally paid in Oct.

(iv) Bills Payable:

There are times when suppliers do not give clean credit. They supply goods against a promissory note to be signed as a promise to pay after or on a particular date. These are called as bills payable or notes payable.

(v) Bank Overdrafts:

Banks may give fund facilities like overdraft whereby, business is permitted to issue cheques up to a certain limit. The bank will honour these cheques and will recover this money from business. This is a short term obligation.

B. Assets

In accounting language, all debit balances in personal and real accounts are called as assets. Assets are broadly classified into fixed assets and current assets.

(a) Fixed Assets:

These represent the facilities or resources owned by the business for a longer period of time. The basic purpose of these resources is not to buy and sell them, but to use for future earnings. The benefit from use of these assets is spread over a very long period. The fixed assets could be in tangible form such as buildings, machinery, vehicles, computers etc, whereas some could be in intangible form viz. patents, trademarks, goodwill etc. The fixed assets are subject to wear and tear which is called as depreciation. In the balance sheet, fixed assets are always shown as "original cost less depreciation".

(b) Investments:

These are funds invested outside the business on a temporary basis. At times, when the business has surplus funds, and they are not immediately required for business purpose, it is prudent to invest it outside business e.g. in mutual funds or fixed deposit. The purpose is to earn a reasonable return on this money instead of keeping them idle. These are assets shown separately in balance sheet. Investments can be classified into Current Investments and Non-current Investments. Non-current Investments are investments which are restricted beyond the current period as to sale or disposal.

Whereas, current investments are investments that are by their nature readily realizable and is intended to be held for not more than one year from the date on which such investment is made.

(c) Current Assets:

An asset shall be classified as Current when it satisfies any of the following :

- It is expected to be realised in, or is intended for sale or consumption in the organisation's normal Operating Cycle,
- It is held primarily for the purpose of being traded,
- It is due to be realised within 12 months after the Reporting Date, or
- It is Cash or Cash Equivalent unless it is restricted from being exchanged or used to settle a Liability for at least 12 months after the Reporting Date.

Current assets comprise of:

(i) Stocks:

This includes stock of raw material, semi-finished goods or WIP, and finished goods. Stocks are shown at lesser of the cost or market price. Provision for obsolescence, if any, is also reduced. Generally, stocks are physically counted and compared with book stocks to ensure that there are no discrepancies. In case of discrepancies, the same are adjusted to P & L A/c and stock figures are shown as net of this adjustment.

(ii) Debtors:

They represent customer balances which are not paid. The bad debts or a provision for bad debt is reduced from debtors and net figure is shown in balance sheet.

(iii) Bills receivables:

Credit to customers may be given based on a bill to be signed by them payable to the business at an agreed date in future. At the end of accounting period, the bills accepted but not yet paid are shown as bills receivables.

(iv) Cash in Hand:

This represents cash actually held by the business on the balance sheet date. This cash may be held at various offices, locations or sites from where the business activity is carried out. Cash at all locations is physically counted and verified with the book balance. Discrepancies if any are adjusted.

(v) Cash at Bank:

Dealing through banks is quite common. Funds held as balances with bank are also treated as current asset, as it is



to be applied for paying to suppliers. The balance at bank as per books of accounts is always reconciled with the balance as per bank statement, the reasons for differences are identified and required entries are passed.

(vi) Prepaid Expenses:

They represent payments made against which services are expected to be received in a very short period.

(vii) Advances to suppliers:

When amounts are paid to suppliers in advance and goods or services are not received till the balance sheet date, they are to be shown as current assets. This is because advances paid are like right to claim the business gets. Please note that both current assets and current liabilities are used in day-to-day business activities. The current assets minus current liabilities are called as working capital or net current assets. The following report is usual horizontal form of balance sheet. Please note that the assets are normally shown in descending order of their liquidity. Also, capital, long term liabilities and short term liabilities are shown in that order.

In case other than Company :

Capital & Liabilities	Amount	Assets	Amount
Capital (separate figures are shown for each owner)		Fixed Assets:	
Long term Liabilities:		Land less depreciation	
Loans from banks or financial Institutions		Building less depreciation	
Current Liabilities:		Plant and Machinery less depreciation	
Sundry creditors		Vehicles less depreciation	
Bills payable		Computer systems less depreciation	
Advances from customers		Office equipments less depreciation	
Outstanding expenses		Current Assets:	
		Stocks	
		Sundry debtors less provisions	
		Bills receivables	
		Cash in hand	
		Cash at bank	
		Prepaid expenses	
		Advances to suppliers	

Illustration 5.

From the following particulars prepare a Balance Sheet of Mr. X, for the year ended 31st March, 2015. Capital : ₹ 2,00,000; Drawings : ₹ 40,000 ; Cash In Hand : ₹ 15,000 ; Loan from Bank : ₹ 40,000; Sundry Creditors : ₹ 40,000; Bills Payable : ₹ 20,000; Bank Overdraft : ₹ 20,000; Goodwill : ₹ 60,000; Sundry Debtors : ₹ 80,000; Land and Building : ₹ 50,000; Plant and Machinery : ₹ 80,000; Investment : ₹ 20,000; Bills Receivable : ₹ 10,000. Cash at Bank : ₹ 25,000.

The following adjustments are made at the time of preparing final accounts:

- (i) Outstanding Liabilities for : Salaries ₹ 10,000; wages ₹ 20,000; Interest on Bank Overdraft ₹ 3,000; and Interest on Bank Loan ₹ 6,000.
- (ii) Provide Interest on Capital @ 10% p.a.
- (iii) Depreciation on Plant and Machinery by 10% p.a.
- (iv) Bad Debts amounted to ₹ 10,000 and make a provision for Bad Debts @ 10% on Sundry Debtors.
- (v) Closing stock amounted to ₹ 1,20,000.

Net profit for the year amounted to ₹ 96,000 after considering all the above adjustments.

Solution:

Liabilities	Amount (₹)	Amount (₹)	Assets	Amount (₹)	Amount (₹)
Capital	2,00,000		Goodwill		60,000
Add: Interest on Capital @ 10%	20,000		Land & Building		50,000
Add: Net Profit	96,000		Plant & Machinery	80,000	
	3,16,000		Less: Depreciation @ 10%	8,000	72,000
Less: Drawings	40,000	2,76,000	Investment		20,000
Bank Overdraft	20,000		Closing Stock		1,20,000
Add: Out. Interest	3,000	23,000	Sundry Debtors	80,000	
Bank Loan	40,000		Less: Bad Debts	10,000	
Add: Out. Interest	6,000	46,000		70,000	
Sundry Creditors		40,000	Less: Prov. for bad debts @ 10%	7,000	63,000
Bills Payable		20,000	Bills Receivable		10,000
Outstanding Liabilities:			Cash at Bank		25,000
Salaries	10,000		Cash in Hand		15,000
Wages	20,000	30,000			
		4,35,000			4,35,000

Manufacturing Account:

Those concerns which convert raw materials into finished goods are required to find out the cost of goods manufactured besides gross and net profit of the concern. These are manufacturing cum trading concerns. In order to have full information about the cost of goods manufactured, these concerns firstly prepare manufacturing Account and then prepare – Trading and profit and loss account.

The main object of Manufacturing Account is to show:

- (i) Cost of finished goods produced and
- (ii) Constituent items thereof such as cost of material consumed, productive wages, direct and indirect expenses.

Debit side of manufacturing account starts with the cost of materials consumed, i.e., opening stock of raw materials plus net purchases less the closing stock of raw materials. Procurement cost e.g., custom duty, landing charges, excise duty, carriage and freight inwards, insurance on incoming raw materials should also be included with the cost of raw materials.

Closing stock is taken and valued at lower of cost or net realizable value and is then deducted from the sum of opening stock and purchases to eliminate the charge to manufacturing account for stock of raw materials in hand on closing date. Next to raw materials are listed productive wages and direct expenses.

It is followed by debits relating to indirect factory expenses e.g., rents, rates, salaries of supervising staff, power, light, heat and fuel, repairs and renewals, depreciation relating to factory property etc.

Total materials, productive wages and direct expenses should be adjusted for opening and closing stock of partly finished goods or work-in-progress etc. Opening stock of these items should be added at its factory cost value, as current periods production has benefitted by drawing on the opening stock of partly finished goods. Closing stock of work in progress should be taken and valued at factory cost and deducted from the resulting total to eliminate the charge in respect thereof. After this adjustment, the net amount will represent cost of production.



Total of debit side will then represent the cost of production of finished goods which is credited to Manufacturing Account and debited to trading account.

Trading account will show the cost of production of finished goods, opening and closing stock of finished goods, purchases and sales of finished goods and gross profit.

A specimen of Manufacturing and Trading Account and Profit and Loss Account is given as follows:

	₹		₹
To Work-in-progress (Beginning)	Xxx	By Cost of goods manufactured transferred to trading A/c (Bal. Fig)	Xxx
To Raw Materials consumed: (opening stock of raw Materials + purchases during the year – closing stock of Raw materials)		By Sale of scrap	Xxx
To Direct wages	Xxx	By Closing work-in-progress	Xxx
To Direct expenses (as carriage on purchases)	Xxx	By sales	Xxx
Prime cost	Xxx	By closing stock of finished goods	Xxx
To Factory expenses:	Xxx	By Gross profit b/s	Xxx
To Factory lighting xxx		By All items of incomes and gains	Xxx
Factory rent xxx			
Factory wages xxx			
Depreciation on Plant & Machinery xxx			
Factory supervisor's salary xxx			
Stores consumed etc. xxx			
To Opening stock of Finished goods	Xxx		
To Cost of goods Manufactured transferred trading A/c	Xxx		
To Gross profit c/d	Xxx		
To Administration Expenses	Xxx		
To Selling expenses	Xxx		
To Distribution expenses	Xxx		
To Financial expenses	Xxx		
To Maintenance expenses	Xxx		
To Net profit transferred to capital account	Xxx		
	Xxx		Xxx

Illustration 6

Prepare a Trading Account of trader for the year ending 31st March, 2014 from following data:

	₹
Stock on 1-4-2013	2,40,000
Cash purchases for the year	2,08,000
Credit purchases for the year	4,00,000
Cash sales for the year	3,50,000
Credit sales for the year	6,000
Purchases returns during the year	8,000
Sales returns during the year	10,000
Direct expenses incurred:	

Freight	10,000
Carriage	2,000
Import duty	8,000
Clearing charges	12,000
Cost of goods distributed as free samples during the year	5,000
Goods withdrawn by the trader for personal use	2,000
Stock damaged by fire during the year	13,000

The cost of unsold stock on 31st March, 2014 was ₹1,20,000 but its market value was ₹ 1,50,000.

Solution:

Trading Account of a trader
For the year ending 31st March, 2014

	₹		₹
To Opening stock	2,40,000	By Sales:	
To Purchases		Cash	3,50,000
Cash	2,08,000	Credit	6,00,000
Credit	4,00,000		9,50,000
	6,08,000	Less: Sales returns	10,000
Less: Purchases Returns	8,000	By Stock damaged by fire	13,000
	6,00,000	By Closing stock	1,20,000
Less: Goods Distributed as free sample	5,000		
	5,95,000		
Less: Goods withdrawn	2,000 for personal use		
	5,93,000		
To Freight	10,000		
To Carriage	2,000		
To Import duty	8,000		
To Clearing charges	12,000		
To Gross profit c/d	2,08,000		
	10,73,000		10,73,000

Illustration 7

Prepare Trading and Profit and Loss Account of M/s Suraj Prakash & Sons for the year ending 31st December, 2014 from following information:

	₹		₹
Stock (1-1-2014)	2,00,000	Salaries	30,000
Purchases	2,55,000	Rent, rates & taxes	12,000
Wages	1,00,000	Depreciation	3,020
Carriage	5,000	Repairs	6,000
Purchases returns	13,250	Discount allowed	12,505
Export duty	9,000	Bad debts	9,000
Sales	5,75,000	Advertisement	2,500
Coal & coke	25,000	Gas & water	1,500
Sales returns	10,000	Factory lighting	2,500
Printing & stationery	2,250	General expenses	4,000
Stock (31-12-2015)	3,00,000		3,00,000



Solution:

**Trading and Profit and Loss Accounts of
M/s Suraj Prakash and Sons**
For the year ending 31st December, 2014
For the year ending 31st December, 2014

To Stock (1-1-2014)	₹ 2,00,000	By Sales	5,75,000	₹
To Purchases	2,55,000	Less: Sales returns	10,000	5,65,000
Less: Purchases Return	13,250	By Stock (31-21-2014)		3,00,000
To Wages	1,00,000			
To Carriage	5,000			
To Coal and coke	25,000			
To Gas and water	1,500			
To Factory lighting	2,500			
To Gross profit c/d	2,89,250			
	8,65,000			8,65,000
To Salaries	30,000	By Gross profit b/d		2,89,250
To Rent, rates & taxes	12,000			
To Printing & stationery	2,250			
To Depreciation	3,020			
To Repairs	6,000			
To Export duty	9,000			
To Discount allowed	12,505			
To Bad Debts	9,000			
To Advertisement	2,500			
To General expenses	4,000			
To Net profit transferred to capital account	1,98,975			
	2,89,250			2,89,250

Illustration 8

Prepare Manufacturing and trading account for the year ending 30th June, 2015 with following figures extracted from the books of a manufacturing concern:

	Opening stock(₹)	Closing stock(₹)
Raw material	1,20,000	80,000
Work-in-progress	24,000	16,000
Finished goods	86,400	64,000
Transactions during the year:		
Purchase of Materials		4,00,000
Wages		2,50,000
Stores consumed		30,000
Indirect wages		72,000
Factory rent		24,000
Depreciation on plant & machinery		40,000
Sales		11,20,000
Purchases of finished goods		10,000

Solution:

Manufacturing and Trading Account
For the year ending 30th June, 2015

	₹		₹
To Opening Stock:		By Closing Stock:	
Raw materials 1,20,000		Raw materials 80,000	
Work-in-progress 24,000	1,44,000	Work-in-progress 16,000	96,000
To Purchase of materials	4,00,000	By Cost of goods manufactured trans. to trading A/c	8,64,000
To Wages	2,50,000		
To Stores consumed	30,000		
To factory rent	24,000		
To Depreciation on plant and Machinery	40,000		
To Indirect wages	72,000		
	9,60,000		9,60,000
To Opening stock of finished goods	86,400	By Sales	11,20,000
To Cost of goods manufactured transferred from manufacturing A/c	8,64,000	By Closing stock of Finished goods	64,000
To Purchase of finished goods	10,000		
To Gross profit transferred to profit and loss account	2,23,600		
	11,84,000		11,84,000

Illustration 9

Following is the Trial Balance of M/s Kasturi Agencies as on 31st March, 2015. Prepare Trading, Profit and Loss Account for the year ended 31st March, 2015 and a Balance Sheet on that date

Particulars	₹	₹
Capital		1,00,000
Buildings	15,000	
Drawings	18,000	
Furniture & Fittings	7,500	
Motor van	25,000	
Loan from Hari @ 12% interest		15,000
Interest paid on above	900	
Sales		1,00,000
Purchases	75,000	
Opening stock	25,000	
Establishment expenses	15,000	
Wages	2,000	
Insurance	1,000	
Commission received		4,500
Sundry debtors	28,100	
Bank balance	20,000	
Sundry creditors		10,000
Interest		3,000
	2,32,500	2,32,500



Adjustments: (a) The value of stock on 31-3-2015 was ₹ 32,000. (b) outstanding wages ₹ 500 (c) Prepaid Insurance ₹ 300. (d) Commission received in advance ₹ 1,300 (e) Allow interest on capital @ 10%. (f) Depreciate building 2 ½%. Furniture & Fitting 10%, Motor van 10%. (g) charge interest on drawings ₹ 5000. (h) Accrued Interest ₹ 500.

Solution:

Trading and Profit and Loss Account of Kasturi Agency for the year ending 31.3.2015

Dr.			Cr.		
	₹	₹		₹	₹
To Opening Stock		25,000	By Sales		1,00,000
To Purchases		75,000	By Closing Stock		32,000
To Wages	2,000				
Add: Outstanding	500	2,500			
To Gross Profit c/d		29,500			
		1,32,000			1,32,000
To Insurance	1,000		By Gross profit		29,500
Less: Prepaid	300	700	By Commission	4,500	
To Interest on loan	900		Less: Received in Advance	1,300	3,200
Add: Outstanding	900	1,800	By Interest	3,000	
To Establishment expenses		15,000	Add: Accrued interest	500	3,500
To Depreciation			By Interest on drawings		500
Buildings	375				
Furniture & Fittings	750				
Motor van	2,500	3,625			
To Interest on capital		10,000			
To Net profit transferred to capital A/c		5,575			
		36,700			36,700

Balance sheet
as on 31st March, 2015

Liabilities		₹	₹	Assets		₹	₹
Outstanding wages			500	Cash at bank		20,000	
Commission received in advance			1,300	Sundry debtors		28,100	
Sundry creditors			10,000	Closing stock		32,000	
Loan from Hari	15,000			Prepaid insurance		300	
Add: Outstanding Interest	900	15,900		Buildings	15,000		
Capital	1,00,000			Less: Depreciation	375	14,625	
Add: Net profit	5,575			Furniture & Fittings	7,500		
Add: Interest on Capital	10,000			Less: Depreciation	750	6,750	
		1,15,575		Motor Van	25,000		
Less: Drawings	18,000			Less: Depreciation	2,500	22,500	
Interest on drawings	500	18,500	97,075	Accrued Interest		500	
			1,24,775			1,24,775	

Illustrations 10

Following is the Trial Balance of M/s Brijesh and Sons. Prepare final accounts for the year ended on 31st March 2015.

Particulars	Debit (₹)	Credit (₹)
Stock as on 01-04-2014	2,00,000	
Purchases and Sales	22,00,000	35,00,000
Bills receivables	50,000	
Returns	100,000	50,000
Carriage Inwards	50,000	
Debtors and Creditors	200,000	4,00,000
Carriage Outwards	40,000	
Discounts	5,000	5,000
Salaries and wages	2,20,000	
Insurance	60,000	
Rent	60,000	
Wages and salaries	80,000	
Bad debts	10,000	
Furniture	4,00,000	
Brijesh's capital		5,00,000
Brijesh's drawing	70,000	
Loose tools	1,00,000	
Printing & stationery	30,000	
Advertising	50,000	
Cash in hand	45,000	
Cash at bank	2,00,000	
Petty Cash	5,000	
Machinery	3,00,000	
Commission	10,000	30,000
Total	44,85,000	44,85,000

Adjustments:

- Stock on 31st March was valued at Cost price ₹ 4,20,000 and market price ₹ 400,000.
- Depreciate furniture @ 10% p.a. and machinery @ 20% p.a. on reducing balance method.
- Rent of ₹ 5,000 was paid in advance. (iv) Salaries & wages due but not paid ₹ 30,000.
- Make a provision for doubtful debts @ 5% on debtors.
- Commission receivable ₹ 5,000.

Solution:

Trading Account for the year ended 31st March 2015				Cr.	
Dr.	Particulars	Amount (₹)	Particulars	Amount (₹)	Amount (₹)
	To Opening Stock		By Sales	35,00,000	
	To Finished Goods		Less: Sales Returns	1,00,000	34,00,000
	To purchases	22,00,000	By Closing Stock		
	Less: Purchases returns	50,000	Finished goods		4,00,000
	To Carriage inwards				
	To Wages & Salaries				
	To Gross profit c/d				
		38,00,000			38,00,000



Dr. Profit & Loss Account for the Year Ended 31st March 2015 Cr.

