

Book Keeping and Accountancy-I

(As Per the Revised Syllabus of S.Y.B.A., 2015-16, Semester III,
University of Mumbai)

Winner of “Best Commerce Author 2013-14” by Maharashtra Commerce Association
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Preface

We are happy to present this book “**Book Keeping and Accountancy-I**” to the students of S.Y.B.A. In this edition, an effort has been made to incorporate professional examination questions at relevant places in the book.

The syllabus contains a list of topics covered in each chapter which will avoid controversies regarding the exact scope of the syllabus. The text follows the term-wise chapter topics pattern prescribed in the syllabus. We have preferred to leave the text of the section and rules as it is and thereafter, added the comments with the intention of explaining the subject to the students in a simplified language. While making an attempt to explain in a simplified language, any mistake of interpretation might have crept in. This book is a unique presentation of subject matter in an orderly manner. This is a student-friendly book and tutor at home. We hope the teaching faculty and students community will find this book of great use.

We are extremely grateful to students of S.Y.B.A and Mr. K.N. Pandey of Himalaya Publishing House Pvt. Ltd. for their devoted and untiring personal attention accorded by them to this publication. I gratefully acknowledge and express my sincere thanks to the following people without whose inspiration, support and constructive suggestions, this book would not have been possible.

- Mr. Jitendra Singh Thakur (Trustee, Thakur College)
- Dr. Chaitaly Chakraborty (Principal, Thakur College)
- Mrs. Janki Nishikant Jha

We welcome suggestions from students and teachers for further improvement of the book.

Authors

Syllabus

Modules at a Glance

Sr. No.	Modules	No. of Lectures
1	Basics of Book-Keeping and Accountancy	15
2	Books of Accounts and Accounting Records	15
3	Depreciation	10
4	Rectification of Errors	10
5	Trial Balance and Final Accounts	10
Total		60

Sr. No.	Modules/Units
1	Basics of Book-Keeping and Accountancy
	Introduction-Definitions-Objectives of Accounting-Accounting Concepts, Conventions and AS (Only Introduction)-Types of Accounts-Double Entry System of Book Keeping-Rules of Accounting.
2	Books of Accounts and Accounting Records
	Introduction-Main Journal-Subsidiary Journals-Ledger-Recordings of Entries-Posting to Ledgers.
3	Depreciation
	Need for Depreciation-Methods of Depreciation-Straight Line Method-Reducing Balance Method or Written Down Value Method.
4	Rectification of Errors
	Types of Errors-Entries to Rectify Errors (Excluding Suspense Account)
5	Trial Balance and Final Accounts
	Manufacturing Account, Trading Account, Profit & Loss Account and Balance Sheet-Adjustments Restricted to-Closing Stock, Outstanding, Prepaid, Bad Debts.

Question Paper Pattern

Maximum Marks: 75

Questions to be Set: 05

Duration: 2 $\frac{1}{2}$ Hrs.

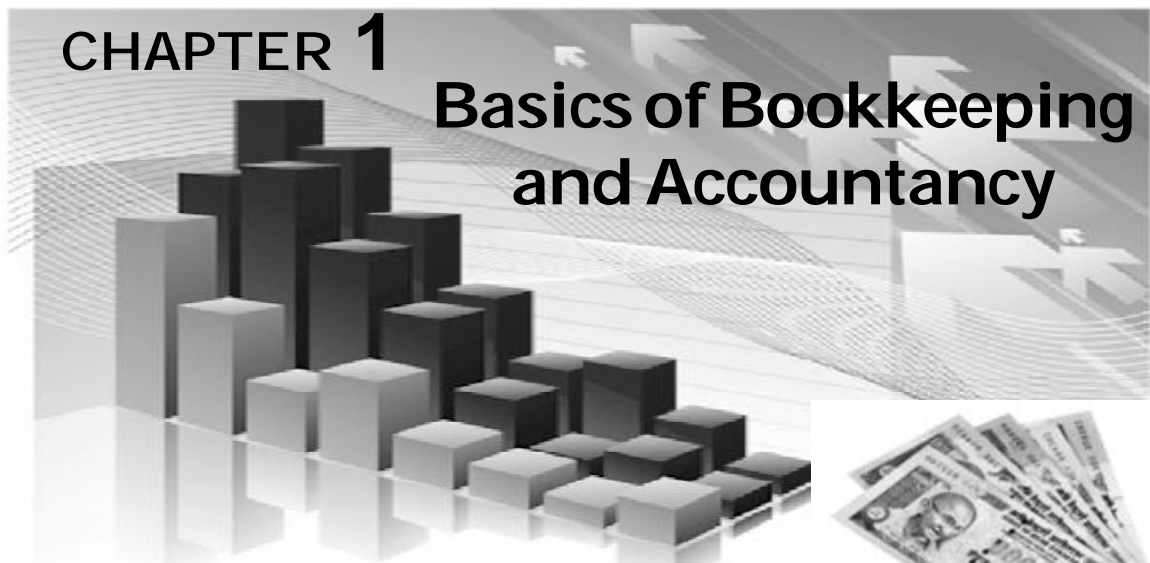
All Questions are Compulsory Carrying 15 Marks each.

Sr. No.	Particulars	Marks
Q.1	Objective Questions	15 Marks
	(a) Sub-questions to be asked 10 and to be answered any 08 (b) Sub-questions to be asked 10 and to be answered any 07 (*Multiple Choice/True or False/Match the Column, Fill in the blanks)	
Q.2	Full Length Practical Question OR	15 Marks
Q.2	Full Length Practical Question	15 Marks
Q.3	Full Length Practical Question OR	15 Marks
Q.3	Full Length Practical Question	15 Marks
Q.4	Full Length Practical Question OR	15 Marks
Q.4	Full Length Practical Question	15 Marks
Q.5	(a) Theory Questions (b) Theory Questions OR	08 Marks 07 Marks
Q.5	Short Notes To be asked 05 To be answered 03	15 Marks

Note: Full length question of 15 marks may be divided into two sub questions of 08 and 07 marks.

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MEANING AND SCOPE OF ACCOUNTING

Introduction

All of you at one point of time would have visited a grocery shop or a medical shop. You might have wondered how the business person maintains the record of all the transactions done during a particular period of time say a year. You might have also thought why he or she has to maintain a record, how is it beneficial and whether it is mandatory or not? As against this, imagine the role of a business organization. They provide goods that might range from simple safety pin to fighter aircrafts. Those who are in service industry provide various services such as transportation services, hospitality services, developing complex software programmes etc.

To make sound decision, a business enterprise need accounting information. This information is also needed by government agencies, regulatory bodies, analysts and individuals at various point of time and at different levels.

Accounting is perhaps one of the oldest and structured management information system. It has evolved in response to the social and economic needs of society. Accounting as an information system is concerned with identification, measurement and communication of economic information of an organization to its users who may need the information for rational decision making. The accounting system is a means to provide relevant and reliable financial information to all the interested parties.

Each and every person of the society is required to keep some accounts. In the stream of social and economic activities of today, each and every person or institution is accountable to someone or to other for his or its economic activities or the wealth acquired, income earned and the expenditure incurred. Different types of transactions occur in business. Without maintaining proper accounts, it is

neither possible to ascertain profit or loss of the business nor to know the financial position of the business at any particular date. This chapter will describe meaning, evaluation, scope and objects of financial accounting. It also discusses importance and uses of accounting in daily life. Let's go through the entire chapter and know introduction to financial accounting.

Definition of Accounting

Accounting is both the science and art of correctly recording in books of accounts all those business transactions that result in the transfer of money or money's worth. It may also be defined as the art of recording merchantile transactions in a regular and systematic manner; the art of keeping accounts in such a manner that a man may ascertain correct result of his business activities at the end of a definite period and also can know the true state of affairs of his/her business and properties by an inspection of his/her books.

Accounting has been defined as, "the art of recording, classifying and summarizing in a significant manner in terms of money, transactions and events which are, in part at least, of financial character, and interpreting the results thereof. " This definition has been given by the AICPA.

More Definitions of Accounting

American Accounting Association (AAA): AAA defines "Accounting refers to the process of identifying, measuring and communicating economic information to permit informed judgment and decisions by users of the information."

A.W. Johnson: "Accounting may be defined as the collection, compilation and systematic recording of business transactions in terms of money, the preparation of financial reports, the analysis and interpretation of these reports and the use of these reports for the information and guidance of management."

Weygandt, Kieso and Kimmel: "Accounting is an information system that identifies, records and communicates the economic events of an organization to interested users."

This definition views accounting as an information system that identifies and records the financial transactions, ascertains the results and provides information to the various interested users in the desirable way or according to their needs. Basically, accounting is not a recording procedure. It is an information device or a tool that works to provide information to interested users to rationalize their decision making.

SCOPE OF ACCOUNTING

The scope of field of accounting is very wide. Accounting is needed not only by business class but also by non-business class. Starting from the private life of a man, the financial activities of school, college, club, society, hospitals and government institutions come within the purview of accounting. The jurisdiction of accounting also includes the financial activities of professionals including doctors, engineers and layers. The monetary transactions which take place in the private life of a man are recorded properly in the books of accounts; it becomes possible to ascertain his receipts and expenditure as well as personal assets and properly in the books of accounts, it becomes to ascertain his receipts and expenditure as well as his personal assets and liabilities. When the financial transactions of a business are prepared, it is essential to maintain accounts of non-profit organizations like school,

college, hospital, club, society etc. In the same way, it is necessary to keep accounts of professionals like service-holders, doctors, lawyers, actors/actress etc. to ascertain their incomes and calculation of income-tax on the basis of those incomes. Maintaining accounting is practiced to determine the income and expenditure of different government offices and public bodies as well as to run those offices and organizations properly. By preparing and evaluating national plan and budget with the help of accounting, it is possible to know the development and deterioration of the country. Hence, in a nutshell, we can say that the scope of accounting is wide enough to cover all the fields of the society.

Objectives of Accounting

The principal object of accounting is to keep permanent record of all monetary transactions effected by a person or enterprise during a definite period and ascertainment of results of those transactions at the end of the period. The main objects of accounting are enumerated below:

1. **Proper Recording of Transactions:** The first and foremost object of accounting is to keep record of monetary transactions in a systematic manner.
2. **Determination of Results:** Every person or institution is always interested to know the results of his/its monetary transactions at the end of a definite period. So, ascertainment of result of financial transactions is an important object of accounting.
3. **Ascertainment of Financial Position:** Another object of accounting is the ascertainment of debtors and creditors, assets and liabilities and the overall financial position.
4. **Supplying Financial Information:** Another important object of accounting is to make available all sorts of financial reports and statements to all parties interested in the affairs of the concerned institution as soon as possible after preparing those reports and statements.
5. **Defalcation Prevented:** Another special object of accounting is the prevention of defalcation of money made through fraud by the officials of the institution as well as control of expenditure.

NEED, IMPORTANCE AND USES OF ACCOUNTING IN DAILY LIFE

Accounting has become part of our daily activities as it implicates monetary transactions of life. People spend money, invest money for future; all these require proper accounting. Let's discuss the matter in detail.

Necessity and Importance of Accounting

The necessity and importance of accounting is limitless or unbounded to men in their day-to-day personal life, family life, and intuitional life. The necessity of accounting is described below:

Institutional Necessity

- Accounting supplies numerical information to the institution relating to its management and administration.
- Exact results of the institution are disclosed through accounting.
- The firm can ascertain the financial status of the business operation.
- Firm can compare the financial position of two/more years.

- Books accounts are very valuable documents.
- Proper accounting makes the firm credible to other party.
- Tax authority can assess taxes for the firm using the accounting information.
- Firm can determine the actual assets and liabilities.
- Using accounting data, a firm can formulate policy and take many decisions on future operations.

Uses of Accounting in Day-to-day Life

- Someone can ensure smooth financial management in his life.
- He/she can bring financial solvency because financial plan helps to be economical.
- Accounting helps in preparing personal budget.
- Accounting promote saving habits.
- Accounting helps to solve family and social disputes as it provides for authentic records.

ACCOUNTING: WHETHER SCIENCE OR ARTS?

There is a great controversy whether accounting is science or arts. According to some scholars accounting is science, someone is describing accounting as arts. But actually accounting is a composition of both science and arts.

Why Accounting is 'Science'?

Science refers to systematic process. In scientific activities, it follows certain rules — observation, analysis, taking actions and then evaluation of activities. Like scientific activities before taking any action, accounting observes the activities, analyses the various alternatives, chooses the best alternatives and takes feedback to evaluate the performance. So, accounting is termed as science.

NATURE OF ACCOUNTING INFORMATION

The following characteristics are pre requisite for events and transactions to become accounting information:

1. Accounting information must be able to change the financial position of an organization. Two types of change may occur:
 - (a) **Net Change:** The events or transactions that change the position of assets and liabilities of the organization, is called the net change.
Example: Salary ` 2000 paid to Mr. Ahmed.
 - (b) **Structural Change:** The events or transactions that change the structure of assets and liabilities of the organization.
Example: Equipment purchased at ` 10,000.
2. Accounting information must be measured in terms of money.
3. There must be two parties related with accounting activities/transactions. (Dual aspect of accounting, i.e., the interchange between two parties will complete a transaction.)
4. Accounting information must be self-sufficient and independent from one another.

5. Any invisible events that change the financial position of an organization may be termed as financial transactions.

Bookkeeping and Accounting: Accounting as a discipline was introduced to have permanent and systematic record of business transactions. This would help a business person to record all relevant business transactions, to ascertain the profit earned during a particular period and finally evaluate the financial position of his/her business. Bookkeeping, accounting and accountancy are the terms used in the science of financial accounting.

Bookkeeping is defined as the science and art of recording business transactions in a systematic manner in a certain set of books known as books of accounts. It identifies the transactions and events, measures the identified transactions and events in a common measuring unit, records them in proper books of accounts and finally classifies them in another book called the ledger.

Accounting is termed as language of business which records all events and transactions that are of monetary value and facilitates communication among individuals in a society.

Accountancy refers to a systematic knowledge of accounting. It explains “why to do” and “how to do” of various aspects of accounting. It tells us why and how to prepare the books of accounts and how to summarize the accounting information and communicate it to the interested parties.

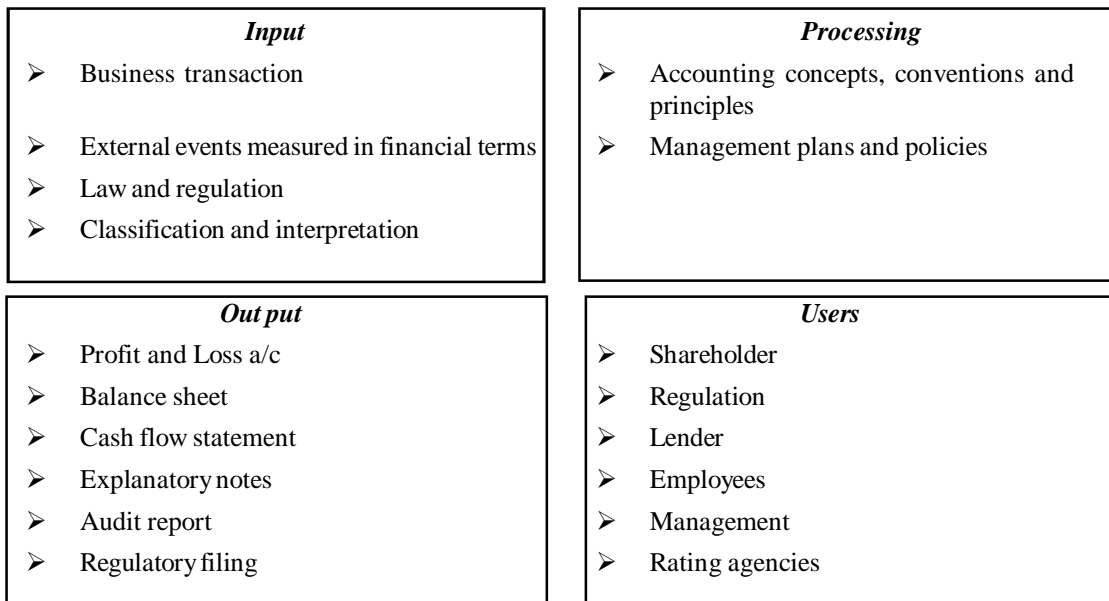
ACCOUNTING PROCESS

Accounting is the process of identifying the transactions and events, measuring the transactions and events in terms of money, recording them in a systematic manner in the books of accounts, classifying or grouping them and finally summarizing the transactions in a manner useful to the users of accounting information.

1. **Identifying the Transactions and Events:** This is the first step of accounting process. It identifies the transaction of financial character that is required to be recorded in the books of accounts. Transaction is transfer of money or goods or services from one person or account to another person or account. Events happen as a result of internal policies or external needs. Events of non-financial character cannot be recorded even though such events may have an impact on the operational results of the firm.
2. **Measuring:** This denotes expressing the value of business transactions and events in terms of money (in terms of rupees in India).
3. **Recording:** It deals with recording of identifiable and measurable transactions and events in a systematic manner in the books of original entry that are in accordance with the principles of accountancy.
4. **Classifying:** It deals with periodic grouping of transactions of similar nature that appear in the books of original entry into appropriate heads by posting or transfer entries. For example, all purchases of goods made for cash or on credit on different dates are brought to purchase account.
5. **Summarizing:** It deals with summarizing or condensing transactions in a manner useful to the users. This function involves the preparation of financial statements such as income statement, balance sheet, statement of changes in financial position and cash flow statement.

6. **Analyzing:** It deals with the establishment of relationship between the various items or group of items taken from income statement or balance sheet or both. Its purpose is to identify the financial strengths and weaknesses of the enterprise. The above six process in the present-day scenario are generally performed using software packages.
7. **Interpreting:** It deals with explaining the significance of those data in a manner that the end-users of the financial statement can make a meaningful judgment about the profitability and financial position of the business. The accountants should interpret the statement in a manner useful to the users, so as to enable the user to make reasoned decision out of the alternative course of action. They should explain various factors on what has happened, why it happened, and what is likely to happen under specific conditions.
8. **Communicating:** It deals with communicating the analyzed and interpreted data in the form of financial reports/statements to the users of financial information, e.g., Profit and Loss account, Balance Sheet, Cash Flow and Funds Flow statement, Auditors Report etc.

The Accounting Information system



OBJECTIVES OF ACCOUNTING

- (a) Accounting helps in systematic recording of all business events or transactions. Written records are more preferable to memorizing (oral recording) because the latter may fade away with time. Also systematic records can be used by different persons for different decision making purposes.
- (b) Accounting measure the financial performance of the enterprise. The results of operations are ascertained by preparing profit and loss account, balance sheet and cash flow statements. This will enable the businessperson to ascertain what the business owes to others, what others owe them and whether his/her capital remained same or increased or decreased.

- (c) Accounting facilitates in reporting the results to both internal and external users. The management requires information for internal purpose at various levels of operations. They need to prepare various reports such as production report, idle time report, cash budget report, receivable report, accounts payable report, project appraisal report, capital budgeting report etc. The management reports the financial performance of the firm to external users such as shareholders, creditors, bankers, investors, stock brokers, stock exchanges, employees, governments etc.
- (d) Accounting is required to fulfill the statutory requirements of various regulatory bodies such as Registrar of Companies, SEBI (Securities Exchange Board of India), income-tax authorities and the Government.
- (e) Accounting helps in internal control by holding the concerned persons responsible for any errors, lapses or under performance. Equally, it helps to identify the strong/weak areas of each unit or department.

Accounting is a tool for effective planning. Current year's financial performance becomes the basis for future predictions and estimations. Since it is tool for planning, it also acts as tool for controlling. Preparation of budgets, cost analysis, tax planning, auditing are some of the functions of accounting.

LIMITATIONS OF ACCOUNTING

1. Though accounting system is the only source for extracting financial information of the firm, it grossly lacks qualitative elements. Qualitative resources could include leadership of top brass, highly talented human resource, highly motivated team, best products, the power of resource and development, brand image etc.
2. Accounting is not free from bias. The accountants have some leeway or freedom on the methods of depreciation charged, inventory valuation etc. Though the convention says consistency has to be maintained on the policies adopted, there is considerable room for bias, favourism and personal judgment.
3. Accounting reveals the estimated position and not the real position of the firm. Generally, financial statements are prepared on separate entity concept, conservatism concept etc. which are based on the estimates that may lead to overvaluation or undervaluation of assets and liabilities. The exact picture of the financial situation can be ascertained only on the liquidation of an enterprise.
4. Accounting ignores the price level changes when financial statements are prepared on historical cost. Fixed assets are shown in the balance sheet at historical cost less accumulated depreciation and not at their replacement value. Land value is shown at historical cost but the replacement value could be far higher than the value stated in the balance sheet due to appreciation of land value over the period of time.
5. The danger of window dressing arises when the management decides to incorporate wrong figures to artificially inflate revenue or deflate losses or when there is a threat of hostile takeover. In such a situation, the management fails to provide true and fair view of the financial position to the various users of the financial statement. Satyam Computer Services, the fourth largest software firm, went into bust when the information on inflated income to the extent of ` 7000 crore was revealed.

MEANING OF ACCOUNTING PRINCIPLES, CONCEPTS AND POLICIES

Accounting information is used by various stakeholders. Since all the stakeholders should understand the accounting language in the same sense, certain principles, concepts and policies of accounting have been laid down.

- **Accounting Principles:** Accounting Principles are basically the rules of action adopted by the accountants universally while recording accounting transactions. The principles are doctrines associated with theory and procedures and current practices of accounting. These principles may be classified as concepts and conventions.
- **Concepts:** Concepts take the form of assumptions or conditions, which guide the accountants while preparing accounting statements.

Example: Business is started with an assumption that it shall be continued for a long period of time and none wishes it to close down within a short period of time.

Based on this assumption, businessperson purchases fixed assets, uses long-term source to fund the fixed assets etc. This strong assumption that the business will continue for a long period of time is called a concept.

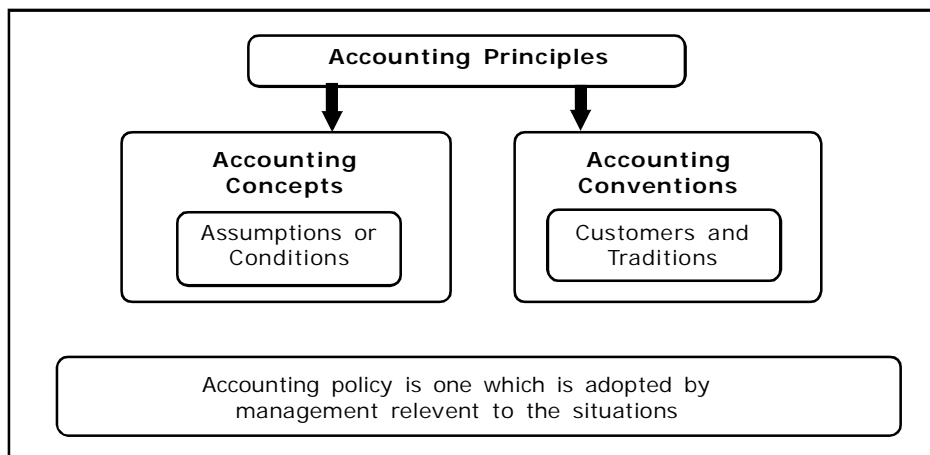


Fig. 1

- **Conventions:** Conventions are those customs and traditions which guide the accountants while preparing the financial statements.
Example: Inventory (stock) in a business is valued at the end of an accounting period, at cost or market price whichever is lower. This is an accepted convention or a practice in accounting.
- **Accounting Policy:** Accounting policy refers to the specific accounting principles and methods of applying those principles adopted by the enterprise in the preparation and presentation of financial statements.
Example: While depreciating an asset, the practice of adopting straight line method or diminishing balance method or any other method is a convention.

The choice of selecting straight line method of depreciation or any other is the policy of the management. No management can exercise discretion regarding fundamental presumptions of accounting. But every management has a choice of making an accounting policy.

GENERALLY ACCEPTED ACCOUNTING PRINCIPLES

The double entry system of accounting is based on a set of principles which are called generally accepted accounting principles. It incorporates the consensus at a particular time as to:

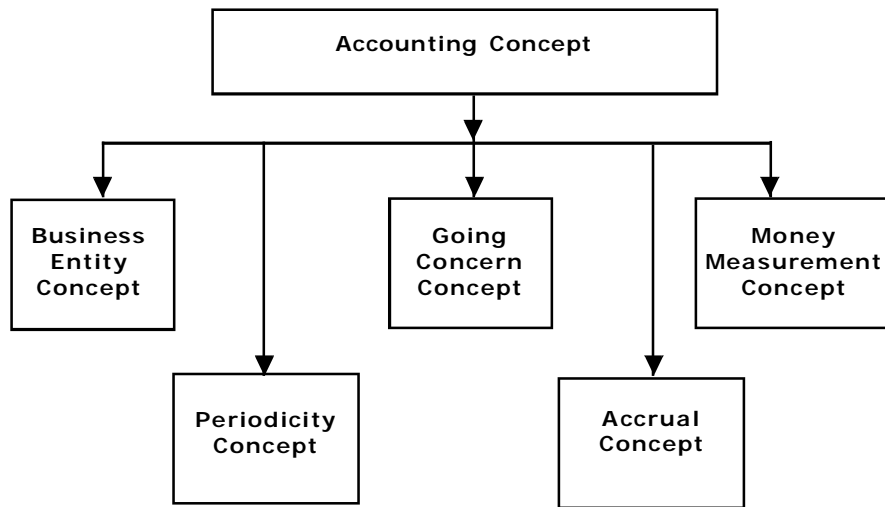
- which economic resources and obligations should be recorded as assets and liabilities by financial accounting,
- which changes in assets and liabilities should be recorded,
- when these changes are to be recorded,
- how the assets and liabilities and changes in them should be measured,
- what information should be disclosed and
- which financial statement should be prepared.

For example, an entity having research and development department may follow the policy of deducting all the R&D expenses incurred in a year as revenue expense while for the same situation another entity may classify R&D expenses into projects and may write off only when the project is not expected to offer any future benefits.

<i>US GAAP</i>	<i>Indian GAAP</i>
It is established under FASB and AICPA	It is established by ICAI
Balance sheet, Income statement and Fund flow statement are alone mandatory	Statement are mandatory
Any change in foreign exchange fluctuations cannot be capitalized but the difference can be shown or debited to income statement	Any difference in foreign exchange can be capitalized
Financial accounting, management accounting and income tax accounting are prepared separately	Only financial accounting and income tax accounting are prepared
The basic tenets is globalization of business	The basic tenet is localization
Any long-term loan repayable in the current financial year is shown separately	Long-term loan maturing in the current financial year need not be disclosed separately
In lease contract, lease is more beneficiary because he can claim depreciation allowance	In lease contract, lessor is eligible for depreciation allowance and not the lease
It is more transparent and accepted worldwide. More disclosure is required	It is comparatively less transparent. For listing the securities in other country's stock exchange, US GAAP is mandatory

TYPES OF ACCOUNTING CONCEPTS

As said earlier, concepts are the basic assumptions or conditions upon which the science of accounting is based. There are five basic concepts of accounting, namely — business entity concept, which is also termed as separate entity concept, going concern concept, money measurement concept, periodicity concept and accrual concept. Each concept is discussed below.



1. Business Separate Entity Concept: The essence of this concept is that business is a separate entity and it is different from the owner or the proprietor. It is an economic unit which owns its assets and has its own obligations. This enables the business to segregate the transactions of the company from the private transactions of the proprietor(s).

Example: Personal bank account of the proprietor, Cash withdrawal from business for private purpose should be accounted separately.

This legal separation between business and ownership is kept in mind while recording the transactions in the books of business.

2. Going Concern Concept: The fundamental assumption is that the business entity will continue fairly for a long time to come. There is no reason why an enterprise should be promoted for a short period only to liquidate the business in the foreseeable future. This assumption is called "going concern concept".

This concept forms the basis for the distinction between expenditure that will yield benefit over a long period of time (Fixed Assets) and expenditure whose benefit will be exhausted in the short term (Current Asset). Similarly, liabilities are classified as short-term liabilities and long-term liabilities.

According to AS-1 issued by ICAI, if this concept is followed, this fact need not be disclosed in the financial statement since its acceptance and uses are assumed. In case this concept is not followed, the fact should be disclosed in the financial statement along with the reasons.

Going concern concept is not valid in the following cases:

- When an enterprise was set up for a particular purpose.
- When the government declares a company sick.

- When the company has been in the grip of severe financial crisis and is expected to wind up shortly.
- When a receiver or liquidator has been appointed to wind up the company.