Particulars	Amount (₹)	Amount (₹)	Particulars	Amount (₹)	Amount (₹)
To Salaries & Wages	2,20,000		By Gross Profit b/d		13,20,000
Add: Not paid	30,000	2,50,000	By Discount received		5,000
To Depreciation on furniture		40,000	By Commission Received	30,000	
To Depreciation of machinery		60,000	Add: Receivable	5,000	35,000
To Insurance		60,000			
To Rent	60,000				
Less: Paid in advance	5,000	55,000			
To Printing & Stationery		30,000			
To Advertising		50,000			
To Carriage outwards		40,000			
To Discounts		5,000			
To Bad debts		10,000			
To Commission		10,000			
To Provision for doubtful debts		10,000			
Net Profit		7,40,000			
		13,60,000			13,60,000

Balance Sheet as on 31st March 2015

Capital & Liabilities	₹	₹	Assets	₹	₹
Brijesh's Capital	5,00,000		Fixed Assets:		
Less: Drawings	(70,000)		Furniture	4,00,000	
Add: Net Profit for the year	7,40,000	11,70,000	Less: Depreciation	40,000	3,60,000
Current Liabilities			Machinery	3,00,000	
Sundry Creditors		4,00,000	Less: Depreciation	60,000	2,40,000
Outstanding salaries & wages		30,000	Loose tools		1,00,000
			Current Assets:		
			Stocks		4,00,000
			Sundry debtors	2,00,000	
			Less: Provision for doubtful debts	10,000	1,90,000
			Bills receivables		50,000
			Cash in hand		45,000
			Cash at bank		2,00,000
			Petty cash		5,000
			Prepaid Rent		5,000
			Commission receivable		5,000
		16,00,000			16,00,000

Notes:

- (1) Closing stock is valued at market price here as it is less than cost price (conservatism concept)
- (2) Returns in debit column mean sales return, while that in credit column means purchase returns
- (3) Discounts in debit column mean allowed (expense) and that in credit means received (income)
- (4) Commission in debit column mean allowed (expense) and that in credit means received (income)
- (5) There are two peculiar items given in the TB. One is Salaries & wages and the other is Wages and salaries. The interpretation is – where first reference is made to wages, it's assumed to be directly for goods and taken to Trading A/c. If the first reference is to salaries, it's assumed to be related to office and taken to P & L.

EXERCISE:

1. Prepare a Trading Account of Rajesh Kumar for the year ending 31st March, 2015 from the following particulars:

	₹		₹
Stock of goods on 1-4-14	2,50,000	Returns to suppliers	25,000
Stock of goods on 31-3-15	4,75,000	Returns by customers	20,000
Purchases – cash	3,70,000	Goods withdrawn by Rajesh Kumar for personal use	21,000
Credit	8,25,000	Goods distributed as free samples during the year	4,000
Sales – cash	5,10,000		
Credit	11,50,000		

Ans: Gross Profit-₹7,20,000

2. From the following balances extracted at the close of the year ended 31st March 2015, prepare profit and loss Account of M/s. Ashok and Sons:

	₹		₹
Gross profit	1,01,000	Discount (Dr.)	500
Carriage outward	2,500	Apprentice premium (Cr.)	1,500
Salaries	5,500	Printing & stationery	250
Rent	4,100	Rates & taxes	350
Fire insurance premium	900	Travelling expenses	200
Bad debts	2,100	Sundry trade expenses	300
Income tax paid	3,500	Rent received on sub-letting	1,000
Life insurance premium	3,000		

Ans: Net Profit - ₹86,800/-

3. The following are the balances of Shri Gupta as on 30th June, 2015:

Debit Balance:	₹		₹
Cash in Hand	540	Patents	7,500
Cash at Bank	2,630	Salaries	15,000
Purchases	40,675	General expenses	3,000
Returns Inward	680	Insurance	600
Wages	8,480	Drawings	5,245
Fuel and power	4,730	Sundry debtors	14,500
Carriage on sales	3,200	Credit balances:	
Carriage on purchases	2,040	Sales	98,780
Stock (1 st July, 2014)	5,760	Returns outwards	500
Buildings	22,000	Capital	62,000
Freehold land	10,000	Sundry creditors	6,300
Machinery	20,000	Rent	9,000
Investments	10,000		

Taking into account the following adjustments prepare the Trading and Profit and Loss Account and Balance Sheet as on 30th June, 2015:

(a) Stock on hand on 30th June, 2015 is ₹6,800. (b) Machinery is to be depreciated at the rate of 10% and patents at the rate of 20%. (c) Salaries for the month of June, 2015 amounting to ₹1500 were unpaid (d) Insurance includes a premium of ₹ 170 on a policy expiring on 31st December 2015. (e) Bad Debts are ₹ 725 (f) rent received in Advances ₹ 1,000. (g) Interest on investment of ₹ 2,000 is accrued.



Ans: Gross Profit = ₹43,715, Net Profit = ₹26,275, Balance Sheet Total = ₹ 91,830

4. Mr. Arvindkumar had a small business enterprise. He has given the trial balance as at 31st March 2015. You are required to prepare final accounts in the books of Mr. Arvindkumar.

Particulars	Debit (₹)	Credit (₹)
Mr. Arvindkumar's Capital		1,00,000
Machinery	36,000	
Depreciation on machinery	4,000	
Repairs to machinery	5,200	
Wages	54,000	
Salaries	21,000	
Income tax of Mr. Arvindkumar	1,000	
Cash in hand	4,000	
Land & Building	1,49,000	
Depreciation on building	5,000	
Purchases	2,50,000	
Purchase returns		3,000
Sales		4,98,000
Citi Bank		7,600
Accrued Income	3,000	
Salaries outstanding		4,000
Bills receivables	30,000	
Provision for doubtful debts		10,000
Bills payable		16,000
Bad debts	2,000	
Discount on purchases		7,080
Debtors	70,000	
Creditors		62,520
Opening stock	74,000	
	7,08,200	7,08,200

Additional information:

- (1) Stock as on 31st March 2015 was valued at ₹ 60,000;
- (2) Write off further ₹6,000 as bad debt and maintain a provision of 5% on doubtful debt;
- (3) Goods costing ₹10,000 were sent on approval basis to a customer for ₹12,000 on 30th March, 2015. This was recorded as actual sales.
- (4) ₹2,400 paid as rent for office was debited to Landlord's Account and was included in debtors.
- (5) General Manager is to be given commission at 10% of net profits after charging his commission.
- (6) Works manager is to be given a commission at 12% of net profit before charging General Manager's commission and his own.

Ans: Gross Profit = ₹1,81,000, Net Profit = ₹1,20,000, Balance Sheet Total = ₹3,39,120

Multiple Choice Questions:

1. The purpose of preparing final accounts is to ascertain ____
(a) profit or loss (b) Capital (c) The value of assets (d) Profit or loss and financial position

2. If the manager is entitled to a commission of 5% on profits before deduction this commission, he will get a commission of ₹ ___ on a profit of ₹ 8400
(a) ₹400 (b) ₹ 442.11 (c) ₹ 420 (d) None of these
3. The balance of the petty cash is
(a) An expense (b) An income (c) An asset (d) A liability
4. Fixed assets are
(a) Kept in the business for use over a long time for earning income
(b) Meant for resale
(c) Meant for conversion into cash as quickly as possible
(d) All of the above
5. The manufacturing account is prepared
(a) To ascertain the profit or loss on the goods produced
(b) To ascertain the cost of the manufactured goods
(c) To show the sale proceeds from the goods produced during the year
(d) both (b) and (c)
6. A company wishes to earn a 20% profit margin on selling price. Which of the following is the profit mark upon cost, which will achieve the required profit margin?
(a) 33% (b) 25% (c) 20% (d) None of the above
7. At the time of preparation of financial accounts, bad debts recovered account will be transferred to
(a) Debtors A/c (b) Profit & Loss A/c (c) Profit & loss Adjustment A/c
(d) Profit & loss Appropriation A/c
8. Depreciation appearing in the Trial Balance should be
(a) Debited to P & L A/c (b) Shown as liability in balance sheet
(c) reduced from related asset in balance sheet (d) both (a) and (c) above
9. Gross profit is equal to
(a) sales – cost of goods sold (b) sales – closing stock + purchase
(c) opening stock + purchases – closing stock (d) none of the above
10. The profit and loss Account shows the
(a) financial results of the concern for a period (b) Financial position of the concern on particular date
(c) financial results of the concern on a particular date (d) cost of goods sold during the period
11. Which of the following is not a financial statement?
(a) Profit and loss account (b) Balance sheet (c) funds flow statement (d) Trial balance
12. Based on which of the following concepts, is share capital account shown on the liabilities side of a balance sheet?
(a) business entity concept (b) money measurement concept
(c) going concern concept (d) matching concept
13. Closing stock appearing in the trial balance is shown in –
(a) trading A/c and balance sheet (b) profit and loss a/c (c) balance sheet only (d) trading A/c only
14. Consider the following data and identify the amount which will be deducted from sundry debtors in Balance sheet.

Particulars	₹
Bad debts (from trial balance)	1,600
Provision for doubtful debts (old)	2,000
Current year's provision (new)	800

- (a) ₹ 400 (b) ₹800 (c) ₹2,000 (d) ₹2,400

15. Inventory is
(a) Included in the category of fixed assets (b) An investment
(c) A part of current assets (d) An intangible fixed asset.

Ans: 1.d 2.c 3.c 4.a 5.b 6.b 7.b 8.a 9.a 10.a 11.d 12.a 13.c 14.b 15.c

Fill in the blanks:

1. Insurance prepaid is shown on the ___ of the balance sheet (Asset side)



2. If sales are ₹2000 and the rate of G.P on cost of goods sold is 25%, then the cost of goods sold will be ___(₹1600)
3. Goodwill is an ___asset (intangible)
4. ___is the difference between assets and liabilities (Capital)
5. Opening stock ₹50,000 closing stocks ₹40,000, purchases ₹1,90,000, profit margin is 25% on the sales, then sales are___(2,40,000)
6. Average stock= ₹12,000, closing stock is ₹3000 more than opening stock the value of closing stock will be ___(₹13500)
7. ___contains closing balances of real and personal account(Balance sheet)
8. Expenses due but not yet paid are known as ___(out-standing expenses)
9. Given old provision for bad & doubtful debt is ₹ 4,000 sundry debtors ₹50,000, new PBD required = 10% on sundry debtors then the amount of additional provision to be credited is ₹ ___(₹1,000)
10. Bills receivable discounted but not due till the date of final accounts is shown in ___(Foot-notes.)
11. ___ are passed at the end of the year.(Closing entries)
12. Assets appearing in the books having no real value are known as ___(Fictitious assets.)
13. Various expenses accounts are closed by ___the profit and loss account and crediting the expenses account. (debiting)
14. Provisions for bad & doubtful debts account will show ___balance.(credit)
15. Loss on sale of old car is shown on debit side of ___(Profit and loss account.)

True or false:

1. Income earned but not received are called accrued incomes. (TRUE)
2. For a shirt factory, cotton is a finished goods. (FALSE)
3. State the following equation is true/false
Gross profit – direct expenses + purchases + opening stock – closing stock = sales. (FALSE)
4. Carriage on goods purchased is shown on Trading Account. (TRUE)
5. The Balance Sheet will not give the information regarding the financial position as on particular date. (FALSE)
6. Preliminary expenses would be included in balance sheet as current asset (FALSE)
7. Fixed assets are kept in the business for use over a long period.(TRUE)
8. Furniture and fittings is a current asset. (FALSE)
9. In sole trade, income tax is recorded as drawings. (TRUE)
10. All revenue receipts and expenditure are shown in trading and profit & loss account (TRUE)

Match the following:

Group – A

1. Carriage on goods purchased	c	a) Distribution overhead
2. Freight outward	d	b) Credit of p& L account
3. Concept relating to Profit and Loss A/c	e	c) Trading account
4. Packing expenses is example of	a	d) Debit of P & L A/c
5. Apprenticeship premium received	b	e) Matching concept

Group-B

1. Gross profit rate on sale is 20%	d	a) current asset
2. Salary outstanding	e	b) Not a fixed asset
3. Rent prepaid	a	c) Book value
4. Fixed deposit in bank	b	d) 25% on cost
5. Fixed assets are included in Balance sheet at	c	e) Representative personal account

3.2 NOT-FOR- PROFIT MAKING CONCERN

Preparation of Financial Statements of a Non-Trading Concern

Until now, we have seen accounting treatment for business transaction of business entities whose main objective is to earn profit. There are certain organisations that are not established for making profit but to provide some service. These services are generally given to members who make subscriptions to avail them. These are also called as non-trading entities. The examples of such organisations are:

- Gymkhana / sports clubs
- Educational institutions
- Public hospitals
- Libraries
- Cultural clubs like Rotary or Lions club
- Religious institutions
- Charitable trusts

These organisations get their funds in the form of contributions by way of entrance fees, life membership fees, annual subscriptions, donations, grants, legacies etc. The accounting of such organisations is based on similar principles followed by the other organisations. Given the nature of these institutions, there are certain items of revenue and expenses that need special understanding so that accounting treatment could be correctly decided.

Special Items

There are certain items of revenue and expenses that are unique for the non-trading entities. They could be listed as:

Revenue items	Expenditure items
Donations	Upkeep of grounds
Entrance fees	Tournament expenses
Subscriptions	Prizes
Grants received Events	

Let us see what accounting treatment should be given to some of the special items:

- Entrance Fees** – These are received at the time of admission of a new member and thus are onetime fees. They are non-recurring in nature. It could be either capitalized as they are non-recurring or taken as revenue as per the rules of the institution. There's a view that addition of member is an ongoing activity and thus every year the institute will get entrance fees. So it may be taken as a normal revenue receipt.
- Donations** – They could be used for meeting capital or revenue expenses. If donations are received for a special purpose, the amount is credited to a fund from which the amounts are disbursed. The fund may be invested in specified securities. Income from such investments is credited to the fund Account only. Small donation amounts which are not earmarked for any specific purpose may be treated as revenue receipts.
- Legacy** – Many times trusts are formed in the memory of certain persons by their will. In such case after the demise of the person, the funds pass on to the institution. Such legacies are of course one-time and therefore should be taken to the capital fund.
- Endowments** – Sometimes, donations are also in the form of endowments to be used as per instructions of the donor. These are to be treated as capital receipts.
- Life membership fees** – These could be taken as capital receipts and every year a charge is debited based on some logic. In other words, when received, it could be treated as deferred receipt in the balance sheet and every year a specific amount is credited to I & E Account.
- Subscriptions** – These are annual receipts and therefore taken as revenue receipts. These must be recognized as revenue on the accrual concept.

Financial Statements



These non-profit organisations prepare

Receipt and Payment Account – This is similar to cash book. Entries are made on cash basis and items pertaining to previous year or current year or subsequent years are also recorded. Receipts are shown on debit side and payments are shown on credit side. Capital as well as revenue items are entered in the R & P Account. This account is real account in nature. No provisions are recorded in this account. The account has an opening and a closing balance which is reflected as an asset in the balance sheet.

Features of receipts and payment account

1. It is an Account which contains all Cash and Bank transactions made by a nonprofit organization during a particular financial period.
2. It starts with the opening balances of Cash and Bank. All Cash Receipts both capital & revenue during the period are debited to it.
3. All Cash Payments both capital & revenue during the period are credited to this Account. It ends with the closing Cash and Bank Balances.
4. While recording the Cash and Bank transactions all entries are made on Cash Basis.
5. It is a summary of Cash Book.
6. It follows Real Account.

Receipt and Payment Account Receipt and Payment Account

Receipts	Amount(₹)	Payments	Amount(₹)
Starts with opening balance			
All receipts - capital or revenue		All payments - Capital or revenue	
May be related to any period previous, current or subsequent.		May be related to any period previous, current or subsequent.	
		Ends with closing balance	

Income and Expenditure account – This is similar to the Profit and loss Account and is prepared exactly based on same principles. As the name suggests only revenue items are recorded herein. Incomes are recorded on the credit side while the expenses on the debit side. Both incomes and expenses must be taken on the basis of accrual concept. This account should reflect only items that are pertaining to current period. Previous and subsequent year items are to be excluded. This account shows either a surplus or deficit. Excess of income over expenditure is called surplus and excess of expenditure over income is called as deficit.

Features of income and expenditure Account

1. It follows Nominal Account.
2. All expenses of revenue nature for the particular period are debited to this Account on accrual basis.
3. Similarly all revenue incomes related to the particular period are credited to this account on accrual basis.
4. All Capital incomes and Expenditures are excluded.
5. Only current year's incomes and expenses are recorded. Amounts related to other periods are deducted. Amounts outstanding for the current year are added.
6. Profit on Sale of Asset is credited. Loss on Sale of Asset is debited. Annual Depreciation on Assets is also debited.
7. If income is more than expenditure, it is called a Surplus, and is added with Capital or General Fund etc. in the Balance Sheet.
8. If expenditure is more than income, it is a deficit, and is deducted from Capital or General Fund etc. in the Balance Sheet.

Income and Expenditure Account

Expenses	Amount (₹)	Income	Amount (₹)
Only revenue expenses		Only revenue receipts	
Only related to current period.		Only related to current period	
Shows either surplus		Or shows deficit	

Balance Sheet – It is prepared as on the last day of the accounting period. It also has assets and liabilities and prepared based on accounting equation. But, there's no capital account. Instead there is a capital fund. The surplus or deficit from Income & Expenditure Account is adjusted against this capital fund at the end of the year.

Difference between Receipts and Payments Account and Income and Expenditure Account

	Receipts & Payments Account	Income & Expenditure Account
1	It is a summarized Cash Book	It closely resembles the Profit & Loss Account of a Trading concern.
2	Receipts are debited and Payments are credited.	Incomes are credited and Expenditures are debited.
3	Transactions are recorded on Cash basis.	Transactions are recorded on Accrual Basis
4	Amounts related to previous period or future period may remain included. Outstanding amount for current year is excluded.	Transactions are recorded on accrual basis. All amounts not related to the current period are excluded. Outstanding amounts of current period are added.
5	It records both Capital and Revenue transactions.	It records Revenue transactions only.
6	It serves the purpose of a Real Account.	It serves the purpose of a Nominal Account.
7	It starts with opening Cash and Bank Balances and ends with closing Cash and Bank Balances.	It does not record such balances, rather its final balance shows a surplus or a deficit for the period.
8	It does not record notional loss or noncash expenses like bad debts, depreciations etc.	It considers all such expenses for matching against revenues
9	Its closing balance is carried forward to the same account of the next accounting Period.	Its closing balance is transferred to Capital Fund or General Fund or Accumulated Fund in the same period's Balance Sheet.
10	It helps to prepare an Income & Expenditure Account.	It helps to prepare a Balance Sheet.

Difference between Profit and Loss Account and Income and Expenditure Account

	Profit and Loss Account	Income & Expenditure Account
1	It is prepared by business undertaking.	It is prepared by non-trading organizations.
2	The credit balance of Profit and Loss Account is known as "net profit" and added to opening capital.	Credit balance of Income and Expenditure Account is known as excess of income over expenditure or surplus and added to opening capital fund.
3	The debit balance of this Profit and Loss Account is known as "net loss" and deducted from opening capital.	Debit balance of this Income and Expenditure Account is known as "excess of expenditure over income" or deficit and deducted from opening capital fund.
4	To check correctness of accounts trial balance is prepared before preparing this account.	To check correctness of accounts, receipts and payments account is prepared before preparing this account.