3. Money Measurement Concept: All transactions of a business are recorded in terms of money. An event or a transaction that cannot be expressed in money terms cannot be accounted in the books of accounts.

Example:

- The honesty of the employees, dynamism of the selling agents, promptness and integrity of the cashier might influence the business results, but cannot be accounted in the books of accounts.
- It makes no sense if the assets are expressed as 10 tons of raw materials, five vehicles, one premise and a few items of furniture, unless all these assets are expressed separately in terms of monetary value.
- Money is the common denominator in which the business transactions should be expressed.

4. Periodicity Concept: The time interval for which accounts are prepared is an important factor even though we assume long life for a business.

Example: The time interval is usually one year and this period is called accounting year.

The accounting period could be half year or even a quarter. The financial statements should be prepared at the end of each accounting period so that income statement shows profit or loss for that accounting period. So also a balance sheet is prepared to depict the financial position of the business.

5. Accrual Concept: Profit earned or loss suffered for an accounting period is the result of both cash and credit transactions. It is possible that certain incomes are earned but not received and similarly certain expenses incurred but not yet paid during an accounting period. But it is relevant to consider them while computing the financial results just because they are related to the specific accounting period.

Example: On 31st December 2006, interest receivable on fixed deposit was ₹ 12,000. The interest amount was credited to the bank account in February 2007 (two months later). According to accrual concept, the income from interest is ₹ 12,000 though it is received after 31-12-2006.

Similarly, the expenses that are incurred for the accounting period could be paid after the accounting period. Such accrued expenses are deducted while calculating the profit for the accounting period. This is the accrual concept.

ACCOUNTING PRINCIPLES

Accounting Principles are the rules based on which accounting takes place and these rules are universally accepted.

Principles of Income Recognition	Dual Aspect Principles
Principles of Expenses	Modifying Principles
Principles of Matching Cost and Revenue	Principles of Materiality
Principles of Historical Cost	Principles of Consistency
Principles of Full Disclosure	Principles of Full Conservatism

There are ten such basic principles, namely principle of income recognition, principle of expense, principle of matching cost and revenue, historical cost principle, principle of full disclosure, double aspect principle, modifying principle, principle of materiality, principle of consistency and principle of conservatism. A brief description is in the following paragraphs.

1. Principle of Income Recognition: According to this concept, revenue is considered as being earned on the date on which it is realized, i.e., the date on which goods and services are transferred to customers for cash or for promise. It should further be noted that it is the amount which the customers are expected to pay which shall be recorded. In effect, only revenue which is actually realized should be taken to profit and loss account. Unrealized revenue should not be taken into consideration for determining the profit.

Examples:

- A sale is considered to be made when the property in goods (ownership) is transferred from the seller to buyer.
- Similarly, when a businessman receives an order for the sale of such products, yet to be manufactured, then revenue is said to have been generated when the products are ready and physically present in deliverable state and payment is received or promised to be received but not when the order is received.

2. Principle of Expenses: Expenses are different from payments. A payment becomes expenditure or an expense only when such payment is revenue in nature and made for consideration.

Examples:

Salaries Paid – Expenses

Furniture Purchased – Capital Payment

Therefore, all revenue expenses are transferred to profit and loss account to ascertain profit or loss of the business undertaking. In other words, there are revenue expenses and capital expenses.

While revenue expenses are charged against profit, capital expenses are shown in the balance sheet as assets.

3. Principle of Matching Cost and Revenue: Revenue earned during a period is compared with the expenditure incurred to earn that income, whether the expenditure is paid during that period or not. This is matching cost and revenue principle, which is important to find out the profit earned for that period. Here, costs are reported as expenses in the accounting period in which the revenue associated with those costs is reported.

Examples:

- Sales revenue in 2005 — ₹ 50 lakhs
- Expenses incurred during the period — ₹ 30 lakhs.
- It is assumed that some of these costs might be payable in 2006.
- Yet, they are considered for the period 2005, when the sales revenue was earned.

While preparing the final accounts, adjustments are made for outstanding expenses, prepaid expenses, outstanding income and income received in advance.

4. Principle of Historical Costs: This is called “cost” principle. All assets are recorded at the cost of acquisition and this cost is the basis for all subsequent accounting for the assets. The expenses and the goods purchased are shown at the value at which they are incurred. The value of the assets is constantly reduced by charging depreciation against their cost to present their book value in the balance sheet.

Example: Land bought for ₹ 5,00,000 will be shown at purchase price irrespective of the market value.

However, on account of inflationary situations, this cost concept does not portray correct picture of the business and so inflation accounting has emerged.

5. Principle of Full Disclosure: The business enterprise should disclose relevant information to all the parties concerned with the organization. It means that any information of substance or of interest to the average investors will have to be disclosed in the financial statements.

Example: The practice of providing Appending Note to the financial statements.

The Companies Act, 1956 requires that income statement and balance sheet of a company must give a fair and true view of the state of affairs of the company.

6. Double Aspect Principles: This concept is the most fundamental one for accounting. A business entity is an independent unit and it receives benefits from some and gives benefits to some other. Benefit received and benefit given should always match and balance.

Balance Sheet as on

<i>Liabilities</i>		<i>Assets</i>	
Capital	20,000	Stock	10,000
		Cash at Bank	8,000
		Cash in hand	2,000
	20,000		20,000

The total liabilities are equal to the total of assets. This is dual aspect of accounting. The established principle of accounting is that for every debit there is an equivalent credit and this is called double entry principle of accounting.

7. Modifying Principle: The modifying principle states that the cost of applying a principle should not be more than the benefit derived from. If the cost is more than the benefit, then that principle should be modified. This is called cost-benefit principle. There should be flexibility in adopting a principle and the advantage out of the principle should outweigh the cost of implementing the principle.

8. Principle of Materiality: While important details of financial status must be informed to all relevant parties, insignificant facts which do not influence any decisions of the investors or any interested group, need not be communicated. Such less significant facts are not regarded as material facts. What is material and what is not material depends upon the nature of information and the party to whom the information is provided. While income has to be shown for income-tax purposes, the amount can be rounded off to the nearest ten and fraction does not matter. The statement of account sent to a debtor contains all the details regarding invoices raised, amount outstanding during a particular period. The information on debtors furnished to Registrar of Companies need not be in detail.

9. Principle of Consistency: Consistency is required to help comparison of financial data from one period to another. Once a method of accounting is adopted, it should not be changed. For instance, if stock is valued under FIFO method in first year, it should be valued under the same method in the subsequent years also. Likewise if the firm chooses to depreciate assets under diminishing balance method, it should continue to do so year after year, unless the management takes a policy decision to change the depreciation method. Any change in the accounting methods should be informed to the concerned authorities with justification.

10. Principle of Conservatism or Prudence: Accountants follow the rule “anticipate no profits but provide for all anticipated losses”. Whenever risk is anticipated, sufficient provision should be made. The value of investments is normally taken at cost, even if the market value is higher than the cost. If the market value expected is lower than the cost, then provision should be made by charging profit and creating investment fluctuation fund. This is the principle of conservatism and it does not mean that the income or the value of assets should be intentionally understated.

ACCOUNTING STANDARDS

To bring uniformity in terminology, accounting concepts, conventions, and assumptions, the Institute of Chartered Accountants of India (ICAI) established Accounting Standards Board (ASB) in 1977. An Accounting Standard is a selected set of accounting policies or broad guidelines regarding the principles and methods to be chosen out of several alternatives. There are altogether 32 accounting standards issued by ASB out of which, one standard (AS-8) has been withdrawn pursuant to AS-26 becoming mandatory. Table given at the end of this unit provides you the details of 32 Accounting Standards (AS).

It is a selected set of accounting policies or broad guidelines regarding the principles and methods to be chosen out of several alternatives. Standards adhere to certain laws, customs, usage and business environment in which it operates.

The basic purpose of accounting standards is to harmonize the diverse accounting policies and practices that are currently used in India. The adoption of accounting standards ensures uniformity,

comparability and qualitative improvement in the preparation and presentation of financial statement. Accounting standards facilitates more disclosure of financial information that is beyond the statutory limits.

Scope and Functions of Accounting Standard Board

The Accounting Standard Board (ASB) was constituted by The Institute of Chartered Accountants of India on 21st April, 1977. The aim of the board was to bring in uniformity among various accounting policies and practices that were practiced in India, to determine the broad areas in which accounting standards need to be formulated and hold a dialogue with various representatives of the government, industry and other organizations to ascertain their views. On the basis of the discussions they hold, the board prepares and issues a draft proposal for comments by the members of the Institute and the public.

After modification (if any) in the draft proposal, a final draft is submitted to the council of the institute. The accounting standard will then be issued under the authority of the Council. At present, there are 32 accounting standards issued by the Council.

<i>Number of the Accounting Standard (AS)</i>	<i>Title of the Accounting Standard</i>	<i>Date From Which Mandatory (Accounting Periods Commencing on or After)</i>	<i>Enterprises to which Applicable</i>
AS-1	Disclosure of accounting policies	1-4-1993	All
AS-2 (Revised)	Valuation of inventories	1-4-1999	All
AS-3 (Revised)	Cash Flow Statement	1-4-2001	Level-1
AS-4 (Revised)	Contingencies and events occurring after the balance sheet date	1-4-1998	All
AS-5 (Revised)	Net profit or loss for the period, prior period items and changes in accounting polices	1-4-1996	Level-I
AS-6 (Revised)	Depreciation Accounting	1-4-1995	All
AS-7 (Revised)	Construction Contracts	1-4-2002	All
AS-8	Withdrawn and included in AS-26	-----	-----
AS-9	Revenue Recognition	1-4-1993	All
AS-10	Accounting for fixed assets	1-4-1993	All
AS-11(Revised 2003)	The effects of changes in foreign exchange rates	1-4-2004	All
AS-12	Accounting for government grants	1-4-1994	All
AS-13	Accounting for investments	1-4-1995	All
AS-14	Accounting for amalgamations	1-4-1995	All
AS-15	Employees benefit	1-4-2006	All
AS-16	Borrowing costs	1-4-2000	All

AS-17	Segment reporting	1-4-2001	Level-I
AS-18	Related party disclosures	1-4-2001	Level-I
AS-19	Leases	1-4-2001	All
AS-20	Earning per share	1-4-2001	Level-I, Refer AS-12
AS-21	Consolidated financial statements	1-4-2001	See note 1
AS-22	Accounting for taxes on income	1-4-2001 1-4-2002	For listed co. Co. other than listed
		1-4-2006 1-4-2002	See Note 2 All
AS-23	Accounting for investment in associates in consolidated financial statements		
AS-24	Discounting operations	1-4-2004	All
AS-25	Interim financial reporting	1-4-2002	Level-I
AS-26	Intangible assets	1-4-2003	Level-I
AS-27	Financial reporting of interests in joint ventures	1-4-2002	See Note 1
AS-28	Impairment of assets	1-4-2004	Level-I
	Amendments	1-4-2006	Level-II
	Amendments	1-4-2008	Level-III
AS-29	Provisions, contingent liabilities and contingent assets	1-4-2004	ALL
AS-30	Financial Instruments — Recognition and Measurement	1-4-2011	Non SMC
AS-31	Financial Instruments — Presentation	1-4-2011	Non SMC
AS-32	Financial Instruments — Disclosure	1-4-2011	Non SMC

- AS-8 was withdrawn in pursuant to AS-26 becoming mandatory.
- 29 accounting standards are issued as of date and only 28 are applicable.
- AS-30, AS-31, AS-32 are published but they will come into effect from 1.4.2009. It is mandatory on or after 1.4.2011.

EXERCISE

Self Assessment Questions

[A]

1. Bookkeeping _____ the transactions and events, _____ the identified transactions and events in a common measuring unit, records them in proper books of accounts and finally classifies them in the ledger.
2. Accounting in addition to bookkeeping involves _____ the classified transactions and _____ the summarized results.
3. _____ interprets the analyzed results and communicates the interpreted information to the interested parties.
4. Accounting is a tool for _____ and _____.
5. Expand SEBI.
6. Mention any five stakeholders.
7. _____ as chief provider of risk capital is keen to understand both the return from their investments and the associated risk.
8. _____ use financial reports for negotiating wage package, declaration of bonus and other benefits.
9. _____ has a legitimate interest in financial reports of publicly held enterprise to ensure efficient operation of capital market.
10. The regulatory agencies use _____ to take action against the firm when appropriate returns are not filed in time or when the returns fails to provide true and fair position of the business or to take appropriate action against the firm when complaints/ misappropriation are being lodged.
11. Accounting grossly lacks _____ elements.
12. The exact picture of the financial situation can be ascertained only on the _____ of an enterprise.
13. The danger of _____ arises when the management decides to incorporate wrong figures to artificially inflate revenue or deflate losses or when there is a threat of hostile takeover.
14. Accounting ignores the price level changes when financial statements are prepared on _____.

- Answers:**
- | | |
|---|-------------------------------------|
| 1. Identifies, measures, | 2. Summarizing, analyzing, |
| 3. Accounting, | 4. Effective planning, controlling, |
| 5. Securities Exchange Board of India, | |
| 6. Shareholders, Creditors, Bankers, Government, Employees, | |
| 7. Investors, | 8. Trade Union, |
| 9. Stock Exchange, | 10. Financial Reports, |

- | | |
|----------------------|----------------------|
| 11. Qualitative, | 12. Liquidation, |
| 13. Window dressing, | 14. Historical Cost. |

[B]

1. Accounting principles are _____, associated with theory and practice of accountings.
2. Accounting principles are classified as _____ and _____.
3. Assets may be depreciated on fixed installment method or reducing balance method. Is it a concept or a convention?
4. A business is started with an assumption of making profit. Is this assumption, a concept or a convention?
5. The purpose of establishing ICAI and ASB is to _____.
6. How many accounting standards are issued by ASB so far?
7. State true or false:
 - (a) If the household expenses of ` 25,000 of a proprietor are shown as business expenses, the profit of the business will be understated to the extent of ` 25,000.
 - (b) If a proprietor invests ` 1,00,000 in the business, it is deemed that the proprietor has given ` 1,00,000 to the “business” and it is shown as an asset in the books of the business.
8. Business and its owner are _____ entities.
9. Profits earned in business form an addition to the _____ of the owner.
10. Accounting of a small calculator as an expense and not as an asset is the application of principles of prudence. State true or false.
11. Classification of assets as current and fixed assets is the application of going concern concept. State true or false.
12. Purchase of a building for your business is made under the assumption that it would last for a long period. This is in accordance with the materiality principle. State true or false.
13. What is the underlying intention in making a provision every year when an asset is purchased?
14. An event or a transaction expressed in monetary value is measured but inflation or changes in the purchasing power are ignored in money measurement concept. Say yes or no.
15. Transactions or events should be expressed in _____.
16. Revenues are matched with expense in accordance with money measurement principle. State true or false.
17. The economic life of the entity is artificially split into periodic intervals in accordance with periodicity concept. State true or false.
18. The accounting data must disclose all relevant information in accordance with periodicity concept. State true or false.
19. The accountants are free to submit financial statement at arbitrary points in time during the life of the entity. This is in accordance with periodicity concept. State true or false.

20. Interest earned but not received within an accounting period is called _____.
21. Following straight line method of depreciation of a particular asset year after year adhere to consistency concept. State true or false.
22. Accrued income should be _____ to compute profit and prepaid expenses should be _____ according to accrual concept of accounting.
23. Accrual concept considers not only cash transactions but also _____ transactions.
24. Income is considered as earned only when it is _____.
25. Income is realized whether it is actually received in cash or promised to be received. Is it true or false?
26. Income realized is different from cash received. Is it true or false?
27. A sale is made on credit. Does it constitute income realization?
28. An order is received for sale of goods. Is it realization of income?
29. An order is received with an advance of ` 1,00,000 cash. Can this be called income?
30. A cash payment may be a revenue payment or capital payment. Is it true or false?
31. A payment which is revenue in nature is expenditure. Is it true or false?
32. Plant is purchased and payment is made. Is it an expenditure or acquisition of asset?
33. All revenue expenses are charged against _____.
34. Capital payments resulting in acquisition of assets appear in the balance sheet. True or False?
35. Matching concept of accounting considers only revenue incomes and expenses relating to a particular accounting period. True or False?
36. Incomes and expenses for an accounting period are considered to compute _____.
37. Expenditure paid or payable and revenue earned whether realised or not in cash are taken into account to find out profit or loss. True or False?
38. For the actual revenue received, outstanding incomes are _____ and income received in advance are _____ to find out the revenue income for the given period.
39. For the actual revenue expenses (costs) paid during the accounting period, outstanding expenses are _____ and prepaid expenses are _____ to find out expenses for the accounting period.
40. All assets are shown at historical cost in balance sheet. True or False?
41. Depreciation is charged against the historical cost of assets. True or False?
42. Historical cost is the cost at which an asset is actually purchased. True or False?
43. Machinery is bought for ` 2,00,000 and its market value is ` 80,000. Which of these values do you consider to mention in the balance sheet according to cost principle?
44. Inflation accounting has emerged as a result of limitation of historical cost concept. True or False?
45. The principle of full disclosure implies that information which is of _____ should be stated in financial statements.

- | | | |
|---|------------------------|-----------------------------|
| 16. False, | 17. True, | 18. False, |
| 19. False, | 20. Accrued interest, | 21. True, |
| 22. Added, Deducted, | 23. Credit, | 24. Realized, |
| 25. True, | 26. True, | 27. Yes, |
| 28. No, | 29. No, | 30. True, |
| 31. True, | 32. Asset Acquisition, | 33. Profit, |
| 34. True, | 35. True, | 36. Profit or loss, |
| 37. True, | 38. Added, Deducted, | 39. Added, Deducted, |
| 40. True, | 41. True, | 42. True, |
| 43. ` 2,00,000, | 44. True, | 45. Substance, |
| 46. True, | 47. Fraud, | 48. True, |
| 49. True, | 50. Total Assets, | 51. Double entry principle, |
| 52. Cost-benefit principle, | 53. True, | 54. No, |
| 55. True, | 56. False, | 57. True, |
| 58. True, | 59. Comparison, | 60. True, |
| 61. Risk, | | |
| 62. Anticipate no profit but provide for all anticipated losses, | | |
| 63. (a) Principles of consistency, (b) Principles of full disclosure, (c) Principles of conservatism. | | |

Multiple Choice Questions

1. The art or science which teaches the technique of recording and explaining financial transaction is called:
A. Recording transactions B. Bookkeeping
C. Accounting D. Bookkeeping and accounting
2. The origin of modern accounting was in _____
A. England B. India
C. Italy D. America
3. Who is the father of modern accounting?
A. L.C. Cooper B. A.W. Johnson
C. Luca Pacioli D. R.N. Carter
4. Which year indicates the period of origin of double entry system of book-keeping?
A. 1414 B. 1394
C. 1494 D. 1449
5. What was the name of the book written by Luca Pacioli?
A. Accounting in ancient Italia

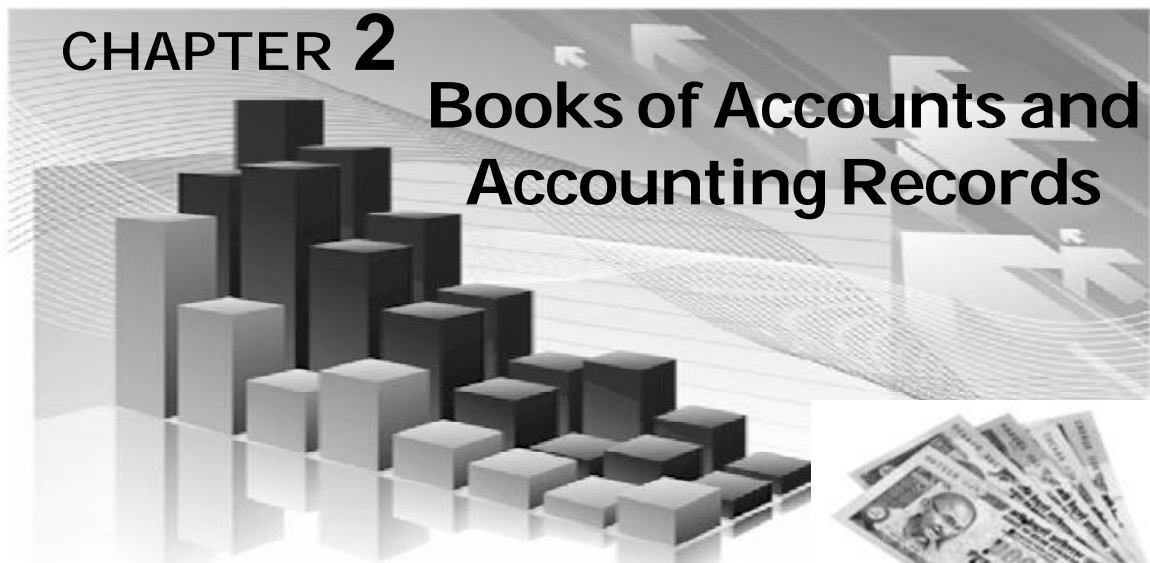
- B. The modern concept on accounting
 - C. Summa de Arithmetica Geometria Proportionate Proportionalita
 - D. Accounting in the past
6. The history of accounting is:
- A. A new discipline
 - B. Invention of science
 - C. As old as the human civilization
 - D. A new achievement of social science
7. The principal object of bookkeeping is:
- A. Keeping written records of transaction
 - B. Keeping written records of expenditure
 - C. Ascertainment of financial results
 - D. Ascertainment of debit and credit
8. The fields and scope of accounting are-
- A. Confined within business field only
 - B. Extended over individual life only
 - C. Extended over all fields of society
 - D. Like individual life and business fields

Answers: 1. B, 2. C, 3. C, 4. C, 5. C, 6. C, 7. A, 8. D.

Essay Type Questions

1. Define accounting.
2. Explain the objects of accounting.
3. Explain the necessity of accounting in a business organization.
4. Explain the process involved in accounting.
5. What are the objectives of accounting?
6. Distinction between book-keeping and accountancy.
7. How accounting information is used by investors and lenders?
8. How Government and Regulatory agencies use accounting information to regulate the activities of the firm?
9. Distinguish between financial accounting and management accounting.
10. What are the basic principles of Accountancy?
11. The salaries paid in 2004 ` 5,00,000; Salaries outstanding ` 20,000; Salaries paid in advance for 2004 ` 30,000; What is the actual salary expenditure for 2004? What is the accounting principle involved in this?
12. What is wrong if assets like buildings are shown at market value in the balance sheet?
13. A business receives capital of ` 1,00,000 and a loan is raised for ` 50,000. This is represented by cash ` 15,000; Machinery ` 85,000; Furniture ` 20,000 and goods ` 30,000. Find the total of debits and credits from business point of view. What principle of accounting is underlying in this case?
14. What is substance over form?





DOUBLE-ENTRY BOOKKEEPING SYSTEM

A double-entry bookkeeping system is a set of rules for recording financial information in a financial accounting system in which every transaction or event changes at least two different nominal ledger accounts.

The name derives from the fact that financial information used to be recorded using pen and ink in paper books — hence "bookkeeping" (whereas now it's recorded mainly in computer systems) and that these books were called journals and ledgers (hence nominal ledger, etc.) — and that each transaction was recorded twice (hence "double-entry"), with the two transactions being called a "debit" and a "credit".

It was first codified in the 15th century by Luca Pacioli. In deciding which account has to be debited and which account has to be credited, the golden rules of accounting are used. In modern accounting, this is done using debits and credits within the accounting equation: $\text{Equity} = \text{Assets} - \text{Liabilities}$. The accounting equation serves as an error detection tool. If at any point the sum of debits does not equal the corresponding sum of credits, an error has occurred. It follows that the sum of debits and the sum of the credits must be equal in value.

Double-entry bookkeeping is not a guarantee that no errors have been made — for example, the wrong ledger account may have been debited or credited, or the entries completely reversed.

ACCOUNTING ENTRIES

The double-entry accounting system records financial transactions in relation to asset, liability, income or expense related to it through accounting entries. Any accounting entry in the double-entry accounting system will result in the recording of equal debit and credit amounts; that is, debits must

equal credits. If the accounting entries are recorded without error, at any point in time the aggregate balance of all accounts having positive balances will be equal to the aggregate balance of all accounts having negative balances. The double-entry bookkeeping system ensures that the financial transaction has equal and opposite effects in at least two different accounts. Accounting entries use terms such as debit and credit to avoid confusion regarding the opposite effect of the accounting entry, e.g., if an accounting entry debits a particular account, the opposite account will be credited and vice versa. The rules for formulating accounting entries are known as "Golden Rules of Accounting". The accounting entries are recorded in the "Books of Accounts". Regardless of which accounts and how many are impacted by a given transaction, the fundamental accounting equation $A = L + OE$ will hold.

APPROACHES

There are two different approaches to the double-entry system of bookkeeping. They are Traditional Approach and Accounting Equation Approach. Irrespective of the two approaches, the effect on the books of accounts remain the same.

Traditional Approach

This approach is also called as the British Approach. Recording of business transactions under this method are formed on the basis of the existence of two aspects (debit and credit) in each of the transactions. Under the traditional approach, the transactions are entered in the books of accounts by following the golden rules of accounting. Under traditional approach, the accounts are classified based on their nature as real, personal and nominal accounts. After classifying the accounts, the following golden rules of accounting are applied to record the financial transaction:

1. **Personal Account:** Debit the receiver and credit the giver.
2. **Real Account:** Debit what comes in and credit what goes out.
3. **Nominal Account:** Debit all expenses and losses and credit all incomes and gains.

Accounting Equation Approach

This approach is also called as the American Approach. Under this approach, transactions are recorded based on the accounting equation, i.e., $Assets = Liabilities + Capital$. The accounting equation is a statement of equality between the debits and the credits. The rules of debit and credit depend on the nature of an account. For this purpose of accounting equation approach, all the accounts are classified into the following five types based on periodicity of flow as: Assets Accounts, Capital Account, Liabilities Accounts, Revenues or Incomes Accounts and Expenses or Losses Accounts.

If there is an increase or decrease in one account, there will be equal decrease or increase in another account. There may be equal increases to both accounts, depending on what kind of accounts they are. There may also be equal decreases to both accounts. Accordingly, the following rules of debit and credit in respect of the various categories of accounts can be obtained. The rules may be summarized as below:

1. **Assets Accounts:** Debit increases in assets and credit decreases in assets.
2. **Capital Accounts:** Credit increases in capital and debit decreases in capital.

- 3. **Liabilities Accounts:** Credit increases in liabilities and debit decreases in liabilities.
- 4. **Revenues or Incomes Accounts:** Credit increases in incomes and gains and debit decreases in incomes and gains.
- 5. **Expenses or Losses Accounts:** Debit increases in expenses and losses and credit decreases in expenses and losses.

Illustration 1: Classify the following accounts according to Traditional and Modern approach:

- 1. Capital a/c, 2. Drawings a/c, 3. Building purchased, 4. Purchases account, 5. Sales account, 6. Carriage inward, 7. Carriage outward, 8. Cash received, 9. Cash paid, 10. Interest paid, 11. Interest received, 12. Commission paid, 13. Commission received, 14. Discount allowed, 15. Conveyance charges, 16. Sales promotion expenses, 17. Entertainment expenses, 18. Subscription paid, 19. Subscription received, 20. Light, power and electricity, 21. Telephone, postage and telegram, 22. Repairs incurred, 23. Insurance premium paid, 24. Bad debts written off, 25. Bad debts recovered, 26. Discount received, 27. Postage and stationery purchased, 28. F&F purchased, 29. Bank a/c, 30. Wages and salaries paid, 31. Travelling expenses, 32. Current a/c of the partner, 33. Loan a/c of a partner, 34. Sales return, 35. Bank overdraft a/c, 36. Loan a/c of the partner, 37. O/s salaries a/c, 38. Prepaid rent a/c, 39. Interest accrued a/c, 40. Interest received in advance.