Fund Asset Accounting and its peculiarities:

Following are the concepts of some funds which are generally maintained by organizations:

- (i) **Capital Fund:** It is also called "General Fund" or "Accumulated Fund." It is actually the Capital of a non-profit concern. It may be found out as the excess of assets over liabilities. Usually "Surplus" or "Deficit" during a period is added with or deducted from it. A portion of Capitalised incomes like donations may be added with it.
- (ii) **Special Fund:** It may be created out of special donation or subscription or out of a portion of the "Surplus". For example a club may have a "Building Fund". It may be used for meeting some specific expenses or for acquiring an asset. If any income is derived out of investments made against this fund or if any profit or loss occurs due to sale of such investments, such income or profit or loss is transferred to this fund.

Other Treatments

(a) If the Special Fund is used to meet an expense

Special Fund A/c Dr.
 To Bank A/c (amt. of expense)

The balance of the Fund is shown as a liability.

If the balance is transferred to Capital Fund, the entry will be—

Special Fund A/c Dr.
 To Capital Fund A/c (Balance of Special Fund)

(b) If the Special Fund is used to purchase an asset

Asset A/c Dr.
 To Bank A/c (Cost of the asset)
Special Fund A/c Dr.
 To Capital Fund A/c (Special Fund closed)

(iii) Donations

- (a) Donation received for a particular purpose should be credited to Special Fund. For example, Donation received for Building should be credited to Building Fund Account.
- (b) For other donations received the by-laws or rules of the concern should be followed.
- (c) If there is no such rule, donations received of non-recurring nature should be credited to Capital Fund. Recurring donations received should be credited to Income & Expenditure Account.
- (d) Donation paid by the concern should be debited to Income & Expenditure Account.

(iv) Legacy received: It is to be directly added with Capital Fund after deduction of tax, (if any). It is a kind of donation received according to the will made by a deceased person.

(v) Entrance Fees or Admission Fees

- (a) The rules or by-laws of the concern should be followed.
- (b) If there is no such rule, Admission or Entrance Fees paid once by members for acquiring membership should be added with Capital Fund.
- (c) If such fees are of small amounts covering the expenses of admission only, the fees may be credited to Income & Expenditure Account.

(vi) Subscriptions

- a) Annual subscriptions are credited to Income & Expenditure Account on accrual basis.
- b) Life membership subscription is usually credited to a separate account shown as a liability.

Annual Subscription apportioned out of that is credited to Income & Expenditure Account and deducted from the liability. Thus the balance is carried forward till the contribution by a member is fully exhausted.

If any member dies before hand, the balance of his life Membership contribution is transferred to Capital Fund or General Fund.

Illustration: 1

Ujjwal Vavishwa Club was holding a building valuing ₹10 lakhs as on 31.03.2014. Building Fund stands ₹8 lakhs and Cash at Bank is ₹15 lakhs as on 01.04.2014. During the year 2014-15 donation received for the building fund is ₹20 lakhs. Give the journal entries and the effect in the Balance Sheet as on 31.03.2015. If

- (i) It purchases building of ₹ 15 lakhs during 2014-15
- (ii) It purchases building of ₹ 30 lakhs during 2014-15

Solution:

(i)

Journal entries

(₹ in Lakhs)

Date	Particulars	L.F	Debit	Credit
	Bank A/c Dr. To, Donation for Building Fund A/c (Donation received for Building Fund)		20	20
	Building A/c Dr. To, Bank A/c (Building purchased utilizing the Building Fund)		15	15
	Building Fund A/c Dr. To, Capital Fund A/c (Being the capital expenditure transferred to the Capital Fund)		15	15

Balance Sheet as on 31.03.2015

Liabilities	Amount (₹ in Lakhs)	Amount (₹ in Lakhs)	Assets	Amount (₹ in Lakhs)	Amount (₹ in Lakhs)
Capital Fund			Building	10.00	
Add: Building Fund (Amount Transferred)	15.00		Add: Purchase of building	15.00	25.00
Building Fund	8.00		Bank	15.00	
Add: Donation	20.00		Add: Donation Received	20.00	
				35.00	
	28.00				
Less: Amount trans. to Capital Fund	15.00	13.00	Less: Purchase of Building	15.00	20.00



(ii) **Journal entries** (₹ in Lakhs)

Date	Particulars	L.F	Debit	Credit
	Bank A/c Dr. To, Donation for Building Fund A/c (Donation received for Building Fund)		20	20
	Building A/c Dr. To, Bank A/c (Building purchased utilizing the Building Fund)		30	30
	Building Fund A/c Dr. To, Capital Fund A/c (Being the capital expenditure transferred to the Capital Fund)		28	28

Balance Sheet as on 31.03.2015

Liabilities	Amount (₹ in Lakhs)	Amount (₹ in Lakhs)	Assets	Amount (₹ in Lakhs)	Amount (₹ in Lakhs)
Capital Fund			Building	10.00	
Add: Building Fund (Amount Transferred)	28.00		Add: Purchase of building	30.00	40.00
Building Fund	8.00		Bank	15.00	
Add: Donation	20.00		Add: Donation Received	20.00	
				35.00	
	28.00		Less: Purchase of Building	30.00	5.00
Less: Amount trans. to Capital Fund	28.00	NIL			

Illustration: 2

On 31st December 2013, a club had subscription in arrears of ₹16,000 and in advance ₹4,000. During the year ended 31-12-2014, the club received subscription of ₹2,08,000 of which ₹10,400 was related to 2015. On 31st December 2014, there were 4 members who had not paid subscription for 2014 @ ₹1,600 per person. Write up subscription Account for the year 2014.

Solution:

A single subscription account should be prepared to reflect both advance and arrears figures. The balancing figure will reflect the subscription amount that will be recognised as Income and transferred to I & E A/c as shown below:

Dr.		Subscription Account		Cr.	
Particulars	Amount (₹)	Particulars	Amount (₹)		
To, Balance c/d (arrears)	16,000	By, Balance c/d (advance)	4,000		
To, I & E A/c (income for 2014) (Balance in figure)	1,92,000	By, R & P A/c (received)	2,08,000		
		By, Balance c/d (arrears)	6,400		
To, Balance c/d (advance)	10,400				
	2,18,400				2,18,400

Illustration: 3

The sports club of Orissa had received in 2013-2014 ₹ 2,000 towards subscription. Subscription for 2012 -13 unpaid on 1.4.2013 were ₹ 200.

Subscriptions paid in advance on 31.3.2013 were ₹ 50 and the same on 31.3.2014 was ₹ 40. Subscriptions for 2013-2014 unpaid on 31.3.2014 were ₹ 90.

Show how the subscriptions item will appear in the Income and Expenditure Account.

Solution:

Particulars	Amount (₹)
Subscriptions received during the year 2013-2014	2,000
Add : Subscription outstanding on 31.3.2014	90
	2,090
Less : Subscription outstanding on 1.4.2013	200
	1,890
Add : Subscription paid in advance on 31.3.2013	50
	1,940
Less : Subscription received in advance on 31.3.2014	40
Subscription Income for 2013-2014	1,900

Illustration: 4

The amount of Subscription appears in the Income and Expenditure Account of South Indian Club is ₹ 3,000.

Adjustments were made in respect of the following:

Subscription for 2013 unpaid at 1st Jan., 2014, ₹ 400; ₹ 200 of which was received in 2014.

Subscription paid in advance at 1.1.2014 ₹ 100.

Subscription paid in advance at 31.12.2014 ₹ 80.

Subscription for 2013 unpaid at 31.12.2014 ₹ 140.

Prepare Subscription Account.

Solution:

Dr.		Subscription Account		Cr.	
Particulars	Amount (₹)	Particulars	Amount (₹)		
To, Balance b/d	400	By, Balance b/d	100		
To, Income & Expenditure A/c	3,000	By, Cash Received (bal. fig.)	3,040		
To, Balance c/d (paid in advance to 2014)	80	By, Balance (200+140) c/d	340		
	3,480		3,480		
To, Balance b/d:		By, Balance b/d (2014)	80		
For 2013	200				
For 2014	140				

Note: Opening outstanding subscription = ₹ 400 of which ₹ 200 received in 2014.

Illustration: 5

From the following information, prepare the Subscription Account for the year ending on March, 31, 2015

- (i) Subscription in arrears on 31.03.2014 ₹ 1,500
- (ii) Subscription received in advance on 31.03.2014 ₹ 1,000
- (iii) Amount of Subscription received during 2014-15 ₹ 40,000, which includes ₹1,000 for the year 2013-14, ₹ 1,500 for the year 2015-16.
- (iv) Subscription outstanding ₹ 1,000.



Solution:

Dr.		Subscription Account		Cr.
Particulars	Amount (₹)	Particulars	Amount (₹)	
To, Balance b/d	1,500	By, Balance b/d	1,000	
To, Income & Expenditure A/c	39,500	By, Bank A/c	40,000	
		By, Balance c/d		
		For 2013-14	500	
		For 2014-15	1,000	
To, Balance c/d				
For 2015-16	1,500			
	42,500		42,500	

Illustration: 6

From the following particulars, prepare Receipts and Payments Account

	₹
Cash in hand	2,000
Cash at Bank	6,000
Subscriptions	3,000
Donations received	2,400
Furniture purchased	1,600
General Expenses	1,000
Postage	400
Stationery	600
Lockers Rent Received	1,800
Office Expenses	800
Closing balance of Cash	7,000

Solution:

Dr.		Receipts and Payments Account		Cr.
Receipts	Amount(₹)	Payments	Amount(₹)	
To Balance b/d(cash)	2,000	By furniture	1,600	
To Balance b/d (Bank)	6,000	By General Exp.	1,000	
To subscriptions	3,000	By Postage	400	
To Donations	2,400	By Stationery	600	
To Locker Rent	1,800	By Office Expenses	800	
		By Balance c/d (Cash)	7,000	
		By Balance c/d (Bank)	3,800	
	15,200		15,200	

Illustration: 7

From the following particulars, prepare Income and Expenditure Account.

	₹
Fees Collected (including ₹3,000 on account of last year)	28,000
Meeting Expenses	2,000
Travelling & Conveyance	800
Fees for the year outstanding	5,000

Salary paid (including ₹300 on account of last year)	2,400
Salary outstanding	400
Entertainment Expenses	500
Tournament Expenses	1,000
Purchase of Books and Periodicals (includes ₹2,000 for purchase of books)	3,000
Rent	1,200
Postage, Telephone and Telegram charges	1,700
Printing & Stationery	500
Donations received	800

Solution:

Dr. Income and Expenditure Account Cr.

Expenditure	Amount (₹)	Amount (₹)	Income	Amount (₹)	Amount (₹)
To Salaries	2,400		By Fees	28,000	
			Add: O/s Current Year	5,000	
Less: O/s last year	(300)		Less Last Year	(3,000)	
Add: O/s Current Year	400				30,000
		2,500	By Donation Received		800
To Entertainment Exp		500			
To Tournament Exp		1,000			
To Meeting Exp.		2,000			
To Travelling Exp.		800			
To Cost of Periodicals (₹3,000 - ₹2,000)		1,000			
To Rent		1,200			
To Postage, Telephone and Telegram charges		1,700			
To Printing & Stationery		500			
To Surplus		19,600			
		30,800			30,800

Illustration: 8

From the figures given below, prepare an Income and Expenditure Account for 2014

Dr. Receipts and Payments Account Cr.

Receipts	Amount (₹)	Payments	Amount (₹)
To Opening Balance in hand	200	By Salaries	4,800
To Balance at Bank	1,600	By Rent	500
To subscriptions		By Stationery and Postage	200
2013	500	By Bicycle purchased	300
2014	8,300	To National Saving Certificates	3,000
2015	600	By Help to Needy Students	2,000
To Sale of Investments	2,000	By Balance in hand	300
To Sale of Old furniture	300	By Balance at Bank	2,400
(Book value ₹400)			
	13,500		13,500

Subscriptions for 2014 still receivable were ₹700, interest due on savings certificates ₹100 and rent unpaid but due was ₹60.



Solution:

Dr. Income and Expenditure Account for the year ended 31.03.2014 Cr.

Expenditure		Amount(₹)	Income		Amount(₹)
To Loss on sale of furniture (₹400 - ₹300)		100	By Subscriptions	8,300	
To Salaries		4,800	Add: Due	700	
To Rent	500				9,000
Add: Outstanding	60	560	By accrued Interest on NSC		100
To Stationery & Postage		200			
To help to Needy students		2,000			
To Surplus – Excess of Income over Expenditure		1,440			
		9,100			9,100

Illustration: 9

From the following Receipts and Payments Account and other details of Pattabhi Memorial Trust, which commences its working from 1st January, 2014 with a capital of ₹40,000 in cash and furniture ₹20,000, prepare Income & Expenditure Account and Balance Sheet.

Dr. Receipts and Payments Account Cr.

Receipts		Amount(₹)	Payments		Amount(₹)
To Balance b/d		40,000	By Salaries		15,000
To Donations		60,000	By Conveyance		6,000
To Legacies		16,000	By Rent		12,000
To subscriptions		14,000	By Subscriptions to Journals		5,400
To Furniture Sold (on 31.12.2014)		6,000	By Stationery		1,000
			By Books		4,000
			By Buildings (Purchased on 1.1.2014)		68,000
			By Balance		24,600
		1,36,000			1,36,000

Additional information:

- Provide for depreciation on Furniture @10% and on Buildings @10% and on Books ₹1,000
- Outstanding subscriptions at the end of the year 2014 ₹15,000 and subscriptions received in advance for 2015 were ₹5,000
- Outstanding expenses: Rent ₹1,000; Salary ₹2,000

Solution:

**Pattabhi Memorial Trust
Income and Expenditure Account for the year ended 31.12.2014**

Expenditure		Amount (₹)	Amount (₹)	Income		Amount (₹)	Amount(₹)
To Salaries		15,000		By Donations		60,000	
Add: Outstanding		2,000	17,000	By Subscriptions		14,000	
To Conveyance			6,000	Add: Outstanding Subscription		15,000	
						29,000	
To Rent		12,000		Less: Received in Adv.		5,000	24,000
Add: Outstanding rent		1,000	13,000				
To Subscriptions to Journals			5,400				

To Stationery		1,000			
To Depreciation on:					
-Furniture @10%	2,000				
-Building @10%	6,800				
-Books	1,000	9,800			
To Loss on sale of Furniture(20000-2000-6000)		12000			
To Surplus –Excess of Income over Expenditure		19,800			
		84,000			84,000

Illustration: 10

From the following Receipts and Payments Account of Shyam Club for the year ended 31st December, 2015:

Dr.		Receipts and Payments Account		Cr.	
Receipts	Amount (₹)	Payments	Amount (₹)		
Cash in hand	150	Mowing Machine	1,100		
Cash at Bank	2,100	Ground men's fee	1,500		
Subscription	5,800	Rent	500		
Rent of the Hall	3,000	Salaries to coaches	4,500		
Life Membership fee	2,000	Office Exp	2,400		
Entrance fee (income)	200	Sports equipment purchased	1,200		
Donations (Gen)	1,500	Cash in hand	350		
Sale of Gross	100	Cash at Bank	3,300		
	14,850		14,850		

Subscriptions due on 31st December, 2014 and December, 2015 were ₹900 and ₹800 respectively. Subscriptions received also included subscriptions for the year 2015 ₹200. Sports equipment in hand on 31st December 2014 was ₹1,100. The value placed on his equipment in hand on 31st December 2015 was ₹1,300. The mowing machine was purchased on 1st January, 2015 and is to be depreciated @ 20% per annum. Office expenses include ₹300 for 2014 and ₹400 are still due for payment.

Prepare Income and Expenditure account and Balance Sheet relating to the year 2015.

Solution:

Shyam Club
Income and Expenditure Account for the year ended 31.12.2015

Dr.				Cr.	
Expenditure	Amount (₹)	Amount (₹)	Income	Amount (₹)	Amount (₹)
To Ground Men's Fees		1,500	By Subscriptions	5,800	
To Rent		500	Less: Outstanding Last Year	900	
To Salaries to Coaches		4,500		4,900	
To Office Expenses	2,400		Add: Outstanding this year	800	
Add: Outstanding this year	400			5,700	
	2,800		Less: for 2015	200	
Less: Outstanding Last Year	300				5,500
		2,500	By Rent of Hall		3,000
To Depreciation:			By Entrance fees		200



-Mowing Machine	220		By Donations		1,500
-Sports Equipments	1,000		By Sales of Grass		100
(1,100+1,200-1,300)		1,220			
To Surplus- Excess of Income over Expenditure		80			
		10,300			10,300

Balance Sheet As on 31st December, 2015

Liabilities		(₹)	Assets		(₹)
Outstanding Office Exp		400	Cash in hand		350
Subscription received in adv.		200	Cash at Bank		3,300
Life membership Fee.		2,000	Subscription Outstanding		800
Capital Fund (1)	3,950		Mowing Machine	1,100	
Add: Surplus	80	4,030	Less: Depreciation	220	880
			Sports equipment	1,100	
			Add:-Purchase	<u>1,200</u>	
				2,300	
			Less:- Depreciation	<u>1,000</u>	1,300
		6,630			6,630

Working Note:

1) Calculation of Beginning Capital Fund:

Balance Sheet as on 31st December, 2014

Liabilities	(₹)	Assets	(₹)
Outstanding Office Exp	300	Cash in hand	150
Capital fund (Bal. Fig)	3,950	Cash at Bank	2,100
		Subscription Outstanding	900
		Sports equipment	1,100
	4,250		4,250

EXERCISE

1. From the following details prepare Receipts and Payments Account

	₹
Opening Cash in hand	3,400
Opening Cash at Bank	23,400
Subscriptions received	25,000
Donations collected	5,000
Salaries paid	6,000
Rent Paid	1,000
Tournament Expenses	3,000
Purchase of Investments	10,000
Interest Received	600
Sundry expenses	1,500
Electricity charges	500
Cash in hand at the end	700

Ans: Receipts and Payments A/c Total = ₹57,400

1. From the following Receipts and Payments Account of the Venkateswara Society for the year ended 31.12.2014. Prepare income and expenditure account for the year ended 31.12.2014

Dr.		Cr.	
Receipts	(₹)	Payments	(₹)
To Balance 1-1-2014	3,485	By Books	6,150
To Entrance Fees	650	By Printing & Stationery	465
To Donations	6,000	By News Papers	1,110
To Subscriptions	6,865	By Sports Materials	5,000
To Interest on Bank Deposits	1,900	By Repairs	650
To Sale of furniture	685	By Investments	2,000
To Sale of old news papers	465	By furniture	1,000
To Proceeds from entertainments	865	By Salaries	1,500
To Sundry Receipts	125	By balance (31-12-2014)	3,165
	21,040		21,040

The Entrance fees and donations are to be capitalized. Sports materials value ₹4,000 as on 31.12.2014.