Solution:

According to Traditional Approach:

Personal a/c: 1, 2, 29, 32, 33, 35, 37, 38, 39, 40

Real a/c: 3, 8, 9, 28

Nominal a/c: 4, 5, 6, 7, 10, 11, 12, 13, 14, 15, 16, 17, 18, 19, 20, 21, 22, 23, 24, 25, 26, 27, 30, 31, 34, 36

According to Accounting Equation or Modern Approach:

Asset a/c: 3, 8, 9, 28, 29, 38, 39

Liabilities a/c: 33, 35, 37, 40

Capital a/c: 1, 2, 32

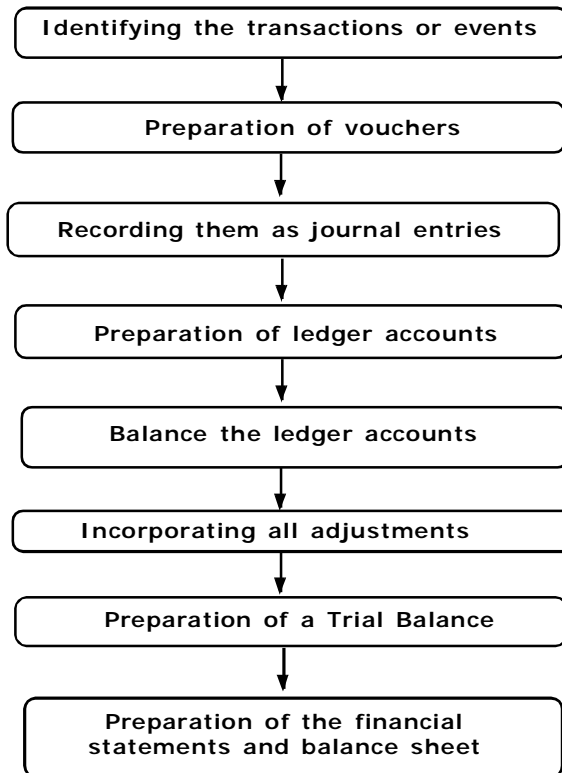
Revenue a/c: 5, 11, 13, 19, 25, 26, 34

Expenses a/c: 4, 6, 7, 10, 12, 14, 15, 16, 17, 18, 20, 21, 22, 23, 24, 27, 30, 31, 36

ACCOUNTING TRIAL

Accounting Trial is a sequential order in which the accounting process flows. All transactions are recorded first in a book called journal. The transactions are posted to the respective accounts, maintained in a separate book called ledger. Later, all adjustments such as opening entries, closing entries, adjusting entries are made in a book called journal proper and thereafter, the ledger balances are summarized to form a trial balance. From trial balance, trading account, profit and loss account and balance sheet are prepared.

Accounting trial is the process of:



Transactions and Events: A transaction is a business activity involving transfer of money or money's worth. It may be cash transaction or credit transaction. In cash transaction, cash flows immediately whereas in credit transaction, cash will be paid or received at future date. Assets acquired or sold, liabilities incurred or paid, expenses paid or payable, incomes received or receivable — are all business transactions. But there are events which are neither cash nor credit transactions but it has an impact on the financial position of a business. These events may include provision for bad debts, provision for repairs, depreciation, taxation, transfer of profit towards reserve fund or sinking fund or investment fluctuation fund, etc. Events happen as a result of internal policies or external needs. In accounting, transactions and events have equal relevance and they must be recorded to arrive at the financial results of the business concern.

Illustration 2: Analyze the following transactions according to traditional approach and modern approach:

- (a) Subramanya started his business with cash
- (b) Borrowed from Mahesh
- (c) Purchased furniture
- (d) Purchased furniture from Mohan on credit

- (e) Purchased goods for cash
- (f) Purchased goods from Ram on credit
- (g) Sold goods for cash
- (h) Sold goods to Shyam on credit
- (i) Received cash from Shyam
- (j) Paid cash to Ram
- (k) Deposited into bank
- (l) Withdrew cash for personal use
- (m) Withdrew from bank for office use
- (n) Withdrew from bank for personal use
- (o) Received a cheque from a customer, Shyam at 5 pm
- (p) Deposited Shyam's cheque next day
- (q) Bank intimated that Shyam's cheque was dishonoured
- (r) Paid Ram by cheque
- (s) Paid salary
- (t) Paid rent by cheque
- (u) Goods withdrawn for personal use
- (v) Paid an advance to suppliers of goods
- (w) Received an advance from customers
- (x) Paid interest on loan
- (y) Paid installment of loan
- (z) Interest allowed by bank

Solution:**Analysis of Transaction under Traditional Approach**

<i>Sl. No.</i>	<i>Account Involved</i>	<i>Nature of Account</i>	<i>How Affected?</i>	<i>Debit/ Credit</i>
(a)	Cash a/c Capital a/c	Real Personal	Cash is coming in Subramanya is the giver	Debit Credit
(b)	Cash a/c Loan from Mahesh	Real Personal	Cash is coming in Mahesh is the giver	Debit Credit
(c)	Furniture a/c Cash a/c	Real Real	Furniture is coming in Cash is going out	Debit Credit
(d)	Furniture a/c Cash a/c	Real Personal	Furniture is coming in Cash is going out	Debit Credit
(e)	Purchase a/c Cash a/c	Nominal Real	Purchase is an expense Cash is going out	Debit Credit
(f)	Purchase a/c Ram's a/c	Nominal Personal	Purchase is an expense Ram is the giver	Debit Credit
(g)	Cash a/c Sales a/c	Real Nominal	Cash is coming in Sales is a revenue	Debit Credit
(h)	Shyam's a/c Sales a/c	Personal Nominal	Shyam is the receiver Sales is a revenue	Debit Credit
(i)	Cash a/c Shyam's a/c	Real Personal	Cash is coming in Shyam is the giver	Debit Credit
(j)	Ram's a/c Cash a/c	Personal Real	Ram is the receiver Cash is going out	Debit Credit
(k)	Bank a/c Cash a/c	Personal Real	Shyam is the receiver Cash is going out	Debit Credit
(l)	Drawings a/c Cash a/c	Personal Real	Subramanya is the receiver Cash is going out	Debit Credit
(m)	Cash a/c Bank a/c	Real Personal	Cash is coming in Bank is the giver	Debit Credit
(n)	Drawings a/c Bank a/c	Personal Personal	Subramanya is the receiver Bank is the giver	Debit Credit
(o)	Cash a/c Shyam's a/c	Real Personal	Cash (Cheque) is coming in Bank is the giver	Debit Credit
(p)	Bank a/c Cash a/c	Personal Real	Bank is the receiver Cash (Cheque) is going out	Debit Credit
(q)	Shyam's a/c Bank a/c	Personal Personal	Shyam is the receiver Bank is the giver	Debit Credit
(r)	Ram's a/c Bank a/c	Personal Personal	Ram is the receiver Bank is the giver	Debit Credit

(s)	Salary a/c Cash a/c	Nominal Real	Salary is an expense Cash is going out	Debit Credit
(t)	Rent a/c Bank a/c	Nominal Personal	Rent is an expense Bank is the giver	Debit Credit
(u)	Drawings a/c Purchase a/c	Personal Nominal	Subramanya is the receiver Decrease in stock	Debit Credit
(v)	Advance to suppliers a/c Cash a/c	Personal Real	Suppliers are the receiver Cash is going out	Debit Credit
(w)	Cash a/c Advance from customers a/c	Real Personal	Cash is coming in Customers are the giver	Debit Credit
(x)	Interest on loan a/c Cash a/c	Nominal Real	Interest is expense Cash is going out	Debit Credit
(y)	Loan a/c Cash a/c	Personal Real	Lender is the receiver Cash is going out	Debit Credit
(z)	Bank a/c Bank interest a/c	Personal Nominal	Bank is the receiver Bank interest is an income	Debit Credit

Accounting Equation:

The preparation of balance sheet is the final step in accounting process. The accounting equation indicates that the sources of funds should be equal to uses of funds. In other words, proprietor's equity and liabilities to outsiders should be equal to assets.

Sources of Funds = Applications of funds OR

Owner's equity = Assets OR

Owner's equity + Outside liabilities = Assets

$$A = L + P$$

$$L = A - P$$

$$P = A - L$$

$A - L - P = \text{Zero}$, where L is liabilities, P is Proprietor' equity and A is Assets.

Steps involved in developing accounting equation:

- Ascertain the variables (assets, liabilities or capital) of an equation affected by the transaction.
- Find out the effect (in terms of increase or decrease) of a transaction on the variables of the equation.
- Show the effect on the appropriate side of an equation.

Illustration 3:**Transaction 1:** Started business with ₹ 1,00,000.

<i>Variable Affected</i>	<i>Asset and Capital</i>
Effect of the transaction	Increase in assets and capital
Accounting equation	Assets = Liabilities + Capital 1,00,000 = 0 + 1,00,000

Transaction 2: Purchased goods for cash ₹ 20,000.

<i>Variable Affected</i>	<i>Asset and Capital</i>
Effect of the transaction	Increase in assets (stock) and decrease in another asset (cash)
Accounting equation	Assets = Liabilities + Capital - 20,000 + 20,000 = 0 + 0

Transaction 3: Sold goods costing ₹ 10,000 for cash ₹ 12,000.

<i>Variable Affected</i>	<i>Asset and Capital</i>
Effect of the transaction	Increase in assets (cash) and decrease in another asset (stock) and increase in capital
Accounting equation	Assets = Liabilities + Capital - Stock + Cash - 10,000 + 12,000 = 0 + 2,000

Illustration 4: Show what accounts are affected in the following transactions. Also show the accounting equation for the transactions.

1. Madan commenced business with cash ₹ 70,000
2. Purchased goods on credit ₹ 14,000
3. Withdrew for private use ₹ 3,000
4. Goods purchased for cash ₹ 12,000
5. Paid wages ₹ 5,000
6. Paid to creditors ₹ 10,000
7. Sold goods on credit (cost price ₹ 18,000) ₹ 22,000
8. Sold goods for cash (Cost price ₹ 3,000) ₹ 6,000
9. Purchased furniture for cash ₹ 5,000
10. Received from debtors ₹ 11,000

Solution:

Analysis of Transaction under Traditional Approach

<i>Transaction No.</i>	<i>Accounts affected in the books of the business</i>	<i>Account to be debited and account to be credited</i>
1	Capital account and cash account	Cash account being real account is debited and Capital account being personal account is credited
2	Goods account and creditors account	Goods account being real account is debited and creditors account being personal account is credited
3	Personal drawings account and cash account	Drawings account being personal account is debited and cash account being real account is credited
4	Goods account and cash account	Cash account being real account is debited and cash account being real account is credited
5	Wages account and cash account	Wages account being nominal account is debited and cash account being real account is credited
6	Cash account and creditors account	Creditors account being personal account is debited and cash account being real account is credited
7	Goods account, Debtors account and profit account	Debtors account being personal account is debited, profit transferred to capital account being personal account is credited and goods account being real account is also credited
8	Furniture account and Cash account	Furniture account being real account is debited and cash account being real account is credited
9	Cash account and debtors account	Cash account being real account is debited and debtors account being personal account is credited

Accounting Equations for the Transactions

<i>Transaction</i>	<i>Assets =</i>				<i>Liabilities + Owner's Equity</i>	
	<i>Cash (+)</i>	<i>Goods (+)</i>	<i>Debtors (+)</i>	<i>Furniture (+)</i>	<i>Creditors (+)</i>	<i>Madan's Capital</i>
01	70,000					7,000
02		14,000			14,000	
03	-3,000					-3,000
04	-12,000	+12,000				
05	-5,000					-5,000
06	-10,000				-10,000	
07		-18,000	22,000			+4,000
08	+6,000	-3,000				+3,000
09	-5,000			5,000		
10	+11,000		-11,000			
End equation	52,000+	5,000+	11,000+	5,000+	4,000+	69,000
				= 73,000		= 73,000

SUBSIDIARY BOOKS

Journal is a book of original entry and only one journal is maintained if the business is very small in size and the transactions are limited. However, if the transactions are multifarious, then subsidiary books which are known as books of original entry are prepared. The types of subsidiary books include:

- (a) **Purchase Book:** To record all credit purchases of goods only.
- (b) **Sales Book:** To record all credit sales of goods only.
- (c) **Purchase Return Book:** To record goods returned to suppliers out of credit purchase.
- (d) **Sales Return Book:** To record goods returned by customers out of credit sales of goods.
- (e) **Cash Book:** To record all cash transactions only.
- (f) **Analytical Petty Cash Book:** To record petty payments.
- (g) **Bills Receivable Book:** To record all bills of exchange which are received from debtors.
- (h) **Bills Payable Book:** To record all bills of exchange accepted and given to creditors.
- (i) **Journal Proper:** It is used to record only those business transactions which cannot be entered in any of above eight books.

It will record following transactions:

- (a) Opening Entries
- (b) Adjustment Entries
- (c) Transfer Entries
- (d) Closing Entries
- (e) Rectification Entries
- (f) Dishonour of bills and Promissory note entries
- (g) Credit Purchase of Assets
- (h) Credit Sales of Assets
- (i) Bad Debts Entries

Format of Purchase Book

<i>Date</i>	<i>Name of Supplier</i>	<i>L.F.</i>	<i>Inward Invoice No.</i>	<i>Amt</i>

Format of Sales Book

<i>Date</i>	<i>Name of Customer</i>	<i>L.F.</i>	<i>Outward Invoice No.</i>	<i>Amt</i>

Format of Purchase Return Book

<i>Date</i>	<i>Name of the suppliers to whom goods are returned</i>	<i>L.F.</i>	<i>Debit Note No.</i>	<i>Amt</i>

Format of Sales Return Book

<i>Date</i>	<i>Name of the customer who returns the goods</i>	<i>L.F.</i>	<i>Credit Note No.</i>	<i>Amt</i>

Rules to Record a Transaction in Subsidiary Book

<i>Sr. No.</i>	<i>Transactions</i>	<i>In ledger</i>	<i>Reasons</i>
1.	Sales/Purchase Return	Party's a/c	Debit Receiver
2.	Purchase/Sales Return	Party's a/c	Credit Giver
3.	Total of Purchase Book	Purchase a/c	Debit Good comes in
4.	Total of Sales Book	Sales a/c	Credit Goods goes out
5.	Total of Purchase Return Book	Purchase Return a/c	Credit Goods goes out
6.	Total of Sales Return Book	Sales Return a/c	Debit Goods comes in

Trade Discount

It is a reduction granted by a supplier from the list price of goods or services on business consideration (such as quantity bought, trade practices etc). For prompt payment, cash discount is allowed.

Example: If 5 gold coins are sold at the list price of ` 15,000 each subject to trade discount of 12%, the trade discount will be calculated as under:

5 Gold coins @ ` 15,000	75,000
Less: Trade discount @ 12%	9,000
Amount payable as per invoice	<u>66,000</u>

Cash Discount

It is the reduction granted by the supplier from the invoice price in consideration of immediate payment or payment within a stipulated period.