Ans: Surplus = ₹5,495

3. From the following Receipts and Payments Account of the Guntur Sports Club for the year ended 31.3.2014. Prepare Income and Expenditure Account

Dr.		Cr.	
Receipts	Amount(₹)	Payments	Amount(₹)
To Balance b/d	14,000	By Salaries	1,400
To Subscriptions		By Repairs	600
(including ₹1,000 for the previous year)	18,000	By Purchase of Sports Equipment	2,000
To Legacies	2,000	By Furniture	8,000
To Life Membership Fees	5,000	By Honorarium paid	5,000
To Sale of tickets	500	By Books	2,000
To Lockers Rent	1,500	By Investments	10,000
To Entrance Fees	1,000	By Office Expenses	1,200
To interest on Investments	200	By balance c/d	12,000
	42,200		42,200

Additional Information:

- Outstanding Salaries ₹600
- Opening value of sports equipments ₹1,000 closing value ₹500
- Interest accrued on investments ₹200
- Subscription receivable for the year 2014 ₹3,000

Ans: Surplus = ₹12,100

4. From the following Receipts and Payments Account prepare Final Accounts of Sports Club Account.



5.

Dr.		Cr.	
Receipts	Amount(₹)	Payments	Amount(₹)
To Subscriptions	15,000	By Land	10,000
To Donations	50,000	By Buildings	40,000
To Legacies	10,000	By Furniture	10,000
To Entrance Fee	5,000	By Sports Material	5,000
To Life Membership Fees	3,000	By Sports Expenditure	6,000
To Sports Income	17,000	By General Exp.	1,000
To Sundries	5,000	By Magazines	1,500
To Sale of old papers	500	By Ground expenses	4,000
		By balance c/d	28,000
	1,05,500		1,05,500

Capitalize half of donations, legacies, entrance and life membership fee. Subscriptions still outstanding ₹5,000. Depreciate fixed assets by 5% and sports material by 10%.

Ans: Surplus = ₹60,500, Balance Sheet Total = ₹94,500

6. From the following Receipts and Payments Account additional information prepare the income and expenditure account for the year ended 31st Dec. 2013 and a Balance sheet as on that date of Cosmopolitan club.

Dr.		Cr.	
Receipts	Amount(₹)	Payments	Amount(₹)
To Donations	50,000	By Furniture (1-1-2013)	10,000
To Life Membership Fees	10,000	By Buildings (1-1-2013)	40,000
To Legacies	40,000	By Salaries	5,000
To subscriptions	41,000	By Wages	1,000
To Lecturers	9,000	By Entertainments	4,000
To Entertainments	13,000	By News paper subscription	800
To Sale of old papers	500	By Printing & Stationery	1,200
To Sundries	500	By Telephone charges	300
		By Gross Seeds	700
		By Bats and Balls	5,000
		By Balance c/d	95,000
	1,64,000		1,64,000

Additional Information:

- Salaries Outstanding ₹1,000
- Printing and Stationery outstanding ₹200
- Bats and Balls on 31.12.2013 ₹3,000
- Depreciate Buildings at 5%
- Depreciate Furniture at 10%
- Subscriptions include ₹1,000 relating to 2014
- Subscriptions payable by members for the year 2013 is ₹500

Ans: Surplus = ₹43,500, Balance Sheet Total = ₹1,45,500

7. Laxman Cricket association gives you the following Receipts and payments account for the year ended 31st March, 2014.

Dr.		Cr.	
Receipts	Amount(₹)	Payments	Amount(₹)
To Balance b/d		By Salaries	22,000
Cash	1,500	By sports Equipment	50,000
Bank	14,200	By Stationery	2,000
To subscriptions	7,50,000	By Maintenance of Ground	8,000
To Admission fee	13,500	By Prizes	1,000
To Interest on investments @10% p.a. for full year	10,000	By Balance c/d	
To Donations	2,000	Cash	23,200
		Bank	10,000
	1,16,200		1,16,200

	On 1-4-2013 (₹)	On 31.3.2014 (₹)
i) Subscriptions due	4,000	5,500
ii) Subscriptions received	800	500
iii) Land and buildings (Cost les depreciate)	2,00,0000	1,90,000
iv) Salaries due	1,000	2,000

Prepare Income and Expenditure A/c for the year ended 31st March, 2014 and Balance sheet as on that date.

Ans: Surplus = ₹58,300, Capital Fund = ₹3,17,900, Balance Sheet Total = ₹3,78,700

Multiple Choose Questions:

- Endowment fund receipt is treated as -
 (a) Capital Receipt (b) Revenue Receipt (c) Loss (d) Expenses
- Which one of the following is not prepared by non-profit organizations
 (a) Profit and loss account (b) Income & Expenditure account
 (c) receipts and payments account (d) Balance sheet
- Legacy are generally -
 (a) Capitalized (b) Treated Loss (c) Revenue Expenses (d) Deferred Revenue expenses
- Any donation received for a specific purpose is a
 (a) Assets (b) Revenue receipts (c) Capital receipts (d) None of the above
- The receipts and payments account of a non-profit organization is a
 (a) Nominal Account (b) Real Account (c) Income Statement Account (d) Financial Account
- The capital of a non-profit organization is generally known as
 (a) Equity (b) Accumulated Fund (c) Finance Reserve (d) Cash Fund
- If ₹1,500 was outstanding at the beginning of the year towards subscription and ₹10,000 is received during the year, with ₹2,500 still outstanding at the end of the year the amount to be taken to receipts and payments account is
 (a) ₹11,000 (b) ₹8,500 (c) ₹10,000 (d) None of the above
- Any revenue expenses for which a separate fund is available will be
 a) Debited to the separate fund
 b) Debited to income and expenditure account
 c) Capitalized and shown in the balance sheet



- d) None of the above
9. Sale of old materials must be shown on the credit side of
a) Cash Book b) Income and expenditure account c) Balance Sheet d) None of the above
10. The information for the preparation of receipts and payments account is taken from
a) Cash Book b) Income and expenditure account c) Cash Book and Balance Sheet d) None
11. Any donation received for a specific purpose is a
a) Capital receipt b) Revenue receipt c) Liability d) None of the above
12. The receipts and payments account shows the following details:
Subscription Arrears ₹500
Current ₹10,500
Advance ₹800
There are ₹1,200 members each paying an annual subscription of ₹10. The amount to be credited to income and expenditure account will be
a) ₹11,800 b) ₹ 11,300 c) ₹12,000 d) None of the above
13. Any income arising from special fund will be credited to
a) Special fund in the balance sheet b) Income and expenditure account
c) General fund in the Balance Sheet d) None of the above
14. Income and expenditure account shows subscriptions at ₹10,000. Subscriptions accrued in the beginning of the year and at the end of the year were ₹1,000 and ₹1,500 respectively. The figure of subscriptions received appearing in receipts and payments account will be
a) ₹9,500 b) ₹ 11,000 c) ₹10,000 d) None of the above
15. Which of the following item(s) is (are) shown in the income and expenditure account
a) Only items of capital nature
b) Only items of revenue nature which are received during the period of accounts
c) Only items of revenue nature pertaining to the period of accounts
d) Both the items of capital and revenue nature

Ans: 1.a 2.a 3.a 4.c 5.b 6.b 7.a 8.a 9.b 10.a 11.c 12.c 13.a 14.a 15.c

Fill in the blanks:

1. In a receipts and payments account the payments are recorded on the ___side (Credit)
2. The closing debit balance in the receipts and payments account indicates the ___balance at the end of the year (Cash)
3. The income and expenditure account is prepared on the basis of ___system of accounting (Mercantile)
4. A debit balance in the income and expenditure account denotes excess of ___ (Expenditure over Income)
5. Income and expenditure matches all ___receipts against Revenue payments pertaining the relevant accounting year.(Revenue)
6. Any amount received towards Endowment fund is a ___Receipt (Capital)
7. Interest received on special fund investments will be added to ___fund in the balance sheet (Special)
8. Subscriptions received in advance will figure in the ___(Balance Sheet)
9. Any revenue expenditure relating to special fund must be deducted from ___ (Special Fund)
10. Out of ₹5,00,000 collection for the building ₹3,00,000 is invested and the balance spent on building. Income from investments ₹20,000. The balance to be shown in the building fund ___(₹5,20,000)

True or False:

1. Receipts and payments account is nothing but a consolidated summary of the Cash Book. (TRUE)
2. Receipts and payments account is a real account. (TRUE)
3. Income and expenditure account is a real account. (FALSE)
4. Entrance fees unless otherwise stated is to be taken as a capital receipt. (FALSE)
5. Donations unless otherwise stated is to be taken as a capital receipt. (TRUE)

6. Sale of old materials must be credited to capital fund in the balance sheet. (FALSE)
7. Income and expenditure relating to special funds should not be dealt with in the income and expenditure account. (TRUE)
8. Receipts and payments account is a summary of all capital receipts and payments.
9. Any subscriptions received in advance are treated as capital receipts and are therefore taken to the liabilities side of the balance sheet. (FALSE)
10. Payment of honorarium is treated as a capital expenditure. (FALSE)

Match The Following:

1. Non-trading concerns collect money at Regular intervals from members. These are known as	d	a) Entertainment programmes, stage shows funds raising programs
2. Non-trading concerns collect amount at the time of admission it is known as	e	b) Income & expenditure account
3. Non-trading concerns collect funds through	a	c) Balance sheet
4. Revenue incomes and expenditures are shown	b	d) Subscriptions
5. Capital items are shown in	c	e) Entrance fee



STUDY NOTE : 4 FUNDAMENTALS OF COST ACCOUNTING

THIS STUDY NOTE INCLUDES

- 4.1 Meaning, Definition, Significance of Cost Accounting, its relationship with Financial Accounting & Management Accounting
- 4.2 Classification of Costs
- 4.3 Format of Cost Sheet

4.1 MEANING, DEFINITION, SIGNIFICANCE OF COST ACCOUNTING, ITS RELATIONSHIP WITH FINANCIAL ACCOUNTING & MANAGEMENT ACCOUNTING

Origin:

All types of businesses, whether service, manufacturing or trading, require cost accounting to track their activities. [1] Cost accounting has long been used to help managers understand the costs of running a business. Modern cost accounting originated during the industrial revolution, when the complexities of running a large scale business led to the development of systems for recording and tracking costs to help business owners and managers make decisions.

In the early industrial age, most of the costs incurred by a business were what modern accountants call "variable costs" because they varied directly with the amount of production.[citation needed] Money was spent on labor, raw materials, power to run a factory, etc. in direct proportion to production. Managers could simply total the variable costs for a product and use this as a rough guide for decision-making processes.

Some costs tend to remain the same even during busy periods, unlike variable costs, which rise and fall with volume of work. Over time, these "fixed costs" have become more important to managers. Examples of fixed costs include the depreciation of plant and equipment, and the cost of departments such as maintenance, tooling, production control, purchasing, quality control, storage and handling, plant supervision and engineering.[2] In the early nineteenth century, these costs were of little importance to most businesses. However, with the growth of railroads, steel and large scale manufacturing, by the late nineteenth century these costs were often more important than the variable cost of a product, and allocating them to a broad range of products led to bad decision making. Managers must understand fixed costs in order to make decisions about products and pricing.

For example: A company produced railway coaches and had only one product. To make each coach, the company needed to purchase ₹60 of raw materials and components, and pay 6 laborers ₹40 each. Therefore, total variable cost for each coach was ₹300. Knowing that making a coach required spending ₹300, managers knew they couldn't sell below that price without losing money on each coach. Any price above ₹300 became a contribution to the fixed costs of the company. If the fixed costs were, say, ₹1000 per month for rent, insurance and owner's salary, the company could therefore sell 5 coaches per month for a total of ₹3000 (priced at ₹600 each), or 10 coaches for a total of ₹4500 (priced at ₹450 each), and make a profit of ₹500 in both cases.

Evolution of Cost Accounting:

Every modern business has to make its way through keen competition, uncertainty and risks. Quick changes in social and economic environment also create impact upon the businesses. Changes in political outlook of the government of the country also require adjustment in the business policies. Thus, a modern business becomes more and more complex in nature.

In old times the business concerns were small in size; there was no keen competition; necessity of adjustment in business outlook due to changes in social, economic and political outlook was rare and the owner/ owners

of the business could maintain personal contact with the business and gather all information relating to the business whenever necessary. The present-day business is big in size and complex in character and is under keen competition. So, information relating to the business in detail, appropriate management policy on the basis of detailed information and proper execution of such policies can only bring about success.

As the successful treatment of a sick person often requires various pathological information, the successful management of a modern business requires various information regarding the business. The traditional financial Accounting fails to furnish all information necessary for managing a modern business successfully. Thus, as a branch of Financial Accounting, cost accounting has evolved and made rapid progress during the last few decades. This branch of accounting, with its developing techniques and procedures, has been rapidly expanding in the fields of its application. In recent years, another aspect of accounting, called Management accounting, has been developed and is being employed in many concerns.

Where Financial accounting limits its activities in determining the financial result of trading during a given period of time and stating the financial position as on the closing date of the period, Cost Accounting takes the responsibility of generating information for controlling operations with a view to maximizing efficiency and hence profit, and Management accounting takes the duty of assisting the management with information for planning and decision making.

The belief that Cost Accounting developed after the rise of factory systems a result of Industrial Revolution in England, is not true. Some Cost Accounting principles were found in application as early as 14th century. Some authorities suggest that, the present day cost Accounting procedure was established at the end of the 19th Century. However, major developments in the subject were noticed during a quarter century before the end of the Second World War. The scientific management movement led to the development of standard Costing. After 1945, the need for data in planning for the future was felt and Cost Accounting developed further. The technique of Cost control is a recent development. Cost Audit also emerged as a branch and it is developing further.

Meaning of Cost:

It is the amount of resources given up in exchange for some goods or services. The resources given up are expressed in monetary terms. Cost is defined as the amount of expenditure (actual or notional) incurred on or attributable to a given thing or to ascertain the cost of a given thing. The cost of an article consists of actual outgoings or ascertained charges incurred in its production and sale. Cost is a generic term and it is always advisable to qualify the word cost to show exactly what it means e.g., prime cost, factory cost, sunk cost etc., cost is also different from value as cost is measured in terms of money whereas value is measured in terms of usefulness or utility of an article.

Meaning of Costing

Costing is a technique and process of ascertaining costs. This technique consists of principles and rules which govern the procedure of ascertaining the cost of products/services. The process of costing includes routines of ascertaining costs by historical or conventional costing, standard costing or marginal costing.

Meaning of cost accounting:

Cost Accounting is the classifying, recording and appropriate allocation of expenditure for the determination of the costs of products or services, and for the presentation of suitable arranged data for purposes of control and guidance of management. It includes the ascertainment of the cost of every order, job contract, process, service or unit as may be appropriate. It deals with the cost of production, selling and distribution. It is thus the provision of such analysis and classification of expenditure as will enable the total cost of any particular unit of production or service to be ascertained with reasonable degree of accuracy and at the same time to disclose exactly how such total cost is constituted (i.e., the value of material used, the amount of labour and other expenses incurred) so as to control and reduce its cost. Thus, cost accounting relates to the collection, classification, ascertainment of cost and its accounting and control relating to the various elements of cost. It establishes budgets and standard costs and actual cost of operations, processes, departments or products and the analysis of the variance, profitability and social use of funds. Accounting to Kohler, "Cost Accounting is the branch of accounting dealing with the classification, recording, allocation, summarizing and reporting of current and prospective costs."

Meanings of cost accountability:

Cost Accountancy is the application of costing and cost accounting principles, methods and techniques to the science, art and practice of cost control and the ascertainment of profitability. It includes the presentation of information derived there from for purposes of managerial decision making. Thus, cost accountancy is the science, art and practice of a cost accountant. It is science because it is a body of systematic knowledge having certain principles which a cost accountant should possess for proper discharge of his responsibilities. It is an art as it requires the ability and skill with which a cost accountant is able to apply the principles of cost accountancy to various managerial problems. Practice includes the continuous efforts of a cost accountant in the field of cost accountancy. Such efforts also include the presentation of information for the purpose of managerial decision making and keeping statistical records.

Importance of Cost Accounting

Importance of Cost Accounting may be considered under the following headings:

(A) Importance to Management:

A good Cost Accounting system serves the management in the following ways:

(i) Classification and sub-division of costs:

Costs are collected and classified by various ways in order to provide information to the management for control purposes and to ascertain the profitability of each area of activity. It enables the concern to measure the efficiency and then to maintain and improve it.

(ii) Control of material, labour and overhead costs:

Various inventory control techniques or methods of costing are used to control the material cost. For example fixation of maximum level helps the management to reduce the over-stocking; use of EOQ helps the Purchase Department to order right quantity. An efficient check on labour and machines is provided by giving detailed information about availability of machine and labour capacity. The work is so planned that no section is over-worked and no section remains idle. By classifying the overheads into controllable and uncontrollable or fixed and variable, helps to control the overhead costs.

Thus cost accounting provides a detailed control of material, labour and overhead costs.

(iii) Price determination:

Cost Accounting helps the management to fix the remunerative selling prices of various items of goods under different circumstances. During the period of depression a businessman has to become very watchful and vigilant in tracking down the concealed inefficiencies and sources of wastage, so that he may reduce the cost of production to the minimum. During depression the businessman has to cut the price to such an extent so as to recover the variable costs. Cost accounting makes the distinction between fixed and variable costs and helps the management in determination of prices. If prices are fixed without cost information, it is possible that prices quoted may be too high or too low.

(iv) Business Policy:

Business policy may require consideration of alternative methods and procedures and this is facilitated by cost information correctly presented. Cost accounting helps the management to take vital decisions such as introduction of new product, selection of optimum product mix, utilization of spare capacity, replacement of existing assets, etc.

(v) Standards for measuring efficiency:

It provides the use of standards to assist management in making estimates and plans for future and to provide the basis for measuring of efficiency. Actual are compared with standards to determine the operating efficiency.

(vi) Best use of limited resources:

Cost accounting provides the reliable data of costs with regard to materials, wages and other expenses. This helps the management to get maximum output at the minimum cost, by indicating where economies may be affected, waste eliminated and efficiency increased.

(vii) Special factors:

Cost accounting informs the management about the special factors such as optimum profitability, seasonal variations in volume and costs, Idle time of labour and idle capacity of the machine, etc. It also helps to curtail the losses during the off season.

(B) Importance to Workers:

Cost accounting discloses the relative efficiencies of different workers and thereby facilitates the introduction of suitable plans of wage payment to reward efficiency and to provide adequate incentive to the less efficient workers. A good system of costing promotes prosperity of the business and thus ensures greater security of service and adequate reward to workers.

(C) Importance to Creditors and Investors:

It enables the creditors and investors to judge the financial strength and credit worthiness of the business. A sound business concern with a good system of costing can attract more investors than a similar concern without an adequate system of costing.

(D) Importance to Government:

It facilitates the assessment of excise duty and income tax and the formulation of policies regarding industry, export, import, taxation, etc. It also facilitates the preparation of national plans for economic development. It provides ready figures for use by government by application to problems like price fixation, price control, tariff protection, and wage level fixation, payment of dividends or settlement of disputes.

(E) Importance to General Public:

The ultimate aim of costing is to reduce cost of production to the minimum and maximize the profits of the business. A part of the benefit resulting from the reduction of the cost is usually passed on to the consumers in the form of lower prices. Besides the installation of a costing system will infuse confidence in the minds of the public about the fairness of the prices charged.

Differences between Financial Accounting and Cost Accounting:

Main difference between financial accounting and cost accounting are given as under:

Point of distinction	Financial Accounting	Cost Accounting
1. Purpose	It provides information about the business in a general way. It tells about the profit and loss and financial position of the business to owners and other outside parties	It provides information to the management for proper planning, operation, control and decision making.
2. Form of accounts	These accounts are kept in such a way as to meet the requirements of companies Act and Income Tax Act.	These accounts are generally kept voluntarily to meet the requirements of the management. But now companies Act has made it obligatory to keep cost records in some manufacturing industries.
3. Recording	It classifies, records and analyses the transactions in a subjective manner i.e. according to the nature of expenses.	It records the expenditure in an objective manner i.e., according to the purposes for which the costs are incurred.

4. Control	It lays emphasis on the recording aspect without attaching any importance of control	It provides a detailed system of control for materials, labour and overhead costs with the help of standard costing and budgetary control.
5. Periodicity of reporting	It reports operating results and financial position usually at the end of the year.	It gives information through cost reports to management as and when desired.
6. Analysis of profit	Financial accounts are the accounts of the whole business. They are independent in nature and disclose the net profit or loss of the business as a whole.	Cost Accounting is only a part of the financial accounts and discloses profit or loss of each product, job or service.
7. Reporting of costs	The costs are reported in aggregate in financial accounts	The costs are broken down on a unit basis in cost accounts.
8. Nature of transactions	Financial accounts relate to commercial transactions of the business and include all expenses viz., manufacturing office, selling and distribution etc.´	Cost accounts relate to transactions connected with the manufacture of goods and services and include only those expenses which enter in to production.
9. Information	Monetary information is only used (i.e. only monetary transactions are recorded).	Non-monetary information like units is also used (i.e., it deals with monetary as well as non-monetary information).
10. Figures	Financial accounts deal mainly with actual facts and figures	Cost accounts deal partly with facts and figures and partly with estimates
11. Reference	In devising or operating a system of financial accounting reference can be made in case of difficulty to the company law, case decisions and to the canons of sound professional practice.	No such reference is possible. Guidance can be had only from a body of convention followed by cost accountants.
12. relative efficiency	Financial accounts do not provide information on the relative efficiencies of various workers, plants and machinery.	Cost accounts provide valuable information on the relative efficiencies of various plants and machinery.
13. Stock valuation	Stock are valued at cost or market price whichever is less	Stock are valued at cost
14. Type of science	Financial accounting is a positive science because it is subject to legal rigidity with regard to the preparation of the financial statements	Cost accounting is not only a positive science but also a normative science because it includes techniques of budgetary control and standard costing.

Meaning of Management Accounting:

Management Accounting is primarily concerned with management. It involves application of appropriate techniques and concepts, which help management in establishing a plan for reasonable economic objective. It helps in making rational decisions for accomplishment of these objectives. Any workable concept of techniques whether it is drawn from cost accounting financial accounting, economics, mathematics and statistics, can be used in management accountancy, The data used in management accountancy should satisfy only one broad test. It should serve the purpose that it is intended for. A management accountant accumulates synthesis and analysis

the available data and present it in relation to specific problems, decisions and day-to-day task of management. A manger accountant reviews all the decisions and analysis form management's point of view to determine how these decisions and analysis contribute to overall organizational objectives. A management accountant judges the relevance and adequacy of available data from management's point of view.

Difference between cost Accounting and Management Accounting

Point of distinction	Cost Accounting	Management Accounting
1. Deals with	It deals with ascertainment, allocation, apportionment and accounting aspect of costs	It deals with the effect and impact of cost on the business
2. Base	It provides a base for management accounting.	It is derived from both cost accounting and financial accounting.
3. Role	It is helpful in collecting costing data for the management	It is a greater degree of relevance and objectivity as the management accountant has a clear idea of the types of costs and items requiring analysis and states the specific problems of business.
4. Status	The status of cost accountant comes after the management accountant	Management accountant is senior in position to cost accountant.
5. Outlook	Cost accountant has a narrow approach. He has to refer to economic and statistical data for analyzing cost effects	Management accountant reports the effect of cost on the business along with cost analysis.
6.Tools & techniques	It has standard costing, variable costing, break even analysis etc., as the basic tools and techniques.	Along with these, the management accountant has funds and cash flow statements, ratio analysis etc. as his accounting tools and techniques.
7. Scope	It does not include financial accounting, tax planning and tax accounting.	It includes financial accounting, cost accounting tax planning and tax accounting.
8. Period of planning	It is concerned with short-term planning	It is concerned with short range and long range planning and uses techniques like sensitivity analysis, probability structure etc. Its special field is evaluation of capital investment projects.
9. Assistance	It merely assists the management in its functions.	It assists and evaluates the management performance.
10. Approach	It is historical in its approach	It is futuristic in its approach
11. Installation	It can be installed without management	It needs financial and cost accounting as its base for its installation.

Scope (or Functions) of cost Accountancy

The scope of cost accountancy is very wide and includes the following:

(i) Cost Ascertainment:

It deals with the collection and analysis of expenses, the measurement of production of the different product at the different stages of manufacture and the linking up of production with the expenses. In fact, the varying procedures



for the collection of expenses give rise to the different systems of costing as Historical or Actual costs, Estimated costs, standard costs etc. Again the varying procedures for the measurement of production have resulted in different methods of costing such as specific order costing operation costing etc. For linking up of production with the expenses the different techniques of costing such as marginal cost technique, the total cost technique, direct cost technique etc., have been evolved. All the three i.e. system, methods and techniques can be used in one concern simultaneously.

(ii) Cost Accounting:

It is the process of accounting for cost which begins with recording of expenditure and ends with the preparation of statistical data. It is formal mechanism by means of which costs of products or services are ascertained and controlled. Cost accounting is helpful to the management in decision making. Decision making requires, apart from other information, cost information which is provided by cost accounting. Cost can be ascertained either by following the historical or predetermined system of costing. Cost can be predetermined either by standard costing or estimated costing. If the cost and financial accounts are kept separately then their reconciliation is also to be done in order to verify the accuracy of both sets of accounts.

(iii) Cost control:

Cost control is the guidance and regulation by executive action of the costs of operating an undertaking. It aims at guiding the actual towards the line of targets: regulates the actual if they deviate or vary from the targets: this guidance and regulation is done by an executive action. The cost can be controlled by standard costing, budgetary control, proper presentation and reporting of cost data and cost audit.

Objectives of Cost Accounting:

The objectives of cost accounting are ascertainment of cost, fixation of selling price, proper recording and presentation of cost data to management for measuring efficiency and for cost control. The aim is to know the methods by which expenditure on materials, wages and overhead is recorded, classified and allocated so that the cost of products and services may be accurately ascertained; these costs may be related to sales and profitability may be determined. Yet with the development of business and industry, its objectives are changing day by day. Following are the main objectives of cost accounting:

- (a) To ascertain the cost per unit of the different products manufactured by a business concern.
- (b) To provide a correct analysis of cost both the process or operations and by different elements of cost.
- (c) To disclose sources for wastage whether of material, time or expenses or in the use of machinery, equipment and tools and to prepare such reports which may be necessary to control such wastage.
- (d) To provide requisite data and serve as a guide to price fixing of products manufactured or services rendered.
- (e) To ascertain the profitability of each of the products and advise management as to how these profits can be maximized.
- (F) To exercise effective control of stocks of raw material, work-in-progress, consumable stores and finished goods in order to minimize the capital locked up in these stocks.
- (g) To reveal sources of economy by installing and implementing a system of cost control for materials, labour and overheads.
- (h) To advise management on future expansion policies and proposed capital projects.
- 9i) To present and interpret data for management planning, decision-making and control.
- (i) To help in the preparation of budgets and implementation of budgetary control.
- (k) To organize an effective information system so that different levels of management may get the required information at the right time in right form for carrying out their individual responsibilities in an efficient manner.
- (l) To guide management in the formulation and implementation of incentive bonus plans based on productivity and cost savings.
 - (m) To supply useful data to management for taking various financial decisions such as introduction of new products, replacement of labour by machine etc.
 - (n) To help in supervising the working of punched card accounting or data processing through computers.
 - (o) To organize the internal audit system to ensure effective working of different departments.

- (p) To organize cost reduction, programmers with the help of different departmental managers.
- (q) To provide specialized services of cost audit in order to prevent the errors and frauds and to facilitate prompt and reliable information to management.
- (r) To find out costing profit or loss by identifying with revenues the costs of those products or services by selling which the revenues have resulted.

Broadly speaking, the above objectives can be re-grouped under the following three heads:

- (a) Ascertainment and analysis of cost and income by product, function and responsibility.
- (b) Accumulation and utilization of cost data for control purposes to have the minimum possible cost consistent with maintenance of quality. This objective is achieved through fixation of targets, ascertainment of actual, comparison of actual with targets, analysis of reasons of deviations between actual and targets and reporting deviations to management for taking corrective action.
- (c) Providing useful data to management for taking decisions.

Advantages of Cost Accounting

The main advantages of cost accounting are given below:

1. **Profitable and unprofitable activities are disclosed** and steps can be taken to eliminate or reduce those activities from which little or no benefit is obtained or to change the method of production in order to make such activities more profitable.
2. **It enables a concern to measure the efficiency and then to maintain and improve it.** This is done with the help of valuable data made available for the purpose of comparison. For example, if material spent upon a pair of shoes in 2015 comes to ₹ 560 and for a similar pair of shoes the amount is ₹ 600 in 2016, the increase may be due to increase in prices of material or more wastage in the use of materials or inefficiency at the time of buying or unnecessarily high prices paid.
3. **It provides information upon which estimates and tenders are based.** If case of big contracts or jobs, quotations cannot be given unless the cost of completing the contracts can be found out.
4. **It guides future production policies.** It explains the cost incurred and profit made in various lines of business and processes and thereby provides data on the basis of which production can be appropriately planned.
5. **It helps in increasing profits** by disclosing the sources of loss or waste and by suggesting such controls so that wastages, leakages and inefficiencies of all departments may be detected and prevented.
6. **It enables a periodical determination of profits or losses** without resort to stock taking.
7. **It furnishes reliable data for comparing costs in different periods,** for different volumes of output, in different departments and processes and in different establishments, this helps in maintaining costs at the lowest point consistent with the most efficient operating conditions.
8. **The exact cause of a decrease or an increase in profit or loss** can be detected. A concern may suffer not because the cost of production is high or prices are low but also because the output is much below the capacity of the concern. This fact is revealed by cost accounts only.
9. **Cost Accounting discloses the relative efficiencies of different workers** and thereby facilitates the introduction of suitable plans of wage payment to reward efficiency and to provide adequate incentive to the less efficient worker ₹ A goods system of costing promotes propriety of the business and thus ensures greater security of service and adequate reward to workers.
10. It enables the creditors and investors to judge the financial strength and credit worthiness of the business. A sound business concern with a goods system of costing can attract more investors than a similar concern without an adequate system of costing.
11. **Helpful to the Government.** It facilitates the assessment of exercise duty and income tax and the formulation of policies regarding industry, export, import, taxation etc. it also facilitates the preparation of national plans for economic development. It provides ready figures for use by the Government for application to problems like price fixation, price control, tariff protection wage level fixation, payment of dividends or settlement of disputes.
12. **Helpful to consumers.** The ultimate aim of costing is to reduce cost of production to the minimum and maximize the profits of the business. A part of the benefit resulting from the reduction of the cost is usually passed on to



consumers in the form of lower prices. Besides, the installation of a costing system will infuse confidence in the minds of the public about the fairness of the prices charged.

13. Efficiency of public enterprises:

Costing has a more important role to play in public enterprises than in private enterprises. In public enterprises, primary objective is not to raise profit but it is to serve the society by providing quality goods at cheaper rates. Therefore, whatever limited information the usual profit and loss account can give in case of private enterprise, is not available in case of a public enterprise. The efficiency of a public sector can be best judged by comparing its cost of production with the cost of production of its counterpart in the private sector. Public enterprises lack the personal initiative and interest of private enterprises. A good system of costing ensures efficient and effective control through a proper analysis of their working. It provides for graded financial control over expenditure and avoids conflict of authority. It measures efficiency and profitability of the undertaking to justify its running in the public sector. It helps management in fixing a reasonable selling price for the products manufactured or services rendered.

Cost Accounting Standards:

CAS	Title
1	Classification of Cost
2	Capacity Determination
3	Overheads
4	Captive Consumption
5	Average (equalized) Cost of Transportation
6	Material Cost
7	Employee Cost
8	Cost of Utilities
9	Packing Material Cost
10	Direct Expenses
11	Administrative Overheads
12	Repairs & Maintenance Cost
13	Cost of Service Cost Centre
14	Pollution Control Cost
15	Selling and Distribution Overheads
16	Cost Accountings Standard on Depreciation and Amortisation
17	Cost Accountings Standard on Interest and Financing Charges
18	Cost Accountings Standard on Research and Development Costs
19	Cost Accountings Standard on Joint Costs
20	Cost Accountings Standard on Royalty and Technical Know-How Fee
21	Cost Accountings Standard on Quality Control
22	Cost Accountings Standard on Manufacturing Cost
23	Cost Accounting Standard on Overburden Removal Cost
24	Cost Accounting Standard on Treatment of Revenue in Cost Statement

Costing – An Aid to Management

Planning, decision- making and control are three important functions of management. It is desirable to have a brief discussion of these functions.

Planning:

Planning is thinking in advance i.e. looking ahead and deciding in advance what to do, how to do it, when to do it and who is to do it. In planning, management is concerned with laying down objectives and determining

the courses of actions to be followed out of the several alternatives available to achieve those objectives. Thus, planning is concerned with future activity and formulates budgets to meet the objectives of the organization.

Decision Making:

Since management has to make a choice of one course of action out of the several alternative courses of action available, it involves decision-making. All rational decisions are based on accounting information. Decisions may relate to various problems like (i) fixation of price (ii) whether or not price should be reduced for increased level of sales (iii) whether a change in production should be followed (iv) whether or not factory should operate at full capacity (v) determination of the most profitable levels of production (vi) whether to make or buy a spare part (vii) whether a new product should be introduced in the market (viii) whether the product should be exported or not (ix) whether a particular market should be tapped or not (x) whether a product should be discontinued to avoid the present loss and (xi) whether or not an investment in a particular asset will be worthwhile.

Controlling:

Controlling is that part of the management activity whereby managers compare actual performance against the planned performance, find out the deviations and take remedial steps to remove the deviations. Immediate action should be taken to remove the deviations to make an improvement in the performance because promptness is the essence of an effective control. Thus, control helps correction. Planning and controlling are interlinked with each other because a manager cannot control unless he has planned a course of action.

The above functions of management cannot be satisfactorily carried out by financial accounting because of its limitations. Cost accounting is very helpful in performing the functions of planning decision-making and controlling effectively.

Cost accounting helps management in carrying out efficiently its functions (i.e. planning budgeting, decision – making, organizing, control, pricing and evaluation of operating efficiency) by developing practical cost procedures that provide information useful in controlling the operations of the business enterprise. Cost accounting does this by analyzing, recoding, standardizing, forecasting, comparing, reporting and recommending. Cost accounting methods supply the basis of factual information on which management can build up its presentation of planning and control. In fact, cost accounting is so closely allied to management that it is difficult to indicate where work of cost accountant ends and managerial control begins. To quote blocker and weltmet, “In general, it may be said that cost accounting is to serve management in the execution of policies and in the comparison of actual and estimated results in order that the value of each policy be appraised and changed to meet future conditions.”

A good system of cost accounting serves management in the following ways:

(a) Classification and sub-divisions of costs:

Costs are collected and classified by various ways in order to provide information to the management for control purposes and to ascertain the profitability of each area of activity. It enables a concern to measure the efficiency, and then to maintain and improve it. Unprofitable activities are disclosed and steps can be taken to make an improvement in those activities.

(b) Control of Materials, Labour and overhead costs”

An efficient check is provided on stores and materials, stores ledger and material Abstracts are maintained which provide an effective check on the stores and material used in a business. BY adopting the maximum limit for stores the total capital outlay is controlled and total financial loss due to over-stocking is obviated. Information of stock of various materials and stores is constantly available. This helps in planning the production according to availability of materials and fresh stocks can be arranged in time. Loss due to carelessness or pilferage or any other mischief is detected and steps may thereof, be taken to minimize such loss in future. An efficient check on labour and machines is provided by giving detailed information about the availability of machine and labour capacity. The work is so planned that no section is over – worked and no section remains idle. The maintenance of time and job cards for workers discloses the loss incurred by idle time and indicates the directions in which losses may be minimized. The relative advantages of remunerating labour on the time or piece work or premium plans may be ascertained. It also measures the efficiency of the wages system in use. Cost Accounting thus provides a detailed control of materials and stores and labour costs. Various techniques of materials control are applied in order to avoid the excessive locking up of capital in stock of materials and stores. Idle time should be kept as low as possible. By having proper classification of overheads into controllable and uncontrollable or fixed and variable, it helps to



control the overhead costs.

(c) Business policies:

Business policy may require the consideration of alternative methods and procedures and this is facilitated by cost information correctly presented. For example, by the aid of cost reports management can be decide whether the manufacture of certain products increases overhead expenditure disproportionately or whether to treat by – product even at a loss to make possible a more important trade in another product. Thus, it helps the management to take vital decisions such as introduction of a new product, selection of a most profitable product mix, utilization of spare capacity, exploration of additional market, whether to make or buy, problem of limiting factor, replacement of existing assets, appraisal of proposed investment to meet expansion programme etc. with the help of marginal costing techniques and differential cost analysis.

(d) Budgeting:

It provides the use of budgets and performance reports and enables management to correct inefficiencies before they enter into business. It is a co-ordinate plan of action of every responsible person for comparing the actual results with the budgets. Two important cost accounting tolls for helping managers are budgets and performance reports. Budgets are financial and/or quantitative statements prepared and approved prior to a defined period of time, of the policies to be pursued during that period for the purpose of attaining objectives of the management. Thus, budgets are the formal quantifications of the plans of management. Performance reports measure actual performance and give accounts of comparisons of budgets with actual results which facilitate action against those persons whose performance is less than the performance specified in the budgets. The technique of control through performance reports is technically known as management by exception, which is the practice of concentrating on areas whose performance is not upto the mark as it was planned and ignoring areas that are running smoothly as these were planned.

(e) Standards for measuring efficiency:

It provides the use of standards to assist management in making estimates and plans for future and to provide the basis of management o efficiency. Actuals are compared with predetermined standards to determine the operating efficiency.

(f) Best use of limited resources:

In all varied fields we are concerned to make the best use of limited resources that are available to us. Thus the intension is to obtain the maximum output from a given input. Cost Accounting provides the reliable data of costs with regard to materials, wages and other expenses. These help management to get maximum output at the minimum cost by indicating where economies may be affected, waste eliminated and efficiency increased; some of the loss occasioned by reduced turnover and falling prices may be avoided.

(h) Instrument of Management Control:

It provides management with valuable data for planning, budgeting and control of costs. The organization and management or undertaking must be planned and controlled in such a way that the desired volume of production is achieved at the least possible cost in relation to the scheduled quantity of the product. The measurement of the degree to which this objective is attained, is provided by cost accounting. An efficient system of cost accounting is, thus, regarded as an important part in the efforts of any management to secure business stability.

(i) Cost Audit:

The operation of a system of cost audit in the organization will assist in prevention of errors and frauds. It will help to improve cost accounting methods and techniques to facilitate prompt and reliable information to the management.