Example: If 5 gold coins are sold at the list price of ` 15,000 each subject to trade discount of 12%, the invoice price after trade discount is ` 66,000. Cash discount terms are 2%, 30 days. This denotes the buyer will get 2% cash discount if he makes payment within 30 days. The cash discount is calculated as follows:

Amount payable as per invoice	66,000
Less: Cash discount @ 2%	1,320
Cash payable within 30 days	<u>64,680</u>

Difference between Trade Discount and Cash Discount:

1. Trade discount is a reduction granted by a supplier from the list price on goods or services on business considerations such as quantity bought, trade practices etc. while cash discount is a reduction granted from the invoice price in consideration of immediate payment or payment within a stipulated period.
2. Trade discount is allowed to promote the sales while cash discount is allowed to encourage early or prompt payment.
3. Trade discount is shown by the way of deduction in the invoice itself. Hence, no further entry is required in the books of accounts. Cash discount is shown as an expense in profit and loss account.
4. Trade discount may vary with the quantity purchased while cash discount varies with the period.

Illustration 5: From the following transactions, prepare the purchase book of Adithya Bros and post the transactions recorded in the Purchase book to the Ledger:

<i>Date</i>	<i>Invoice No.</i>	<i>Particulars</i>
5.3.20×1	442	Purchased on credit from Goyal Bros – 55 Polyester sarees @ ` 100 <i>Less:</i> Trade Discount @ 10%
8.3.20×1	445	Purchased for cash from Greg Mac – 100 Orissa cotton sarees @ ` 200
15.3.20×1	450	Purchased on credit from Adikari Mills – 10 Silk sarees @ 10%

Solution:**Purchase Book**

<i>Date</i>	<i>Purchase Invoice No.</i>	<i>Name of the supplier</i>	<i>L.F.</i>	<i>Details</i>	<i>Amount</i>
5.3.20×1	442	Goyal Bros <i>Less:</i> Trade Discount @ 10%		5,500 550	4,950
8.3.20×1	450	Adikari Mills <i>Less:</i> Trade Discount @ 10%		25,000 2,500	22,500

Cash purchases from Greg Mac will be recorded in cash book.

Ledger of Adithya Bros**Goyal Bros a/c**

<i>Date</i>	<i>Particulars</i>	<i>L.F.</i>	<i>Amount</i>	<i>Date</i>	<i>Particulars</i>	<i>L.F.</i>	<i>Amount</i>
				5.3.20×1	By Purchases a/c		4,950

Adikari Mills a/c

<i>Date</i>	<i>Particulars</i>	<i>L.F.</i>	<i>Amount</i>	<i>Date</i>	<i>Particulars</i>	<i>L.F.</i>	<i>Amount</i>
				8.3.20×1	By Purchases a/c		22,500

Purchases a/c

Date	Particulars	L.F.	Amount	Date	Particulars	L.F.	Amount
31.3.20×1	To Sundries as per purchase book		27,450				

Observe that in every case of credit purchase, the supplier's account is credited and goods account is debited.

At the end of the day or week or month, the total of purchases is transferred to one ledger account known as Purchases account in the ledger.

Illustration 6: From the following transactions, prepare the Sales Book of Adithya Bros and post the transactions recorded in the Sales book to the Ledger:

Date	Invoice No.	Particulars
5.3.20×1	442	Sold on credit from Goyal Bros – Polyester sarees @ ` 100 <i>Less:</i> Trade Discount @ 10%
8.3.20×1	450	Sold on credit from Adikari Mills – 10 silk sarees @ ` 2,500 <i>Less:</i> Trade Discount @ 10%

Solution:

Sales Book

Date	Sales Invoice No.	Name of the supplier	L.F.	Details	Amount
5.3.20×1	442	Goyal Bros <i>Less:</i> Trade Discount a 10%		5,500 550	4,950
8.3.20×1	450	Adikari Mills <i>Less:</i> Trade Discount a 10%		25,000 2500	22,500

Cash Sales from Greg Mac will be recorded in cash book.

**Ledger of Adithya Bros
Goyal Bros a/c**

Date	Particulars	L.F.	Amount	Date	Particulars	L.F.	Amount
5.3.20×1	To Sales a/c		4,950				

Adikari Mills a/c

Date	Particulars	L.F.	Amount	Date	Particulars	L.F.	Amount
8.3.20×1	To Sales a/c		22,500				

Sales a/c

Date	Particulars	L.F.	Amount	Date	Particulars	L.F.	Amount
				5.3.20×1	By Sundries as per sales book		27,450

Example:**Bills Receivable Book of Sham Sunder & Co.**

<i>No. of the Bill</i>	<i>Date of Receipt</i>	<i>From Whom Received</i>	<i>Acceptor</i>	<i>Where payable</i>	<i>Term of the Bill</i>	<i>Due Date</i>	<i>L.F.</i>	<i>Amount</i>	<i>Remarks</i>
1	04.7.04	04.7.04	Mr. X	Delhi	3 mths	7.10.04		7,000	
2	1.8.04	01.8.04	Mr. Y	Noida	4 mths	4.12.04		9,000	
3	9.9.04	09.9.04	Mr. A	Agra	3 mths	12.12.04		12,000	
4	10.9.04	10.9.04	Mr. B	Delhi	4 mths	13.1.04		10,000	
								38,000	

For every bill, the due date is calculated after adding three days of grace. The total of the bill receivable is transferred to bills receivable account in the ledger. The bills receivable account shows debit balance and the amount receivable against them is an asset.

Example:**Bills Payable Book of Sun Shine Co.**

<i>No. of the Bill</i>	<i>Date of Receipt</i>	<i>To Whom Given</i>	<i>Drawer</i>	<i>Payee</i>	<i>Where Payable</i>	<i>Due Date</i>	<i>L.F.</i>	<i>Amount</i>	<i>Date of Payment</i>	<i>Remarks</i>
1	7.6.2000	Ram & Co.	Ram & Co.	Agra	3 mths	10.9.2000		56,000		
2	12.6.2000	Sunder	Sunder	Delhi	4 mths	15.10.2000		72,000		
3	20.6.2000	KV. & Co.	KV & Co.	Chennai	5 mths	23.11.2000		50,000		
								1,78,000		

CASH BOOK

The cash book is a book of original entry where all cash and bank transactions relating to receipts and payments are recorded. It serves the purpose of journal as well as ledger.

Since the cash book enables the trader to find out the daily cash and bank balance, there is no need to open separate Cash a/c and Bank a/c.

Different Types of Cash Book:

- (i) Simple Cash Book is single column cash book with one cash column on each side.
- (ii) Double column cash book, viz., Cash and Discount column on each side.
- (iii) Triple column cash book, viz., Cash, Discount and Bank column on each side.

Example:

Single Column Cash Book of Rekha & Bros

<i>Date</i>	<i>Receipts</i>	<i>Cash</i>	<i>Date</i>	<i>Payments</i>	<i>Cash</i>
2003			2003		
July 1	To Balance b/d	4,500	July 1	By Rent of shop	900
4	To Sales	8,050	3	By Postage	50
10	To Interest on FD	2,000	14	By Purchases	7,000
20	To Commission	4,000	20	By Stationery	800
28	To Sale of goods	10,000	28	By Wages	2,000
30	To Balagopalan	5,000	31	By Narasimhan	9,000
				By Balance c/d	13,800
	Total	33,550		Total	33,550

Example:

Two Column Cash Book of Simpson Co.

<i>Date</i>	<i>Receipts</i>	<i>Cash ()</i>	<i>Bank ()</i>	<i>Date</i>	<i>Payments</i>	<i>Cash ()</i>	<i>Bank ()</i>
2003				2003			
Apr 5	To Balance b/d	1,500	13,000	Apr 2	By Wages		400
	To Sales	800		5	By Electricity	50	
7	To Ashok Co.		2,000	8	By Repairs	400	
11	To Beta Co.		2,350	15	By Venki Ltd.		10,800
20	To Sales	500		30	By Balance b/d	2,350	6,150
	Total	2,800	17,350		Total	2,800	17,350

Example:

Three Column Cash Book of Janardhan Works

<i>Date</i>	<i>Receipts</i>	<i>Discount</i>	<i>Cash</i>	<i>Bank</i>	<i>Date</i>	<i>Payment</i>	<i>Discount</i>	<i>Cash</i>	<i>Bank</i>
2002					2002				
Jan 2	To Balance b/d		3,700	4,500	Jan 6	By Wages		1,550	
5	To Patel	100	2,400		3	By Agarwal	50	950	
10	To Neelima			6,000	15	By Cash (C)			3,000
15	To Bank (C)		3,000		22	By Drawings			2,000
30	To Cash (C)			1,000	30	By Bank (C)		1,000	
31	To Dividend from X Co.			2,000	31	By Rent			1,500
					31	By Bal c/d		5,600	7,000
	Total	100	9,100	13,500			50	9,100	13,500

Note the following points from the above illustration:

- (a) Discount column on the debit side represents discount allowed and on the credit side, it represents discount received. Balancing is not done for these columns for a simple reason to find out separately the discount allowed and discount received.

- (b) There are two contra entries each on 15th and 30th. On 15th, the transaction is cash withdrawn from bank ₹ 3,000. It is a payment from bank and it is receipt to business cash. Similarly, on 30th, cash is deposited to bank ₹ 1,000. It is a receipt to the bank account and payment from cash account.
- (c) To indicate contra entry, “C” is mentioned against the entry.
- (d) Drawings represent the amount withdrawn from bank for business purposes.
- (e) Dividend from X Co. is received by cheque and the company should have remitted the dividend directly to the bank account of the businessman.
- (f) The balance c/d is the closing balance for the month of January 2002 and this becomes opening balance for February 2002.

Illustration 7: Enter the following transactions in the single column cash book of Gopichand.

March, 2003

1 st	Commenced business with cash	20000
2 nd	Bought goods for cash	5000
3 rd	Sold goods for cash	4000
4 th	Goods purchased from Ravi Kumar	10000
10 th	Paid to Ravi Kumar	7000
14 th	Cash sales	8000
18 th	Purchased furniture for office	4000
22 nd	Paid wages	500
25 th	Paid rent	600
30 th	Received commission	4000
30 th	Withdrew for personal purpose	1000
31 st	Paid salary	900

Solution:

Cash Book of Gopichand

<i>Date</i>	<i>Particulars</i>	<i>Amount</i>	<i>Date</i>	<i>Particulars</i>	<i>Amount</i>
2003			2003		
March 1 st	To Capital	20,000	March 2 nd	By Goods	5000
3 rd	To Sales	4,000	10 th	By Ravi Kumar	7000
14 th	To Sales	8,000	18 th	By Office furniture	4000
	To Commission	4,000	22 nd	By Wages	500
			25 th	By Rent	600
			30 th	By Drawings	1000
			31 st	By Salary	900
			31 st	By Balance c/d	17,000
		36,000			36,000

Hint: Goods purchased from Ravi Kumar is a credit purchase.

Illustration 8: Record the following transactions in two column cash book (Cash and Bank) in the books of Soft Silk Co. for the month of July, 2004. Find out the closing balances for the month of July 2004.

July, 2004

01 st	Opening balance b/d (Cash)	14,500
	Opening balance b/d (Bank)	7,000
04 th	Cash purchases	6,700
05 th	Rent for June month paid by cheque	2,500
09 th	Cash sales	15,200
12 th	Dividend paid by cheque	4,350
15 th	Cash deposited into bank	5,000
18 th	Cash paid to Rahim & Bros to settle his account	10,000
20 th	Repairs paid	1,000
22 nd	Commission paid by cheque	2,000
23 rd	Customer, Deepak remitted to our bank account	20,000
25 th	Cash withdrawn from bank for office use	5,000
27 th	Drawings made from business cash for personal purpose	2,000
28 th	Purchased stationery by cash	3,000
30 th	Cash withdrawn for personal use from bank	1,400

Solution:

Two Column Cash Book

<i>Date</i>	<i>Particulars</i>	<i>Cash</i>	<i>Bank</i>	<i>Date</i>	<i>Particulars</i>	<i>Cash</i>	<i>Bank</i>
July 04				July 04			
1 st	To Op bal b/d	14,500	7,000	4 th	By Purchases	6,700	
9 th	To Sales	15,200		5 th	By Rent		2,500
15 th	To Cash (C)		5,000	12 th	By Dividend paid		4,350
23 rd	To Deepak		20,000	15 th	By Bank (C)	5,000	
25 th	To Bank (C)	5,000		18 th	By Rahim & Bros	10,000	
				20 th	By Repairs	1,000	
				22 nd	By Comm. paid		2,000
				25 th	By Cash (C)		5,000
				27 th	By Drawings	2,000	
				28 th	By Stationery	3,000	
				30 th	By Drawings		1,400
				30 th	By Balance c/d	7,000	16,750
		34,700	32,000			34,700	32,000
	To Balance b/d	7,000	16,750				

Illustration 9: Enter the following transactions in the cash book with discount, cash and bank columns. Prepare three columnar cash book for the month of May.

May 1 st	Balance of cash in hand ` 14,000; bank overdraft at bank ` 5,000
4 th	Invested further capital ` 10,000 out of which ` 6,000 was deposited in the bank
6 th	Sold goods for cash ` 30,000
6 th	Collected from debtors of last year ` 80,000; Discount allowed to them ` 2,000
10 th	Purchased goods for cash ` 55,000
11 th	Paid Ram Vilas, our creditor ` 25,000; discount allowed by him ` 650
13 th	Commission paid to our agent ` 5,300
14 th	Office furniture purchased for cash ` 2,000
14 th	Rent paid ` 400; electricity charges paid ` 1,000
14 th	Drew cheque for personal use ` 7,000
17 th	Cash sales ` 25,000
18 th	Collection from Atal Bihari ` 40,000, deposited in the bank on 19 th April
19 th	Drew from the bank for office use ` 5,000
22 nd	Drew cheque for petty expenses ` 1,500
24 th	Dividend received by cheque ` 500, deposited in the bank on the same day
25 th	Commission received by cheque ` 2,300, deposited in the bank on 28 th April
29 th	Drew from the bank for salary of the office staff ` 15,000
30 th	Deposited cash in the bank ` 10,000.