(i) Special Factors:

It informs the management about the special factors such as optimum profitability, seasonal variations in volume and costs, idle time of labour and idle capacity of the machine etc. It also helps to curtail the losses during the off season.

(j) Price Determination:

It helps the management to fix the remunerative selling prices of various items of goods in different circumstances. During the period of depression a businessman has to become very watchful and vigilant in tracking down the concealed inefficiencies and sources of wastage, so that he may reduce the cost of production to the minimum. He has to resort to price cutting to such an extent so as to recover variable costs. Cost accounting makes a distinction between fixed and variable costs and helps the business man in the determination of prices in the depression period. The fixation of prices cannot be properly done unless proper figures of cost are available, if prices are fixed without costing information, it is possible, that prices quoted may be too high to low. In periods of depression, it may become necessary to reduce the prices even below total cost. It is only costing which will guide the businessmen in this matter.

(k) Expansion:

Management is able to formulate expansion policy on the basis of estimates of cost for production at various levels provided by cost accountant.

Characteristics of an Ideal Costing System:

An ideal system of costing is that which achieves the objectives of a costing system and brings all advantages of costing to the business. Following are the main characteristics which an ideal system of costing should possess or the points which should be taken into consideration before installing costing system.

i) **Suitability to the business:** A costing system must be devised according to the nature, conditions, requirements and size of the business. Any system which serves the purposes of the business and supplies necessary information for running the business efficiently is an ideal system.

ii) **Simplicity:** the system of costing should be simple and plain so that it may be easily understood even by a person of average intelligence. The facts, figures and other information provided by cost accounting must be presented in the right form at the right time to the right person in order to make it more meaningful.

iii) **Flexibility:** the system of costing must be flexible so that it may be changed according to change conditions and circumstances. The system without such flexibility will be outmoded because of fast changes in business and industry. Thus, the system must have the capacity of expansion or contraction without much change.

iv) **Economical:** A costing system is like other economic goods. It costs money just like economic goods. If the system is too expensive, the management may be unwilling to pay as buyers are not willing to pay for the goods if these are expensive as compared to their utility. A costing system should not be expensive and must be adapted according to the financial capacity of the business. The benefits to be derived from the system must be more than its costs as management will be willing to install the system when its perceived expected benefits exceed its perceived expected costs. In short, the system must be economical taking into consideration the requirements of the business.

v) **Comparability:** The costing system must be such so that it may provide facts and figures necessary to the management for evaluating the performance by comparing it with the past figures, or figures of other concern or against the industry as a whole or other department of the same concern.

vi) **Capability of presenting information at the desired time:** The system must provide accurate and timely information so that it may be helpful to the management for taking decisions and suitable action for the purpose of cost control.

vii) **Minimum changes in the existing setup:** The existing system of delegation and division of authority and responsibility must not be disturbed with the costing system. As far as possible the system must be such so that it may least disturb the existing organizational set up.

viii) **Uniformity of forms:** All forms and Performa's etc. necessary to the system should be uniform in size and quality of paper. Higher efficiency can be obtained by using colour of the paper to distinguish different forms. Printed forms should contain instructions as to their use and disposal.

ix) **Maximum clerical work:** The filling of the forms by foremen and workers should involve little clerical work as possible as most of workers are not well educated. To ensure reliable statistics, every original entry should be supported by an examiner's signatures.

x) **Efficient system of material control:** there should be an efficient system of stores and stock control as materials usually account for a greater proportion of the total cost



xi) **Adequate wage procedure:** There should be a well defined wage procedure for recording the time spent by workers on different jobs, for preparing the wage sheets and for the payment of wages, thus the introduction of well defined wage system will help to control the cost of labour.

xii) **Departmentalization of expenses:** A sound plan should be devised for the collection, allocation, apportionment and absorption of overheads in order to ascertain the cost accurately.

xiii) **Reconciliation of cost and financial accounts:** If possible the cost and financial accounts should be interlocked into one integral accounting scheme. If this is not possible the systems should be so devised that the two sets of accounts are capable of easy reconciliation.

xiv) **Duties and responsibilities of the cost accountant:** Under a good system of cost accounting the duties and responsibilities of the cost accountant should be clearly defined. The cost accountant should have access to all works and departments.

4.2 CLASSIFICATION OF COST

1. By nature or element
 - Materials
 - Labour
 - Expenses
2. By Functions
 - Manufacturing and Product Cost
 - Commercial Cost
3. By Degree of traceability to product
 - Direct Cost
 - Indirect Cost
4. By changes in Activity or volume
 - Fixed Cost
 - Variable Cost
 - Semi Variable Cost
5. By controllability
 - Controllable Cost
 - Un controllable Cost
6. By Normality
 - Normal Cost
 - Abnormal Cost
7. By Relationship with accounting period
 - Capital Cost
 - Revenue Cost
8. By Time
 - Historical Cost
 - Pre-determined Cost

9. According to planning
 - Budgeted Cost
 - Standard Cost
10. By Association with the product
 - Product Costs
 - Period Costs
11. For Managerial decisions
 - Marginal Cost
 - Out of pocket Cost
 - Differential Cost
 - Sunk Cost
 - Imputed or Notional Cost
 - Opportunity Cost
 - Replacement Cost

Now each classification will be discussed in detail.

1. By Nature or Elements or Analytical classification:

According to this classification, the costs are divided into three categories i.e., Materials, Labour and expenses. There can be further sub classification of each element: For example, material into raw material components, spare parts, consumable stores, packing material etc. This classification is important as it helps to find out the total cost, how such total cost is constituted and valuation of work-in-progress.

2. By Functions (i.e., Functional classification).

According to this classification costs are divided in the light of the different aspects of basic managerial activities involved in the operation of a business undertaking. It leads to grouping of costs according to the broad divisions or functions of a business undertaking i.e., production, administration, selling and distribution, According to this classification costs are divided as follows:

Manufacturing and production cost:

This is the total of costs involved in manufacture construction and fabrication of units of production.

Commercial cost:

This is the total of costs incurred in the operation of a business undertaking other than the cost of manufacturing and production. Commercial cost may further be sub-divided into.

- (a) Administrative cost, and
- (b) Selling and distribution cost.

These terms will be explained in a subsequent chapter

3. By degree of Traceability to the product (Direct and Indirect):

According to this classification, total cost is divided into direct costs and indirect costs. Direct costs are those which are incurred for and may be conveniently identified with a particular cost centre or cost unit. Materials used and labour employed in manufacturing an article or in a particular process of production are common examples of direct costs. Indirect costs are those costs which are incurred for the benefit of number of cost centers or cost units and cannot be conveniently identified with a particular cost centre or cost unit. Examples of indirect costs include rent of building, management salaries, machinery depreciation etc. The nature of the business and the cost unit chosen will determine which costs are direct and which are indirect. For example, the hire of a mobile crane for use by a contractor at site would be regarded as a direct cost but if the crane is used as a part of the services of a factory, the hire charges would be regarded as indirect cost because it will probably benefit more than one cost



centre. The importance of the distinction of costs into direct and indirect lies in the fact that direct costs of a product or activity can be accurately determined while indirect costs have to be apportioned on certain assumptions as regards their incidence.

4. By changes in Activity or volume:

According to this classification, costs are classified according to their behavior in relation to changes in the level of activity or volume of production. On this basis, costs are classified into three groups' viz., fixed, variable and semi-variable.

(i) Fixed costs:

Fixed costs are commonly described as those which remain fixed in total amount with increase or decrease in the volume of output or productive activity for a given period of time. Fixed cost per unit decreases as production increase and increases as production declines. Examples of fixed costs are rent, insurance of factory building, factory manager's salary etc. These fixed costs are constant in total amount but fluctuate per unit as production changes. These costs are known as period costs because these are dependent on time rather than on output. Such costs remain constant per unit of time such as factory rent of ` 10,000 per month remaining same for every month irrespective of output of every month.

Classification of Fixed costs:

(a) Committed costs:

These costs are the result of inevitable consequences of commitments previously made or are incurred to maintain certain facilities and cannot be quickly eliminated. The management has little or no discretion in such type of costs e.g., rent, insurance, depreciation on building or equipment purchased.

(b) Policy and Managed costs:

Policy costs are incurred for implementing some management policies as executive development, housing etc. and are often discretionary. Managed costs are incurred to ensure the operating existence of the company e.g., staff services.

(c) Discretionary costs:

These costs are not related to the operation but can be controlled by the management. These costs arise from some policy decisions, new researches etc. and can be eliminated or reduced to a desirable level at the discretion of the management.

(d) Step Costs:

Such costs are constant for a given level of output and then increase by a fixed amount at a higher level of output.

(ii) Variable costs:

Variable costs are those which vary in total in direct proportion to the volume of output. These costs per unit remain relatively constant with changes in production. Thus, variable costs fluctuate in total amount but tend to remain constant per unit as production activity changes. Examples are direct material costs, Direct labour costs, Power, repairs etc., Such costs are known as product costs because they depend on the quantum of output rather than on time.

(iii) Semi-variable costs:

Semi-variable costs are those which are partly fixed and partly variable. For example, telephone expenses include a fixed portion of monthly charge plus variable according to calls; thus total telephone expenses are semi-variable. Other examples of such costs are depreciation, repairs and maintenance of building and plant etc.

5. By Controllability:

Under this, costs are classified according to whether or not they are influenced by the action of given member of the undertaking. On this basis costs are classified into two categories:

(i) Controllable costs are those which can be influenced by the action of a specified member of an undertaking, that is to say, costs which are at least partly within the control of management. An organization is divided into a

number of responsibility centers and controllable costs incurred in a particular cost centre can be influenced by the action of the manager responsible for the centre. Generally speaking, all direct costs including direct materials, direct labour and some of the overhead expenses are controllable by lower level of management.

(ii) Uncontrollable costs are those which cannot be influenced by the action of a specified member of an undertaking, that is to say, which are not within the control of management. Most of the fixed costs are uncontrollable. For example, rent of the building is not controllable and so is managerial salaries. Overhead cost, which is incurred by one service section and is apportioned to another which receives the service, is also not controllable by the latter.

The distinction between controllable and uncontrollable is sometimes left to the individual judgment and is not sharply maintained. It is only in relation to a particular level of management or an individual manager that we may say whether a cost is controllable or uncontrollable. A particular item of cost which may be controllable from the point of view of one level of management, may be uncontrollable from another point of view. Moreover, there may be an item of cost which is controllable from long-term point of view and uncontrollable from short-term point of view. This is partly so in the case of fixed costs.

6. By normality:

Under this, costs are classified according to whether these are costs which are normally incurred at a given level of output in the conditions in which that level of activity is normally attained. On this basis, it is classified into two categories.

(a) Normal cost:

It is the cost which is normally incurred at a given level of output in the conditions in which that level of output is normally attained. It is a part of cost of production.

(b) Abnormal cost:

It is the cost which is not normally incurred at a given level of output in the conditions in which that level of output is normally attained. It is not a part of cost of production and charged to costing profit and loss account

7. By relationship with accounting period (capital and revenue):

The cost which is incurred in purchasing an asset either to earn income or increasing the earning capacity of the business is called capital cost, for example, the cost of a rolling machine in case of steel plant. Such cost is incurred at one point of time but the benefits accruing from it is spread over a number of accounting years. If any expenditure is done in order to maintain the earning capacity of the concern such as cost of maintaining an asset or running a business it is revenue expenditure e.g., cost of materials used in production, labour charges paid to convert the material into production, salaries, depreciation, repairs and maintenance charges, selling and distribution charges etc. the distinction between capital and revenue items is important in costing as all items of revenue expenditure are taken into consideration while calculating cost whereas capital items are completely ignored.

8. By Time.

Costs can be classified as (i) Historical costs and (ii) predetermined costs

(i) Historical costs:

The costs which are ascertained after being incurred are called historical costs. Such costs are available only when the production of particular thing has already been done. Such costs are only of historical value and not at all helpful for cost control purposes. Basic characteristics of such costs are:

(a) They are based on recorded facts.

(b) They can be verified because they are always supported by the evidence of their occurrence.

(c) They are mostly objective because they relate to happenings which have already taken place.

(ii) Predetermined costs:

Such costs are estimated costs i.e. computed in advance of production taking into consideration the previous period costs and the factors affecting such costs. Predetermined cost determined on scientific basis becomes standard cost. Such costs when compared with actual costs will give the reasons of variance and will help the management to fix the responsibility and to take remedial action to avoid its recurrence in future.

Historical costs and predetermined costs are not mutually exclusive but they work together in the accounting system of an organization. In competitive age, it is better to lay down standards, so that after comparison with the actual, management may be able to take stock of the situation of find out as to how far the standards fixed by it have been achieved and take suitable action in the light of such information. Therefore, even in a system when historical costs are used, predetermined costs have a very important role to play because a figure of historical cost by itself has no meaning unless it is related to some other standard figure to give meaningful information to the management.

9. According to Planning and Control:

Planning and control are two important functions of management. Cost accounting furnishes information to the management which is helpful in the due discharge of these two functions. According to this, costs can be classified as budgeted costs and standard costs.

Budgeted costs:

Budgeted costs represent an estimate of expenditure for different phases of business operations such as manufacturing, administration, sales, research and development etc., coordinated in a well convinced framework for a period of time in future which subsequently becomes the written expression of managerial targets to be achieved. Various budgets are prepared for various phases, such as raw material cost budget, labour cost budget, cost or production budget, manufacturing overhead budget, office and administration overhead budget etc. continuous comparison of actual performance (i.e. actual cost) with that of the budgeted cost is made so as to report the variations from the budgeted cost to the management for corrective action.

Standard costs:

Budgeted costs are translated in to actual operation through the instrument of standard costs. The chartered Institute of Management Accountants, London defines "standard cost as the predetermined cost based on a technical estimate for materials, Labour and overhead for a selected period of time and for a prescribed set of working conditions". Thus, standard cost is determination, in advance of production, of what should be the cost.

Budgeted costs and standard costs are similar to each other to the extent that both of them represent estimates for cost for a period of time in future. In spite of this, they differ in the following aspects:

1. Standard costs are scientifically predetermined costs of every aspect of business activity whereas budgeted costs are mere estimates made on the basis of past actual financial accounting data adjusted to future trends. Thus, budgeted costs are projection, of financial accounts whereas standard costs are projection of cost accounts.
2. The primary emphasis of budgeted costs is on the planning function of management whereas the main thrust of standard costs is on control because standard costs lay emphasis what should be the costs.
3. Budgeted costs are extensive whereas standard costs are intensive in their application. Budgeted costs represent a macro approach of business operations because they are estimated in respect of the operations of a department. Contrary to this, standard costs are concerned with each and every aspect of business operation carried in a department. Thus budgeted costs deal with aggregates whereas standard costs deal with individual parts which make the aggregate. For example, budgeted costs are calculated for different functions of the business i.e., production, sales, purchases etc. whereas standard costs are compiled for various elements of costs i.e., materials, labour and overhead.

10. By Association with the product:

Under this classification, cost can be product costs and period costs.

Product costs: are those costs which are traceable to the product and are included in inventory valuation. Product costs are inventoriable costs and they become basis for product pricing and cost plus contracts. They comprise direct materials, direct labour and manufacturing overheads in case of manufacturing concerns. These are used for valuation of inventory and are shown in the balance sheet till they are sold because such costs provide income or benefit only after sale. The product cost of goods sold is transferred to the cost of goods sold account.

Period costs are incurred on the basis of time such as rent, salaries etc. These may relate to administration with

production and are necessary to generate revenue but cannot be assigned to a product. These are charged to the period in which these are incurred and treated as expense.

The net income of concern is influenced by both product and period costs. Product costs are included in the cost of production and do not affect income till it is sold. Period costs are charged to the period in which these are incurred.

11. For Managerial Decision:

On this basis, costs may be classified into the following costs:

(i) Marginal cost:

Marginal cost is the total of variable costs i.e., prime cost plus variable overheads. It is based on the distinction between fixed and variable costs. Fixed costs are ignored and only variable costs are taken into consideration for determining the costs of products and value of work-in-progress and finished goods.

(ii) Out of pocket costs:

This is that portion of the costs which involves payment to outsiders i.e., gives rise to cash expenditure as opposed to such costs as depreciation, which do not involve any cash expenditure. Such costs are relevant for price fixation during recession or when make or buy decision is to be made.

(iii) Differential cost:

The change in costs due to change in the level of activity or pattern or method of production is known as differential cost. If the change increases the cost, it will be called incremental cost. If there is decrease in cost resulting from decrease in output, the difference is known as decremental cost.

(iv) Sunk cost:

A sunk cost is an irrecoverable cost and is caused by complete abandonment of a plant. It is the written down value of the abandoned plant less its salvage value. Such costs are not relevant for decision-making and are not affected by increase or decrease in volume. Thus, expenditure which has taken place and is irrecoverable in a situation, is treated as sunk cost. For taking managerial decision with future implications, a sunk cost is an irrelevant cost. If a decision has to be made for replacing the existing plant, the book value of the plant less salvage value (if any) will be a sunk cost and will be irrelevant cost for taking decision of the replacement of the existing plant.

(v) Imputed or notional costs:

Imputed costs and notional costs have the same meaning. The American, equivalent term of the British term 'notional cost' is imputed costs. These costs are notional in nature and do not involve any cash outlay. The chartered Institute of Management Accountants, London, defines notional cost as "the value of a benefit where no actual cost is incurred". Even though such costs do not involve any cash outlay but are taken into consideration while making managerial decisions. Example of such costs are: Notional rent charged on business premises owned by the proprietor, interest on capital for which no interest has been paid. When alternative capital investment projects are being evaluated it is necessary to consider the imputed interest on capital before a decision is arrived as to which is the most profitable project.

(vi) Opportunity cost:

It is the maximum possible alternative earning that might have been earned if the productive capacity or services had been put to some alternative use. In simple words, it is the advantage, in measurable terms, which has been foregone due to not using the facility in the manner originally planned. For example, if an owned building is proposed to be used for a project, the likely rent of the building is the opportunity cost which should be taken into consideration while evaluating the profitability of the project. Similarly, if the fixed deposit in a bank is withdrawn for financing a new project, the loss of interest on such fixed deposits is the opportunity cost.

(vii) Replacement cost:

It is the cost at which there could be purchase of an asset or material identical to that which is being replaced or revalued. It is the cost of replacement at current market

(viii) Avoidable and unavoidable cost:

Avoidable costs are those which can be eliminated if a particular product or department with which they are directly related, is discontinued. For example, salary of the clerks employed in a particular department can be eliminated, if his department is discontinued. Unavoidable cost is that cost which will not be eliminated with the discontinuation of a product of department. For example, salary of factory manager or factor rent cannot be eliminated even if a product is eliminated.

Types of costing:

Following are the main types of costing for ascertaining costs:

1. Uniform costing:

It is the use of same costing principles and/or practice by several undertakings from common control or comparison of costs.

2. Marginal costing:

It is the ascertainment of marginal cost by differentiation between fixed and variable cost. It is used to ascertain the effect of changes in volume or type of output on profit.

3. Standard costing:

A comparison is made of the actual cost with a pre-arranged standard and the cost of any deviation (called variance) is analyzed by causes. This permits the management to investigate the reasons for these variances and to take suitable corrective action.

4. Historical costing:

It is ascertainment of costs after they have been incurred. It aims at ascertaining costs actually incurred on work done in the past. It has a limited utility, though comparisons of costs over different periods may yield goods results.

5. Direct costing:

It is practice of charging all direct costs, variable and some fixed costs relating to operations, processes or products leaving all other costs to be written off against profits in which they arise.

6. Absorption costing.

It is the practice of charging all costs, both variable and fixed to probations, processes or products. This differs from marginal costing where fixed costs are excluded.

Costing Methods and Techniques:-**Introduction:-**

It is necessary to understand the difference between the costing methods and techniques. Costing methods are those which help a firm to compute the cost of production or services offered by it. On the other hand, costing techniques are those which help a firm to present the data in a particular manner so as to facilitate the decision making as well as cost control and cost reduction. Costing methods and techniques are explained below.

Methods of costing: - The following are the methods of costing.

I. Job Costing: -

Job costing method is used in firms which work on the basis of job work. There are some manufacturing units which undertake job work and are called as job order units. The main feature of these organizations is that they produce according to the requirements and specifications of the consumers. Each job may be different from the other one. Production is only on specific order and there is no predetermining production. Because of this situation, it is necessary to compute the cost of each job and hence job costing system is used. In this system, each job is treated separately and a job cost sheet is prepared to find out the cost of the job. The job cost sheet helps to compute the cost of the job in a phased manner and finally arrives the total cost of production.

II. Batch Costing:

This method of costing is used in those firms where productions are made on continuous basis. Each unit coming out is uniform in all respects and production is made prior to the demand i.e., in anticipation of demand. On batch

of production consists of the units produced from the time machinery is set to the time when it will be shut down for maintenance. For example, if production commences on 1st January 2015 and the machine is shut down for maintenance on 1st April 2015, the number of units produced in this period will be the size of one batch. The total cost incurred during this period will be divided by the number of units produced and unit cost will be worked out. Firms producing consumer goods like television, air-conditioners, washing machines etc use batch costing.

III. Process Costing:

Some of the products like sugar, chemical etc involve continuous production process and hence process costing method is used to work out the cost of production, The meaning of continuous process is that the input introduced in the process I travels through continuous process before finished product is produced. The output of process I becomes input of process II and the output of process II becomes input of the process III. If there is no additional process, the output of process III will be the finished product. In process costing, cost per process is worked out and per unit cost is worked out by dividing the total cost by the number of units. Industries like sugar, edible oil, Chemical are examples of continuous production process and use process costing.

IV. Operating Costing:-

This type of costing method is used in service sector to work out the cost of services offered to the consumers. For example, operating costing method is used in hospitals, power generating units, Transportation sector etc. A cost sheet is prepared to compute the total cost and is divided by cost units for working out the per unit cost.

V. Contract Costing:-

This method of costing is used in construction industry to work out the cost of contract undertaken. For example, cost of constructing a bridge, commercial complex, residential complex, highways etc is worked out by use of this method of costing. Contract costing is actually similar to job costing, the only difference being that in contract costing, one construction job may take several months or even years before they are complete while in job costing, each job may be of a short duration. In contract costing, as each contract may take a long period of completion, the question of computing of profit, it to be solved with the help of a well defined and accepted method.

Base for selection of suitable Costing method

1.	Name of industry	Method of costing
2.	Sugar industry	Process costing
3.	Toy making	Batch costing
4.	Steel or cement	Process costing
5.	Bicycle manufacturing	Multiple costing
6.	Steel or cement	Process costing
7.	Aircraft manufacturing	Multiple costing
8.	Printing	Job costing
9.	Hospital	Service/operating
10.	Pharmaceuticals	Process costing
11.	Breweries	Single unit (or) output
12.	Canteen	Operating/service costing
13.	House building	Contract costing
14.	Road transport	Operating/service



15.	Readymade garments	Batch costing
16.	Soft drinks	Process costing
17.	Coal	Single unit or output
18.	Oil refining	Process costing
19.	Brick kiln	Single unit or output
20.	Interior decoration	Job costing
21.	College	Operating/service
22.	Advertising	Job costing
23.	Soap industry	Process costing
24.	Electricity supply	Operating/service
25.	Foundries	Job costing
26.	video/audio manufacturing	Multiple costing
27.	Sub-assembling	Operation costing

Technique of costing:-

As mentioned above, costing methods are for computation of the total cost of production/services offered by a firm. On the other hand, costing technique help to present the data in a particular format so that decision making becomes easy. Costing techniques also help for controlling and reducing the costs. The following are the techniques of costing.

I. Marginal costing:-

This technique is based on the assumption that the total cost of production can be divided into fixed and variable. Fixed costs remain same irrespective of the changes in the volume of production while the variable costs vary with the level of production, i.e. they will increase if the production increases and decrease if the production decreases. Variable cost per unit always remains the same. In this technique, only variable costs are taken into account while calculating production cost. Fixed costs are not absorbed in the production units. They are written off to the costing profit and loss account. The reason behind this is that the fixed costs are period costs and hence should not be absorbed in the production. Secondly they are variable on per unit basis and hence there is not equitable basis of charging them to products. This technique is effectively used for decision making in the areas like make or buy decisions, optimizing of product mix, key factor analysis, fixation of selling price, accepting or rejecting an export offer, and several other areas.

II. Standard costing:-

Standard costs are predetermined costs relating to material, labour and overheads. Though they are predetermined, they are worked out on scientific basis by conducting technical analysis. They are computed for all elements of costs such as material, labour and overheads. The main objective of fixation of standard cost is to have benchmark against which the actual performance can be compared. This means that the actual costs are compared with the standards. The difference is called as 'variance'. If actual costs are more than the standard, the variance is adverse which if actual costs are less than the standard, the variance is favorable. The adverse variances are analyzed and reasons for the same are found out. Favorable variances may also be analyzed to find out the reasons behind the same standard costing, thus is an important technique of cost control and reduction.

III. Budget and Budgetary control:-

Budget is defined as a quantitative and/ or a monetary statement prepared to prior to a defined period of time for the policies during that period for the purpose of achieving a given objective. If we analyze this definition, it will be clear that a budget is a statement, which may be either in monetary form or quantitative form or both. For

example, a production budget can be prepared in quantitative form showing the target production, it can also be prepared in monetary terms showing the expected cost of production. Some budgets can be prepared only in monetary terms, e.g., cash budget showing the estimated receipts and payments in a particular period can be prepared in monetary terms only. Another feature of budget is that it is also ways prepared prior to a defined period of time which means that budget is always prepared for future and that to a defined future. For example, a budget may be prepared for next 12 months or 6 months or even for 1 month, but the time period must be certain and not vague. One of the important aspects of budgeting is that it lays down the objective to be achieved during the defined period of time and for achieving the objectives, whatever policies are to be pursued are reflected in the budget.

Budgetary control involves preparation of budgets and continuous comparison of actual with budgets so that necessary corrective action can be taken. For example, when a production budget is prepared, the production targets are laid down in the same for a particular period. After the period is over, the actual production is compared with the budget and the deviation is found out so that necessary corrective action can be taken.

Budget and budgetary control is one of the important techniques of costing used for cost control and also for performance evaluation. The success of the technique depends upon several factors such as support from top management, involvement of employees and coordination within the organization.

Cost Unit

It is a device for the purpose of breaking up or separating cost into smaller sub-divisions attributable to products and services. It is the unit of product, service or time in relation to which costs may be ascertained, e.g. tone in case of coal. It must be clearly defined and selected before the process of cost finding can be started. It must not be too big or too small and must be so selected that expenditure can be associated with it and is appropriate to the needs of the business. In case of industries rendering service usually the unit is a compound of two measures since the single measure may be meaningless.

Name of the industry	Suitable cost unit
1. Steel making (or) cement industry	Cost pr tone
2. Sugar industry	Cost per quintal/tonne
3. Textile industry	Cost per meter
4. Cycle industry	Cost per cycle
5. Hospital/nursing home	Cost per bed per patient per days
6. Timber industry	Cost per foot
7. Pharmaceutical	Cost per strip/bottles of diff sizes
8. Brick manufacturing	Cost per 1000 bricks
9. Chemical	Cost per kg/ tonne
10. Soft drinks	Cost per case (24)/bottle of diff sizes
11. Aerated water (beer)	Cost per liter/barrel
12. Furniture manufacturing	Cost per article
13. Coal industry	Cost per tonne
14. Confectionary	Cost per kg
15. Good carrier/passenger	Cost per passenger per km/
16. Hotel	Cost per tonne per km
17. Canteen	Cost per meal



18. Construction	Cost per contract
19. Building	Cost per sq. ft
20. Power manufacturing	Cost kilowatt per hr.
21. Education	Cost per student per year
22. Railways	Cost per passenger per km
23. Automobile	Cost per each item
24. Professional service	Cost per hour
25. BPO services (call centers)	Cost per account handled
26. Tele marketing	Cost per customer call
27. Gas	Cost per Cubic Foot

Cost center:

Common understood, cost centers are sub-units of an organization. We use the terms such as departments, divisions, regions, and zones etc. that convey the same meaning of cost center. Correct identification of these sub-units is essential for implementing cost accounting system as the costs are ascertained and controlled with respect to the cost centers. Cost centers are sometimes called as centers that add to costs of the organization and only indirectly add to the profit of the organization.

The official terminology of CIMA defines a cost centre as " a location, a person or an item of equipment for a group of them) in or connected with an undertaking, in relation to which costs ascertained and used for the purpose of cost control".

- (a) A cost centre could be a location or locations like a branch, office or MD's office
- (b) It could be identified as a person such as chairman's office or MD's office
- (c) It could be equipment or a group thereof such as lathe machines, computers etc.,
- (d) It may be a department carrying out a certain activity e.g., production departments like turning fitting, welding, blending, assembly etc. The activity could be a service activity as well like a stores department, labour office, accounts departments etc.,

When different responsibility centers are properly setup, cost collection and use of cost information for control purposes can be done effectively.

Cost Control And Cost Reduction

Cost Control:

"Cost control is an important derivative of cost accounting. Modern business management not only must plan for the future but also must constantly scrutinize the results of operations, so that, wherever possible, out-of-control situations can be attacked and eliminated."

Cost control is the application of management's discretion to maintain cost within a specified limit. Control is a management's function, which aims at attaining management objectives with limited resources available. Cost control means and includes establishment of standards with a view to assessing results by comparison against them. It involves improving performance or efficiency to achieve the task assigned. It, therefore, involves:

- i) Fixation of standards;
- ii) Ascertaining actual results against the standards;
- iii) Analysis of the variances; and
- iv) Establishing the action that may be called for

Characteristics of a good Cost Control System

According to Backer and Jacobson an effective cost control is characterized by the following:

- (a) Delineation of centres responsibility, i.e., deciding responsibility centres;
- (b) Delegation of authority;
- (c) Cost standards;
- (d) Relevance of controllable cost;
- (e) Cost reporting; and
- (f) Cost reduction

Cost Reduction:

A cost reduction programme always endeavors to achieve a real and permanent reduction in cost. Cost reduction starts where cost control ends. It is a challenge to the standard itself. The philosophy behind cost reduction is that no item of expenditure is in such an idle level as to preclude reduction. By cost reduction is meant "real and permanent" reduction in cost due to genuine savings in cost. It may mean either i) producing more at the existing level of expenditure, or ii) producing at the existing level at reduced expenses.

Area of Cost Reduction:

- i) Design of the product – Standardization and simplification of the product; this is the most important stage for controlling and reducing cost, for once a design is approved and arrangements for production made, choices available in the firm will be limited.
- ii) Factory organization and production methods; and
- iii) Marketing – points of distribution, transport, channels of distribution, etc.

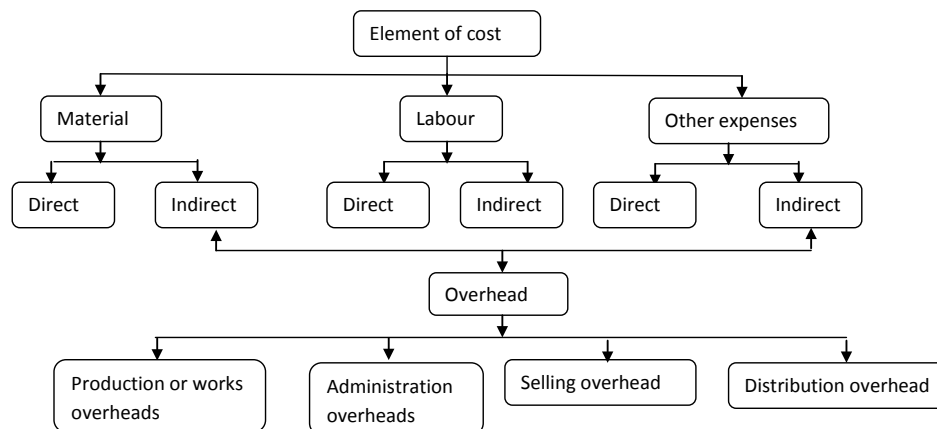
Distinction between Cost Control and Cost Reduction:

A Cost control technique differs from a cost reduction programme in the sense that it does not accept standards or budgets as yardstick, rather it always challenges them in order to make improvements.

In practice, however, both these will be working side by side so that it will be impossible to draw a line of demarcation. Costs may be lower because of lower prices at which, say materials are available in the market; this is welcome but hardly to feel satisfied at. Real cost reduction comes when a lower quantity of inputs is used per unit of output. However, if one is able to maintain quality of output by using materials of lower quality or labour of lesser skill, and thus effecting a saving in prices or wages paid, it will also be a case of real cost reduction.

Elements of cost:

Mere knowledge of total cost cannot satisfy the needs of management. For proper control and managerial decisions, management is to be provided with necessary data to analyse and classify costs. For this purpose, the total cost is analysed by elements of cost i.e., by the nature of expenses. Strictly speaking, the elements of cost are three i.e., materials, labour and other expenses. These elements of cost are further analysed into different elements as illustrated in the following chart.





Now all these terms will be examined in detail one by one.

1. Direct Material:

Direct materials are those materials which can be identified in the product and can be conveniently measured and directly charged to the product. Thus, these materials directly enter the production and form a part of the finished product. For example, timber in furniture making, cloth in dress making and bricks in building a house. Following are normally classified as direct materials:

- (i) **All raw materials like** jute in the manufacture of gunny bags, pig iron in foundry, and fruits in canning industry.
- (ii) **Materials specifically purchased for** a specific job, process or order like glue for book binding, starch powder for dressing yarn.
- (iii) **Parts or components purchased or produced** like batteries for transistor- radios and tyres for cycles.
- (iv) **Primary packing materials** like cartons, wrappings, cardboard boxes, etc. used to protect finished product from climatic conditions or for easy handling inside the factory.

From the above discussion it becomes clear that indirect materials are those materials which cannot be classified as direct materials. Examples of indirect materials are: consumables, like cotton waste, lubricants, brooms, rags, cleaning materials, materials for repairs and maintenance of fixed assets, high speed diesel used in power generators etc.

Classification of materials into direct and indirect facilitates material control. Direct materials are usually high value items as compared to indirect materials and need strict control and critical analysis for reducing their cost. On the other hand, simple control techniques are sufficient in case of indirect materials being low value items.

However, in some cases, though the material is a part of the finished product yet it is not treated as direct material; for example, sewing thread in dress making and nails in furniture making. This is because they are used in comparatively small quantities and it would be futile elaboration to make an analysis of them for the purpose of direct charge. Such materials are treated as indirect materials. Thus, it can be concluded that the ease and the feasibility with which a material can be traced into the composition of a finished product will determine what is to be treated as direct material.

2. Direct Labour:

Direct labour is all labour expended in altering the construction, composition, confirmation or condition of the product. In simple words, it is that labour which can be conveniently identified or attributed wholly to a particular job, product or process or expended in converting raw materials into finished goods. Wages of such labour are known as direct wages. Thus, it includes payment made to the following groups of labour.

- (i) Labour engaged on the actual production of the product or carrying out of an operation or process.
- (ii) Labour engaged in aiding the manufacture by way of supervision, maintenance, tools setting transportation of material etc.

Inspectors, analysts etc, specially required for such production.

Wages paid to supervisors, inspectors, etc., though not direct labour, can be treated as direct labour if they are directly engaged on specific product or process and the hours they spend on it can be directly measured without much of an effort. Similarly where the cost is not significant like the wages of trainees or apprentices, their labour though directly spent on a product is not treated as direct labour.

3. Direct Expenses (or chargeable expenses)

All expenses which can be identified to a particular cost centre and hence directly charged to the centre are known as direct expenses. In other words all expenses (other than direct materials and direct labour) incurred specifically for a particular product, job, department etc. are called direct expenses. These are directly charged to the product. Examples of such expenses are royalty, excise duty, hire charges of a specific plant and equipment cost of any experimental work carried out specially for a particular job, travelling expenses incurred in connection with a particular contract or job etc.

4. Overheads

Overheads may be defined as the aggregate of the cost of indirect materials, indirect labour and such other expenses including services as cannot conveniently be charged direct to specific cost units. Thus overheads are all expenses other than direct expenses. In general terms, overheads comprise all expenses incurred for or in connection with the general organization of the whole or part of the undertaking i.e., the cost of operating supplies and services used by the undertaking and including the maintenance of capital assets. The main groups into which overheads may be sub-divided are (i) manufacturing overheads; (ii) Administration overheads (iii) selling overheads (iv) distribution overheads and (v) research and development overheads.

4.3 FORMAT OF COST SHEET

Cost sheet is a statement designed to show the output of a particular accounting period along with break-up of costs. The data incorporated in cost sheet are collected from various statements of accounts which have been written in cost accounts, either day-to-day or regular records.

There is no fixed form for preparation of a cost sheet but in order to make the cost sheet more useful it is generally presented in columnar form. The columns are for the total cost of the current period, per unit for the current period, total cost and per unit cost for a preceding period and total and per unit cost for the budget period and so on. The information to be incorporated in a cost sheet would depend upon the requirement of management for the purpose of control.

Advantage of cost sheet:

Main advantages of a cost sheet are:

1. It discloses the total cost and the cost per unit of the units produced during the given period
2. It enables a manufacturer to keep a close watch and control over the cost of production
3. By providing a comparative study of the various elements of current cost with the past results and standard costs, it is possible to find out the causes of variations in cost and to eliminate the adverse factors and conditions which go to increase the total cost
4. It acts as a guide to the manufacturer and help him in formulating a definite useful production policy
5. It helps in fixing up the selling price more accurately.
6. It helps the business man to minimize the cost of production, When there is a cut throat competition.
7. It helps the business to submit quotations with reasonable degree of accuracy against tenders for the supply of goods.