Solution:**Three Column Cash Book**

<i>Particulars</i>	<i>Disc `</i>	<i>Cash `</i>	<i>Bank `</i>	<i>Particulars</i>	<i>Disc `</i>	<i>Cash `</i>	<i>Bank `</i>
To Balance b/d		14,000		By Balance b/d			5,000
To Capital		4000	6000	By Purchases		55,000	
To Sales		30,000		By Ram Vilas	650	25,000	
To Debtors	2,000	80,000		By Commission		5,3000	
To Sales		25,000		By Office furniture		2,000	
To Atal Bihari		40,000		By Rent		400	
To Cash (C)			40,000	By Electricity		1,000	
To Bank (C)		5,000		By Drawings			7,000
To Dividend			500	By Bank (C)		40,000	
To Comm.		2,300		By Cash (C)			5,000
To Cash (C)			2300	By Petty expenses			1,500
To Cash (C)			10,000	By Bank (C)		2,300	
				By Salary			15,000
				By Bank (C)		10,000	
				By Balance c/d		59,300	25,300
Total	2,000	2,00,300	58,800	Total	650	2,00,300	58,800

PETTY CASH BOOK

Petty cash book is a separate cash book where we record small or petty cash expenses of routine nature. It is of two types:

- (i) Simple Petty Cash Book
- (ii) Analytical or Columnar Petty Cash Book

In large organizations, petty expenses like stationery, postage, stamps, refreshments, carriage, cartage, daily wages etc. are incurred day in and day out. All these expenses are more in number and very insignificant in value. To look after payment of such expenses, a separate petty cashier is appointed who obtains a definite sum of money at the beginning of a month and gives a statement of account at the end of the period to the chief cashier. To record such payments, a separate book, known as petty cash book is maintained.

There is a distinct method, namely Imprest system which is adopted in maintaining such petty cash book. Under this system, at the beginning of a month, a definite sum of money is given by chief cashier to petty cashier for petty expenses. At the commencement of the next period, the petty cashier is reimbursed equal to what he had spent during the earlier period.

Illustration 10: Enter the following transactions in an analytical petty cash book. Also open relevant ledger accounts.

2005 Nov

1 st	Received a cheque for petty cash	₹ 1,000
2 nd	Paid bus fare to messengers	₹ 50
4 th	Paid auto fare	₹ 70
10 th	Postal stamps purchased	₹ 80
12 th	Paid for stationery	₹ 90
15 th	Paid for carriage	₹ 60
16 th	Purchased envelopes	₹ 50
20 th	Wages paid	₹ 100
25 th	Tips given to driver	₹ 50
30 th	Telephone calls paid	₹ 20

Solution:

Petty Cash Book

Date	Particulars	Amount	Date Nov	Particulars	V. No.	Total payments	Analysis of Payments						L.F.	Ledger a/cs
							Tra	Post	Carr	P & S	Wages	Sundry Exps		
Nov 1	To Bank	100	1st	By Bus fare		50	50							
			2	By Auto fare		70	70							
			4	By Postal		80			80					
			10	By Stationery		90					90			
			12	By Carriage		60				60				
			15	By Envelopes		50					50			
			16	By Wages		100						100		
			20	By Tips		50							50	
			25	By Telegram		20				20				
			30	Total exp				570	120	100	60	140	100	50
			No 30	By Balance c/d		430								
				Total		1000								
Dec 1 st	To Bal b/d	430												
	To Cash	570												

Cash Book

Date	Receipts	Amount	Date	Payments	Amount
			1 st Nov	By Petty cash	1,000

Ledger

Travelling Expenses Account

Date	Receipts	Amount	Date	Payments	Amount
1 st Nov	To Petty cash	120			

Postage Expenses Account

Date	Receipts	Amount	Date	Payments	Amount
1 st Nov	To Petty cash	100			

Carriage Expenses Account

<i>Date</i>	<i>Receipts</i>	<i>Amount</i> `	<i>Date</i>	<i>Payments</i>	<i>Amount</i> `
1 st Nov	To Petty cash	60			

Printing and Stationery Account

<i>Date</i>	<i>Receipts</i>	<i>Amount</i> `	<i>Date</i>	<i>Payments</i>	<i>Amount</i> `
1 st Nov	To Petty cash	140			

Wages Account

<i>Date</i>	<i>Receipts</i>	<i>Amount</i> `	<i>Date</i>	<i>Payments</i>	<i>Amount</i> `
1 st Nov	To Petty cash	100			

Sundry Expenses Account

<i>Date</i>	<i>Receipts</i>	<i>Amount</i> `	<i>Date</i>	<i>Payments</i>	<i>Amount</i> `
1 st Nov	To Petty cash	50			

Illustration 11: Prepare petty cash book on imprest system from the following particulars:

- (i) Jan 1st Received for petty cash payment ` 500/-
- (ii) Jan 2nd Paid for postage ` 40/-
- (iii) Jan 5th Paid for stationery ` 25/-
- (iv) Jan 8th Paid for advertisement ` 150/-
- (v) Jan 12th Paid for wages ` 50/-
- (vi) Jan 16th Paid for carriage ` 25/-
- (vii) Jan 20th Paid for conveyance ` 22/-
- (viii) Jan 25th Paid for travelling expenses ` 80/-
- (ix) Jan 27th Paid for postage ` 50/-
- (x) Jan 28th Paid wages to cleaner ` 10/-
- (xi) Jan 30th Paid for telegram ` 20/-
- (xii) Jan 30th Sent registered notice ` 10/-

Solution:**Petty Cash Book**

<i>Cash recd</i>	<i>Date</i>	<i>Particulars</i>	<i>L.F.</i>	<i>Total Pay-ment</i>	<i>Postage & tele-gram</i>	<i>Carriage</i>	<i>Printing & stry</i>	<i>Advt</i>	<i>Travel exp.</i>	<i>Wages</i>	<i>Sundry</i>
500	1996										
	Jan										
	1 st	To Cash									
	2 nd	By Postage		40	40						
	5 th	By Stationery		25			25				
	8 th	By Advt		150				150			
	12 th	By Wages		50						50	
	16 th	By Carriage		25		25					
	20 th	By Conveyance		22					22		
	25 th	By Travelling		80					80		
	27 th	By Postage		50	50						
	28 th	By Wages		10						10	
	30 th	By Telegram		20	20						
	30 th	By Register		10	10						
				482	120	25	25	150	102	60	
	30 th	By Balance b/d		18							
500				500							
18	July 1 st	By Balance b/d									
482	July 1 st	To Cash									

JOURNAL PROPER

This book is used to record all transactions which cannot be included in the cash book or any of the other six subsidiary books discussed so far. The transactions that will be recorded in Journal Proper are purchase or sale of fixed assets and investments on credit, adjusting entries, rectification entries, etc.

Journal Proper of Excellent Enterprises

<i>Date</i>	<i>Particulars</i>	<i>Doc Ref</i>	<i>Ledger Folio</i>	<i>Debit</i>	<i>Credit</i>
Apr. 10	Furniture and Fittings a/c Dr. To Furniture Mart a/c (Being the purchase of furniture on credit)			4,000	4,000
30	Repairs to Machinery a/c Dr. To Machinery a/c (Being the rectification of a wrong posting of a repair expense to asset a/c)			500	500

Illustration 12: During January 19x1, Narayan transacted the following business:

Dates

1	Commenced business with cash	40,000
2	Purchased goods on credit from Shyam	30,000
3	Purchased goods for cash	1,000
4	Paid Gopalan an advance for goods ordered	2,000
5	Received cash from Murthy as advance for goods ordered by him	3,000
6	Purchased furniture for goods for office use for cash	2,000
7	Paid wages	500
8	Received commission (in cash)	600
9	Goods returned to Shyam	200
10	Goods sold to Kamal	10,000
12	Paid for postage and telegrams	200
13	Goods returned by Kamal	500
15	Paid for stationery	200
18	Paid into bank	500
20	Goods sold for cash	750
22	Bought goods for cash	1,000
25	Paid salaries	700
28	Paid rent	500
31	Drew cash for personal use	1,000

Solution:

Journal Entries

<i>Date</i>	<i>Particulars</i>	<i>Debit</i>	<i>Credit</i>
Jan 1	Cash Account Dr. To Narayan's Capital Account (Being the cash brought into business as capital) <i>(Logic:</i> Cash is a real account. Debit what comes in. Proprietor's capital is a personal account. Credit the giver.)	40,000	40,000
Jan 2	Purchases Account Dr. To Shyam's Account (Being the goods purchased on credit) <i>(Logic:</i> Purchases is expenses. Debit all expenses. Shyam is a personal account. Credit the giver.)	30,000	30,000
Jan 3	Purchases Account Dr. To Cash Account (Being the goods purchased for cash) <i>(Logic:</i> Purchases is expenses. Debit all expenses. Cash is a real account. Credit what goes out.)	1,000	1,000

Jan 4	Gopalan's Account To Cash Account (Being the amount paid to Gopalan) (Logic: Gopalan is a personal account. Debit the receiver. Cash is a real account. Credit what goes out.)	Dr.	2,000	2,000
Jan 5	Cash Account To Murthy's Account (Being the cash received from Murthy) (Logic: Cash is a real account. Debit what comes in. Murthy is a personal account. Credit the giver.)	Dr.	3,000	3,000
Jan 6	Furniture Account To Cash Account (Being the furniture purchased for office use for cash) (Logic: Furniture is a real account. Debit what comes in. Cash is a real account. Credit what goes out.)	Dr.	2,000	2,000
Jan 7	Wages Account To Cash Account (Being the wages paid) (Logic: Wages is a nominal account. Debit all expenses. Cash is a real account. Credit what goes out.)	Dr.	500	500
Jan 8	Cash Account To Commission Received Account (Being the commission received) (Logic: Cash is a real account. Debit what comes in. Commission (received) is a nominal account. Credit all incomes.)	Dr.	600	600
Jan 9	Shyam's Account To Purchase Returns Account (Being goods returned to Shyam) (Logic: Shyam is a personal account. Debit the receiver. Purchase returns is nominal a/c. Credit all income.)	Dr.	200	200
Jan 10	Kamal's Account To Sales Account (Being goods sold to Kamal on credit) (Logic: Kamal is a personal account. Debit the receiver. Sale is nominal a/c. Credit all incomes)	Dr.	10,000	10,000
Jan 12	Postage & Telegrams Account To Cash Account (Being the amount paid for postage & telegrams) (Logic: Postage and telegrams is a nominal account. Debit all expenses. Cash is a real account. Credit the giver.)	Dr.	200	200
Jan 13	Sales Return Account To Kamal's Account (Being the goods returned by Kamal) (Logic: Sales returns is nominal account. Debit all reduction in income. Kamal is a personal account. Credit the giver.)	Dr.	500	500

Jan 15	Stationery Account To Cash Account (Being the amount paid for stationery) (Logic: Stationery is a nominal account. Debit all the expenses. Cash is a real account. Credit what goes out.)	Dr.	200	200
Jan 18	Bank Account To Cash Account (Being the amount deposited into the bank) (Logic: Bank is a real account. Debit what comes in. Cash is a real account. Credit what goes out.)	Dr.	500	500
Jan 20	Cash Account To Sales Account (Being the goods sold for cash) (Logic: Cash is a real account. Debit what comes in. Sales is income. Credit all income.)	Dr.	750	750
Jan 22	Purchase Account To Cash Account (Being the goods purchase for cash) (Logic: Purchase is expenses. Debit all the expenses. Cash is a real account. Credit what goes out.)	Dr.	1,000	1,000
Jan 25	Salaries Account To Cash Account (Being the amount paid as salaries) (Logic: Salaries is a nominal account. Debit all expenses. Cash is a real account. Credit what goes out.)	Dr.	700	700
Jan 28	Rent Account To Cash Account (Being the rent paid) (Logic: Rent is a nominal account. Debit all the expenses. Cash is a real account. Credit what goes out.)	Dr.	500	500
Jan 31	Narayan's Drawings Account To Cash Account (Being the cash drawn for personal use) (Logic: Personal drawing is a personal account. Debit the receiver. Cash is a real account. Credit what goes out.)	Dr.	1,000	1,000

POSTING IN THE LEDGER ACCOUNTS

Now let us prepare the ledger accounts based on the entries passed earlier. A separate account is opened in ledger for each account. All the debit entries and credit entries are duly entered. At the end, the accounts are properly balanced. In other words, the total of all debit entries is adjusted against the total of credit entries and balance is brought forward to the next accounting period.

Cash Book, Subsidiary Books and General Ledger**Cash Book**

Dr.					Cr.				
Date	Receipts	Ledger Folio	Cash	Bank	Date	Payments	Ledger Folio	Cash	Bank
19×1					19×1				
Jan. 1	To Capital a/c		40,000		Jan. 3	By Purchase a/c		1,000	
Jan. 5	To Murthy's a/c		3,000		Jan. 4	By Gopalan a/c		2,000	
Jan. 8	To Commission a/c		600		Jan. 6	By Furniture a/c		2,000	
Jan. 18	To Cash a/c	C		500	Jan. 7	By Wages a/c		500	
Jan. 20	To Sales a/c		750		Jan. 12	By Postage & Telegrams a/c		200	
					Jan. 15	By Stationery a/c		200	
					Jan. 18	By Bank a/c	C	500	
					Jan. 22	By Purchase a/c		1,000	
					Jan. 25	By Salary a/c		700	
					Jan. 28	By Rent a/c		500	
					Jan. 31	By Drawings a/c		1,000	
					Jan. 31	By Balance c/d		34,350	500
			44,350	500				44,350	500

Note: The letter 'C' in the Ledger Folio column denotes a 'contra entry'. That is an entry for which the debit and credit aspects are found in the Cash Book itself.

Purchases Book

Date	Name of Supplier	Ledger Folio	Inward Invoice No.	Amount
19×1				
Jan. 2	Shyam			30,000
			Total	30,000

Purchase Returns Book

Date	Name of Supplier	Ledger Folio	Inward Invoice No.	Amount
19×1				
Jan. 9	Shyam			200
			Total	200

Sales Book

Date	Name of Customer	Ledger Folio	Outward Invoice No.	Amount
19×1				
Jan. 10	Kamal			10,000
			Total	10,000

Sales Return Book

<i>Date</i>	<i>Name of Customer</i>	<i>Ledger Folio</i>	<i>Credit Notes No.</i>	<i>Amount</i>
19×1 Jan. 13	Kamal			500
			Total	500

General Ledger

Capital Account

Dr.

Cr.

<i>Date</i>	<i>Particulars</i>	<i>JF No.</i>	<i>Amount</i>	<i>Date</i>	<i>Particulars</i>	<i>JF No.</i>	<i>Amount</i>
19×1 Jan. 31	To Balance c/d		40,000	19×1 Jan. 1	By Cash a/c		40,000
			40,000				40,000
				Feb. 1	By Balance b/d		40,000

Shyam's Account

Dr.