The following items are not included in Cost Sheet

a)	Income Tax
b)	Dividends to shareholders
c)	Premium on redemption of shares and debentures
e)	Capital losses i.e., loss out of sales
f)	Interest on loan or debentures or bank interest
g)	Donations
h)	Capital expenditure
i)	Discounts on shares and debentures
j)	Commission to managing directors



k)	Underwriting commission
l)	Writing off goodwill and preliminary expenses
m)	Reserve for bad debts
n)	Transfer to all reserves or appropriation of profits
o)	Share premium
p)	Interest on capital
q)	Drawing of proprietors
r)	All personal expenses of owner

Format of Cost Sheet

Particulars	Amount	Amount
A. Direct Material opening stock		
+ Purchases		
+ Carriage inwards		
- Closing stock		
B. Direct wages		
C. Direct Expenses		
I. Prime cost (A+B+C)		
D. Factory overheads- Indirect materials		
Loose tools		
Indirect wages		
Rent and rates (Factory)		
Lighting and heating (F)		
Power and fuel		
Repairs and Maintenance		
Drawing office expenses		
Research and experiment		
Depreciation – plant (F)		
Insurance – (F)		
Work manger's salary		
II. Factory cost/works cost (I+D)		
E. Office and Administrative Overheads		
Rent and rates – office		
Salaries – Office		
Insurance of office building and equipments		
Telephone and postage		
Printing and stationery		
Depreciation of furniture and office equipments		
Legal expenses		
Audit fees		
Bank charges		
III. Cost of production (II + E)		
F. selling and distribution overheads		

Showroom rent and rates		
Sales men's salaries and commission		
Traveling expenses		
Printing and stationery – sales department		
Advertising		
Postage		
Collection expenses		
Carriage outward		
Depreciation of delivery van		
Samples and free gifts		
IV. Cost of sales (III+F)		
V. Profits / loss		
VI. sales (IV + V)		

A glance at the above cost sheet will reveal that it works out the total cost of production/service in a phased manner. In other words, total costs are segregated into elements like prime cost, Factory or works cost, cost of production, cost of sales and finally the profit/loss in worked out by comparing the total cost with the selling price. Appropriate adjustments are made for opening and closing stock of work in progress and opening and closing stock of finished goods. The format of cost sheet may be suitably changed according to the requirements of each firm but the basic form remains the same.

Illustration: 1.

From the following information, find out purchases.

Raw material consumed = ₹26,500.

Closing Stock = ₹4,500

Opening Stock = ₹3,000

Solution:

We Know, Raw Material Consumed = Opening Stock + Purchases – Closing Stock.

Purchases = Raw Material Consumed + Closing Stock – Opening Stock

= ₹ (26,500 + 4,500 – 3,000)

= ₹ 28,000.

Illustration: 2.

Prime Cost = ₹33,500, Depreciation = ₹1,500. Factory rent is 200% of Depreciation.

Find out the Factory Cost.

Solution:

Particulars	₹
Prime Cost	33,500
Add: Factory Overheads:	
Depreciation	1,500
Factory Rent (1,500 x 200%)	3,000
Factory Cost	38,000

Illustration: 3.

Cost of Sales = ₹37,416. Advertisement Expenses = ₹600. Discount on sales = 50% of advertisement Expenses. Find Cost of Goods Sold.

**Solution:**

We Know, Cost of Goods Sold + Selling and Distribution Overheads = Cost of Sales.

Both Advertisement Expenses and Discount on sales together constitutes Selling and Distribution Overhead

Particulars	₹
Cost of Sales	37,416
Less: Selling and Distribution Overheads	
Advertisement Expenses	600
Discount on sales (50% of ₹600)	300
Cost of Goods Sold	36,516

Illustration: 4.

Factory Cost is ₹3,95,000. Find Office and Administration overheads cost which is 7.315% of factory cost.

Solution:

Office and Administration Overheads = 7.315% of Factory Cost = 7.315% of ₹3,95,000 = ₹28,894.25.

Illustration 5.

Gross Factory Cost = ₹58,000. Net Factory Cost = ₹54,000. Opening stock of work-in- progress is ₹8,000. Find closing stock of work-in-progress.

Solution:

Net Factory Cost = Gross Factory Cost + Opening Stock in WIP – Closing Stock in WIP

₹54,000 = ₹58,000 + ₹8,000 – Closing Stock in WIP

Closing Stock in WIP = ₹66,000 - ₹54,000 = ₹12,000

Illustration: 6.

Prime Cost is ₹41,000. Direct labour cost consists of skilled labour ₹6,000 and unskilled labour ₹2,000. Variable works overhead is 100% of direct wages and fixed works overhead is 60% of direct wages. Sale of scrap is ₹1,800. Find works cost.

Solution:

Particulars	₹
Prime Cost	41,000
Works Overhead:	
Add: Variable 100% direct wages	8,000
Add: Fixed 60% direct wages	4,800
Less: Sale of scrap	(1,800)
Works Cost	52,000

Illustration 7.

From the information, prepare a statement showing expenses which you would disregard in estimating costs. Rent, rates and insurance of office ₹2500, Bad Debt ₹200, Discount Allowed ₹300, Bank charges ₹100 and Donations ₹150.

Solution:

Expenses excluded from estimating cost	₹
Donations	150
Discount Allowed	300

Bad debt	200
Total	650

Illustration: 8.

Calculate the amount of direct material if:

Prime cost = ₹50,000. Direct labour = 70% of prime cost.

Solution:

Prime Cost = ₹50,000.

Direct Labour = 70% of prime cost = 70% of ₹50,000 = ₹35,000.

Direct Material = ₹ (50,000 – 35,000) = ₹15,000.

Illustration: 9.

Direct materials cost is ₹80,000. Direct labour cost is ₹ 60,000. Factory overhead is ₹ 90,000. Beginning goods in process were ₹ 15,000. The cost of goods manufactured is ₹ 245,000. What is the cost assigned to the ending goods in process?

Solution:

Particulars	₹
Direct Material	80,000
Direct Labour	60,000
Prime Cost	1,40,000
Add: Factory Overhead	90,000
Add: Opening WIP	15,000
Less: Closing WIP	-
Cost of goods manufactured (given)	2,45,000

As cost of goods manufactured is given as ₹ 2,45,000 so there will be no closing goods in process.

Illustration 10.

Given data that:

Finished goods Opening Inventory ₹ 30,000

Finished goods Closing Inventory ₹ 50,000

Cost of goods sold ₹ 1,90,000

What will be the value of Cost of Production?

Solution:

We Know, Cost of Goods Sold = Cost of Production + Opening stock of finished goods – Closing stock of finished goods.

Particulars	₹
Cost of Goods Sold	1,90,000
Add: Closing Stock of finished goods	50,000
Less: Opening stock of finished goods	(30,000)
Cost of Production	2,10,000

Illustration: 11

Prepare a statement of cost from the following data to show material consumed, Prime cost, factory cost, Cost of goods sold and profit.

	1-1-2015(₹)	31-12-2015(₹)
Raw material	60,000	50,000



Work-in-progress	24,000	30,000
Finished goods	1,20,000	1,10,000
Purchase of materials during the year		9,00,000
Wages paid		5,00,000
Factory overheads		2,00,000
Administration overheads		50,000
Selling and distribution overheads		30,000
Sales		20,00,000

Solution:

Statement of cost and profit

Opening stock of raw materials	60,000	
Add: purchase of raw materials	9,00,000	
	9,60,000	
Less: Closing stock of raw materials	50,000	
Materials consumed		9,10,000
Wages paid		5,00,000
Prime cost		14,10,000
Factory overheads		2,00,000
Add: opening stock or WIP		24,000
		16,34,000
Less: closing stock of WIP		30,000
Factory cost		16,04,000
Administrative overheads		50,000
Add: opening stock of finished goods		1,20,000
		17,74,000
Less: closing stock of finished goods		1,10,000
Cost of goods sold		16,64,000
Selling and distribution overheads		30,000
Cost of sales		16,94,000
Profit		3,06,000
Sales		20,00,000

Illustration: 12

From the following particulars, prepare cost statement showing the component of total cost and the profit for the year ended 31st December, 2015.

	1-1-2001 (₹)		31-12-2001 (₹)
Stock of finished goods	6,000	Stock of finished goods	15,000
Stock of raw materials	40,000	Stock of raw material	50,000
Work-in-progress	15,000	Work-in-progress	10,000
Purchase of raw materials	4,75,000	General expenses	32,500
Carriage inward	12,500	sales for the year	8,60,000
Wages	1,75,000	Income tax	500

Works manager's salary	30,000	Dividend	1,000
Factory employees salaries	60,000	Debenture interest	5,000
Factory rent, taxes and insurance	7,250	transfer to sinking fund for	
replacement of machinery	10,000		
Power expenses	9,500	goodwill written off	10,000
Other production expenses	43,000	payment of sales tax	
		Selling expenses	9,250

Solution:

Statement of Cost and Profit

	₹	₹
Opening stock of raw materials	40,000	
Add: purchase of raw materials	4,75,000	
	5,15,000	
Less: closing stock of raw materials	50,000	
	4,65,000	
Add: Carriage inward	12,500	
Materials consumed		4,77,500
Wages		1,75,000
Prime cost		6,52,500
Factory expenses:		
Works manager's salary	30,000	
Factory employees salaries	60,000	
Factory rent, taxes and insurance	7,250	
Power expenses	9,500	
Other production expenses	43,000	
Opening work-in-progress	15,000	1,64,750
		8,17,250
Less: closing work-in-progress		10,000
Works cost		8,07,250
General expenses		32,500
Cost of production		8,39,750
Add: opening stock of finished goods		6,000
		8,45,750
Less: opening stock of finished goods		15,000
Cost of goods sold		8,30,750
Selling expenses		9,250
Cost of sales		8,40,000
Profit		20,000
Sales		8,60,000

**Illustration: 13**

Mr. Gopal furnishes the following data relating to the manufacture of a standard product during the month of April, 2015:

Raw materials consumed	₹ 15,000
Direct labour charges	₹ 9,000
Machine hours worked	900
Machine hour rate	5
Administrative overheads	20% on works cost
Selling overheads	₹ 0.50 per unit
Units produced	17,100
Units sold	16,000 at ₹ 4 per unit.

You are required to prepare a cost sheet from the above, showing: (a) the cost per unit (b) profit per unit sold and profit for the period.

Solution:**STATEMENT OF COST**

	Total	Per unit
Raw materials consumed	15,000	
Direct labour charges	9,000	
Prime cost	24,000	
Factory expenses (900 hrs, @ ` 5 per hr)	4,500	
Works cost	28,500	
Administrative overheads (20% on works cost)	5,700	
Cost of production	34,200	2.00 (` 34,200 ÷ 17,100)

Statement of profit

	₹
Cost of production of 16,000 units @ ₹ 2 per unit	32,000
Selling overheads @ 50 paise per unit for 16,000 units	8,000
Cost of sales	40,000
Profit for the period	24,000
Sales (16,000 units @ ₹ 4 unit)	64,000
Profit per unit sold =	= ₹1.50

EXERCISE:

1. The following data relate to the manufacture of a standard product during the month of March, 2015.

Raw materials	80,000
Direct wages	48,000

Machine hours worked	8,000
Office overhead	10% on works cost
Machine hour rate	₹ 4
Selling overhead	₹ 1.50 p unit
Units produced	4,000
and sold @ ₹ 50 each	3,600

Prepare cost sheet

You are required to find out from the above showing a) Cost of Production per unit b) Profit per unit sold and profit for the period.

Ans: a) ₹44 per unit b) ₹4.5 per unit, Profit ₹16,200

2. From the following particulars prepare a cost sheet showing the total cost per tone for the period ended 31st Dec. 2015.

	₹		₹
Raw Materials	33,000	Rent and taxes (office)	500
Productive wages	38,000	Water supply (works)	1,200
Unproductive wages	10,500	Factory insurance	1,100
Factory rent and taxes	7,500	Office insurance	500
Factory lighting	2,200	Legal expenses	400
Factory heating	1,500	Rent of warehouse	300
Motor power	4,400	Depreciation of	
Haulage (works)	3,000	-Plant and machinery	2,000
Directors fees (works)	1,000	-Office building	1,000
Directors fees (office)	2,000	- Delivery vans	200
Factory cleaning	500	Bad debts	100
Sundry office expenses	200	Advertising	300
Estimating expenses(works)	800	Sales department's salaries	1,500
Factory stationery	750	Upkeep of delivery vans	700
Office stationery	900	Bank charges	50
Loose tools written off	600	Commission on sales	1,500

The total output for the period has been 14,775 tonnes

Ans: Prime Cost ₹71,000, Factory Cost ₹1,08,050, Cost of Production ₹1,13,600, Total Cost ₹1,18,100, Cost per ton ₹8/-

Multiple choice questions:

- The total cost incurred in the operation of a business undertaking other than the cost of manufacturing and production is known as:
 - direct cost
 - Variable cost
 - commercial cost
 - conversion cost
- Which of the following is not a relevant cost?
 - Replacement cost
 - Sunk cost
 - Marginal cost
 - standard cost
- Process cost is very much applicable in:
 - construction industry
 - pharmaceutical industry
 - Air line company
 - none of these
- The main purpose of cost accounting is to:



- (a) maximize profits, (b) help in inventory valuation
(c) provide information to management for decision making (d) Aid in the fixation of selling price
5. Opportunity cost is the best example of:
(a) sunk cost (b) Standard cost (c) relevant cost (d) irrelevant cost
6. Costs are classified into fixed costs, variable costs and semi-variable costs, it is known as
(a) functional classification (b) behavioral classification
(c) element wise classification (d) classification according to controllability
7. Which method of costing is used for determination of costs for printing industry?
(a) process costing (b) operating costing (c) batch costing (d) job costing
8. Over which of the following costs, management is likely to have least control
(a) wages cost (b) building insurance cost
(c) machinery breakdown cost (d) advertisement cost
9. Variable costs are fixed
(a) for a period (b) per unit (c) depends upon the entity (d) for a particular process of production
10. In behavioral analysis', costs are divided into
(a) production and non-production costs (b) controllable and non-controllable costs
(c) direct and indirect costs (d) fixed and variable costs
11. Prime cost plus factory overheads is known as
(a) factory on cost (b) conversion cost (c) factory cost (d) marginal cost
12. Which of the following items is excluded from cost Accounts?
(a) Income tax (b) interest on debentures (c) cash discount (d) All of these
13. The following is included in financial accounts, but not in cost accounts.
(a) carriage and freight (b) Excise duty (c) Royalty (d) Dividend paid
14. Advertisements are treated as
(a) direct expenses (b) cost of production (c) selling overheads (d) distribution overheads
15. Which cost system description applies to the manufacture of 20 engraved doors for the new club house at a golf course?
(a) contract (b) process (c) Batch (d) service
16. Prime cost may be correctly termed as
(a) the sum of direct material and labour cost with all other costs excluded.
(b) the total of all cost items which can be directly charged to product units.
(c) The total costs incurred in producing a finished unit.
(d) the sum of the large cost there in a product cost.
17. The guidance and regulation by executive action of the cost of operating an undertaking is said to be
(a) Budgetary control (b) cost control (c) cost analysis (d) None
18. Direct expenses are also known as
(a) Overhead expenses (b) process expenses (c) chargeable expenses (d) None
19. Indirect material cost is a part of
(a) Prime cost (b) Factory overhead (c) chargeable expenses (d) None of these
20. Which of the following is a part of both Prime cost and conversion cost
(a) Direct Material (b) Indirect Labour (c) Indirect Material (d) Direct Labour
21. Statement showing break-up of costs is known as
(a) cost-sheet (b) statement of profit (c) production account (d) Tender
22. The works cost plus administration expenses
(a) Total Cost (b) Cost of production (c) cost of sales (d) Factory cost
23. Directors remuneration and expenses form a part of
(a) Production overhead (b) Administration overhead (c) Selling overhead (d) Distribution overhead

24. Cost reduction is
 (a) Long term phenomena (b) It challenges the standards
 (c) It is carried out without compromising the quality (d) All of the above
25. Interest on own capital is
 (a) Cash cost (b) Notional cost (c) Sunk cost (d) Part of Prime Cost

Ans: 1. c 2. b 3. b 4. c 5. c 6. b 7. d 8. d 9. b 10. d 11. c 12. d 13. d 14. c 15. c 16. b 17. b 18. c 19. b 20. d 21. a 22. b 23. b 24. d 25. b

Fill in the blanks:

1. Costing is a technique of __ (ascertaining cost)
2. Cost accountancy is the science, art and ___ if a cost accountant.(practice)
3. Cost accounting serves the information needs of ____ (Management.)
4. Cost accounting provides data for ___ decision making.(managerial)
5. Cost accounting has been developed because of ___ of financial accounting. (Limitations)
6. The method of costing used in a refinery is ___ (process.)
7. For the goods Transport Company ___ is the suitable cost unit.(per ton km)
8. The cost which does not change due to change in volume of production is called ___ (fixed cost)
9. The semi- finished goods is also known as ___ in cost accounting. (work-in-progress)
10. An item of cost that is direct for the business may be ___ for another business.(indirect)
11. The total of all direct expenses is known as ____ (prime cost)
12. All costs are ___ controllable (not)
13. The aggregate of indirect material indirect labour and indirect expenses together is called ___ (overheads)
14. Factory overheads are also know as ___ overheads.(works)
15. Chargeable expenses are an example ___ cost.(direct)
16. ___ cost are cost which are ascertained after they have been incurred. (Historical)
17. Any expenditure over and above prime cost is known as ___ (overheads)
18. In ___ the cost of a group of products is ascertained.(Batch Costing)
19. Cost accounting is a separate ___ of accounting. (branch)
20. In automobile industry cost unit is ___ (number.)
21. ___ costs are partly fixed and partly variable in relation to output.(Semi variable)
22. Fixed cost per unit ___ with increasing output. (decreases)
23. Wages of delivery van driver is a ___ (Distribution Overhead.)
24. Cost accounting deal partly with facts and figures and partly with ___ (estimates)
25. Cost accountant provides the detailed information about ___ of various products, processes services and operations.(costs)

True or False:

1. Process costing method is suitable for coal industry (False)
2. Fixed cost per unit remains fixed but variable cost per unit vary with variation in output (False)
3. Financial accounts provide information for determination of profit or loss (True)
4. Cost accounts provide information for ascertainment of the financial position as on a particular date (false)
5. Cost accounting is an instrument of management control (True)
6. Service costing is used in industries producing goods (False)
7. In construction industry, contract costing is used (True)
8. The process of finding cost is costing (true)
9. Depreciation is an out of pocket cost (false)

10. Variable cost per unit varies with increase or decrease in volume of output (false)
11. All costs are controllable (False)
12. Cash discount is excluded from cost sheet (true)
13. Finance expenses are included in cost sheet (False)
14. Discount to customer comes under "distribution cost" (false)
15. Variable overhead cost is a period cost (False)
16. In the cement industries the unit of cost is per tone (true)
17. Scrap is a residue which in a manufacturing process but has no recoverable value (false)
18. Contract costing us a basic method is specific order costing (True)
19. All the indirect cost related to indirect material, Indirect labour and indirect expenses are termed as overheads (true)
20. Direct wages is a variable cost (True)
21. Historical costs are relevant costs for decision making (False)
22. Contract costing is based on job costing principles (True)
23. Cost accounting is an instrument of management control.(True)
24. Abnormal cost is controllable (True)
25. Fixed cost per unit decreases with rise in output and increases with fall in output (True)

Matching the following:

Business

Cost unit

Group-I

1. Tele-marketing	d	(a) accounts handled
2. Power	c	(b) Chargeable Hours
3. BPO service	a	(c) Kilowatt hour
4. Professional service	b	(d) customer calls made

Group – II

1. Road transport company	c	(a) process
2. Chemical works	a	(b) job costing
3. Toy manufacturing	d	(c) operating costing
4. Interior decoration	b	(d) batch costing

Group – III

1. Total Fixed Cost	c	(a) Cost Control
2. Regulation of Cost	a	(b) What cost should be
3. Timber used in furniture making	d	(c) Remain constant in total
4. Standard Cost	b	(d) Direct Material

Group – IV

1. Ship building	c	(a) Service Costing
2. Readymade garments	d	(b) Job costing
3. Electric Supply Company	a	(c) Contract Costing
4. Printing Press	b	(d) Batch Costing