Cr.

<i>Date</i>	<i>Particulars</i>	<i>JF No.</i>	<i>Amount</i>	<i>Date</i>	<i>Particulars</i>	<i>JF No.</i>	<i>Amount</i>
19×1 Jan. 9	To Purchase Returns		200	19×1 Jan. 1	By Purchases a/c		30,000
Jan. 31	To Balance c/d		29,800				
			30,000				30,000
				Feb. 1	By Balance b/d		29,800

Purchase Account

Dr.

Cr.

<i>Date</i>	<i>Particulars</i>	<i>JF No.</i>	<i>Amount</i>	<i>Date</i>	<i>Particulars</i>	<i>JF No.</i>	<i>Amount</i>
19×1 Jan. 2	To Shyam a/c		30,000	19×1 Jan. 31	By Balance c/d		32,000
Jan. 3	To Cash		1,000				
Jan. 22	To Cash		1,000				
			32,000				32,000
Feb. 1	To Balance b/d		32,000				

Wages Account

Dr. **Cr.**

<i>Date</i>	<i>Particulars</i>	<i>JF No.</i>	<i>Amount</i>	<i>Date</i>	<i>Particulars</i>	<i>JF No.</i>	<i>Amount</i>
19×1 Jan 7	To Cash a/c		500	19×1 Jan. 31	By Balance c/d		500
			500				500
Feb.1	To Balance b/d		500				

Commission Received Account

Dr. **Cr.**

<i>Date</i>	<i>Particulars</i>	<i>JF No.</i>	<i>Amount</i>	<i>Date</i>	<i>Particulars</i>	<i>JF No.</i>	<i>Amount</i>
19×1 Jan. 1	To Balance c/d		600	19×1 Jan. 31	By Cash a/c		600
			600				600
				Feb.1	By Balance b/d		600

Kamal's Account

Dr. **Cr.**

<i>Date</i>	<i>Particulars</i>	<i>JF No.</i>	<i>Amount</i>	<i>Date</i>	<i>Particulars</i>	<i>JF No.</i>	<i>Amount</i>
19×1 Jan. 10	To Sales a/c		10,000	19×1 Jan. 31	By Sales returns a/c		500
			10,000	Jan. 31	By Balance c/d		9,500
Feb.1	To Balance b/d		9,500				10,000

Postage and Telegrams Account

Dr. **Cr.**

<i>Date</i>	<i>Particulars</i>	<i>JF No.</i>	<i>Amount</i>	<i>Date</i>	<i>Particulars</i>	<i>JF No.</i>	<i>Amount</i>
19×1 Jan. 10	To Cash a/c		200	19×1 Jan. 31	By Balance c/d		200
			200				200
Feb.1	To Balance b/d		200				

Stationery Account

Dr.				Cr.			
<i>Date</i>	<i>Particulars</i>	<i>JF No.</i>	<i>Amount</i>	<i>Date</i>	<i>Particulars</i>	<i>JF No.</i>	<i>Amount</i>
19×1 Jan. 15	To Cash a/c		200	19×1 Jan. 31	By Balance c/d		200
			200				200
Feb.1	To Balance b/d		200				

Salaries Account

Dr.				Cr.			
<i>Date</i>	<i>Particulars</i>	<i>JF No.</i>	<i>Amount</i>	<i>Date</i>	<i>Particulars</i>	<i>JF No.</i>	<i>Amount</i>
19×1 Jan. 25	To Cash a/c		700	19×1 Jan. 31	By Balance c/d		700
			700				700
Feb.1	To Balance b/d		700				

Rent Account

Dr.				Cr.			
<i>Date</i>	<i>Particulars</i>	<i>JF No.</i>	<i>Amount</i>	<i>Date</i>	<i>Particulars</i>	<i>JF No.</i>	<i>Amount</i>
19×1 Jan. 28	To Cash a/c		500	19×1 Jan. 31	By Balance c/d		500
			500				500
Feb.1	To Balance b/d		500				

Drawings Account

Dr.				Cr.			
<i>Date</i>	<i>Particulars</i>	<i>JF No.</i>	<i>Amount</i>	<i>Date</i>	<i>Particulars</i>	<i>JF No.</i>	<i>Amount</i>
19×1 31	To Cash a/c		1,000	19×1 Jan. 31	By Balance c/d		1,000
			1,000				1,000
Feb.1	To Balance b/d		1,000				

Murthy's Account

Dr. **Cr.**

<i>Date</i>	<i>Particulars</i>	<i>JF No.</i>	<i>Amount</i>	<i>Date</i>	<i>Particulars</i>	<i>JF No.</i>	<i>Amount</i>
19×1 Jan. 31	To Balance c/d		3,000	19×1 Jan. 5	By Cash a/c		3,000
			3,000				3,000
				Feb.1	By Balance b/d		3,000

Furniture Account

Dr. **Cr.**

<i>Date</i>	<i>Particulars</i>	<i>JF No.</i>	<i>Amount</i>	<i>Date</i>	<i>Particulars</i>	<i>JF No.</i>	<i>Amount</i>
19×1 Jan. 6	To Cash a/c		2,000	19×1 Jan. 31	By Balance c/d		2,000
			2,000				2,000
Feb.1	To Balance b/d		2,000				

Notes:

- (i) In a specific ledger, Ledger A/c can never be debited on credited.
- (ii) If Ledger a/c is having an opening balance, then it will start with the word "Balance b/d" (i.e., brought down). However, if the Ledger a/c is having a closing balance, then it will close with the word "Balance c/d" (i.e., carried down).
- (iii) All closing balance of Ledger a/c is transferred to "Trial Balance" at the end of every financial year.
- (iv) Trial Balance is a statement showing the list of accounts with their closing balance, i.e., either debit or credit balance.

TRIAL BALANCE

It shows "ARITHMETICAL ACCURACY" of ledger posting. It should be tallied. If there is any difference, for time being it should be transferred to "SUSPENSE a/c".

There are two types of "Trial Balance". They are as follows:

Journal Form/Statement Form of Trial Balance

Trial Balance of.....as on

<i>Sr. No</i>	<i>Particulars</i>	<i>L.F.</i>	<i>Debit bl.</i>	<i>Credit bl.</i>
	Capital		**	
	Assets			**
	Total		**	**

Ledger Form of Trial Balance

Trial Balance of.....as on.....

<i>Sr.</i>	<i>Particulars</i>	<i>Debit</i>	<i>Sr.</i>	<i>Particulars</i>	<i>Credit</i>
1.	Purchase	**	1.	Sales	**
2.	Sales Return/Return Inward	**	2.	Purchase Returns/Return Outward	**
3.	Expenses/Losses	**	3.	Incomes/Gain	**
4.	Bad Debts	**	4.	Bad Debts Recovery	**
5.	Stock	**	5.	Gross Profit	**
6.	Drawings	**	6.	Capital	**
7.	Debtors	**	7.	Creditors	**
8.	Bills Receivable	**	8.	Bills Payable	**
9.	Cash/Bank Balance	**	9.	Bank Overdraft	**
10.	Prepaid Expenses	**	10.	Outstanding Expenses	**
11.	Outstanding Incomes	**	11.	Advance income	**
12.	Loan given	**	12.	Loan taken	**
13.	Depreciation	**	13.	Reserves/Funds	**
14.	All Assets	**	14.	All Liabilities	**
	Total	**		Total	**

Illustration 13: From the above ledger accounts of Mr. Narayan for January 19x1, prepare a trial balance.

Trial Balance of Mr. Narayan as on January 19x1

<i>Particulars</i>	<i>Debit</i>	<i>Particulars</i>	<i>Credit</i>
Purchase	32,000	Sales	10,750
Sales Return/Return Inward	500	Purchase Return/Return Outward	200
Wages	500	Commission Received	600
Postage and Telegrams	200	Capital	40,000
Stationery Account	200	Creditors (Shyam)	29,800
Drawings	1,000	Creditors (Murthy)	3,000
Debtors (Gopalan)	2,000		
Debtors (Kamal)	9,500		
Cash	34,750		
Bank Balance	500		
Salaries	700		
Rent	500		
Furniture	2,000		
Total	84350	Total	84350

Opening Journal Entries: In the case of running business, all the assets and liabilities of the previous year should be brought down to the current year and therefore an entry is drawn debiting all assets account individually and crediting liabilities account individually and the difference being credited to capital account.

Illustration 14: On 31st Dec., 2011, the following were the assets and liabilities of a firm:

1. Cash at bank - ₹ 50,000;
2. Furniture - ₹ 48,000;
3. Plant and machinery - ₹ 2,00,000;
4. Debtors - ₹ 1,00,000;
5. Stock in trade - ₹ 20,000;
6. Creditors - ₹ 50,000;
7. Bank loan - ₹ 45,000.

On 1st January, 2012, the assets and liabilities have to be brought in. The following entry is recorded in Journal Proper.

<i>Date</i>	<i>Particulars</i>	<i>L.F.</i>	<i>Debit ₹</i>	<i>Credit ₹</i>
1-1-05	Cash at bank a/c Dr.		5,000	
	Furniture a/c Dr.		48,000	
	P and M a/c Dr.		2,00,000	
	Debtors a/c Dr.		1,00,000	
	Stock in trade a/c Dr.		20,000	
	To Creditors a/c			50,000
	To Bank Loan a/c			45,000
	To Capital a/c (Difference)			32,3,000
	(Being assets and liabilities of the previous year brought in)			

Similarly, a newly set up business may commence its activities with some assets and liabilities. Then the assets are debited and liabilities are credited and the difference is transferred to capital account.

EXERCISE

1. Self Assessment Questions:

1. The system of recording transactions based on dual aspect concept is called
 - (a) Double account system
 - (b) Double entry system
 - (c) Single entry system
2. Show the dual aspect effect of the following transactions on the assets and liabilities of business.
 - (a) Purchased goods for cash ₹ 80,000
 - (b) Purchased delivery van on credit for ₹ 4,00,000

- (c) Paid ₹ 5,000 to a supplier of goods on credit
- (d) The proprietor withdrew ₹ 20,000 from the bank account of business for personal expenses.
3. State yes or no:
- (a) State Bank of India is a Nominal Account.
- (b) Machinery is a Real Account.
- (c) Life Insurance Corporation is a Personal Account.
- (d) Proprietor's Capital Account is a Personal Account.
- (e) Loan Account is a Real Account.
- (f) Postage and Telegram Account is a Nominal Account.
- (g) Interest on Investment Account is a Nominal Account.
- (h) Carriage on Goods Account is a Real Account.
- (i) The giver of a benefit must be debited.
- (j) Nominal Accounts fall in the category of impersonal accounts.
- (k) Every debit has an equal and corresponding credit.
- (l) Loss by fire is a Nominal Account.
- (m) Outstanding Wages Account is a Nominal Account.
- (n) Brokerage Account is a Real Account.
- (o) Investment Account is a Personal Account
4. Accounting trial is a process starting from identifying the transactions or events to preparation of final statement of accounts. True or False.
5. There are three types of accounts namely _____ and _____.
6. A trial balance is the summarized form of ledger balances. True or False.
7. A transaction is a business activity which involves transfer of money or money's worth. True or False.
8. An event happens as a result of internal policy of an organization. True or False.
9. Business transactions and events have equal importance in finding the financial results of the business concern. True or False.
10. Identify the following as transactions or events as the case may be.
- (i) Depreciation of assets: _____
- (ii) Tax rates announcement: _____
- (iii) Acquisition of assets: _____
- (iv) Selling an asset: _____
- (v) Transfer of profits to Reserve Fund: _____
11. Liabilities plus Equity is equal to _____.
12. Assets minus liabilities to outsiders are equal to _____.
13. If assets are ₹ 5 lakhs, liabilities are ₹ 3 lakhs, find out the equity.

14. If Owner's equity is ` 3 lakhs, Outsider's liabilities are ` 2 lakhs, Owner's share of profit is ` 1 lakh, find out the total value of assets.
15. Every transaction influences balance sheet and it is shown by accounting equation. True or False.

Answers:

1. (b)
2. (a) Stock of goods increases and cash balance is reduced, (b) Delivery Van is an asset and the supplier of the delivery van becomes a creditor and it appears as liability, (c) Creditor's balance is reduced on liabilities side and cash paid brings down the cash balance on the asset side, (d) The bank balance comes down on asset side and capital account is reduced by the amount of drawings on the liabilities side.
3. Yes : (b, c, d, f, g, j, k, l)
No : (a, e, h, i, m, n, o)
4. True
5. Personal, real and nominal
6. True
7. True
8. True
9. True
10. (i) Event, (ii) Event, (iii) Transaction, (iv) Transaction, (v) Event.
11. Assets
12. Equity
13. ` 2 lakhs
14. Assets are ` 6 lakhs
15. True

2.

1. All purchases — cash or credit — is entered into purchases day book. (State True/False)
2. Purchases of goods and other assets can also be recorded in purchase book. (State True/False)
3. Inwards Invoice is a document to verify the quantity, price and other details of goods purchased. (State True/False)
4. Purchases made from Mr. Ganesh on credit for ` 6,000, entered in the purchases book. What is the journal entry?
5. Sales day book contains only credit sales of goods made. (State True/False)
6. Sale of any other asset other than goods is also recorded in sales day book. (State True/False)
7. Persons to whom sales are made on credit are called _____.

8. Outward invoice is a document issued to customer, when the goods are sold on credit. (State True/False).
9. Purchase returns are also called returns outwards. (State True/False).
10. Purchase returns take place when the goods bought are not as per the specification. (State True/False).
11. When goods bought are returned, the supplier's account is _____ and purchase return account is _____.
12. Debit note is a document to show the supplier's account is being debited. (State True/False).
13. Sales return are also called returns inwards. (State True/False).
14. Credit note is a document to indicate that the goods are received as returned by customers. (State True/False).
15. Credit noted is sent by _____ to _____.
16. A bill is an instrument in writing similar to that of a promissory note. (State True/False).
17. Who is a drawer of a bill of exchange in a business?
18. Who is the acceptor of a bill of exchange in a business?
19. Bills Receivable account shows _____ balance.
20. Can bills receivable be discounted?
21. Bills of exchange drawn by the supplier of goods and accepted by the proprietor of the business are called _____.
22. Every bill has _____ days of grace .
23. Bills payable account shows _____ balance.
24. Bills payable represents a _____.
25. When bills payable account is credited, _____ account is debited.
26. Cash book and cash account are one and the same. (State True/False)
27. Trade discounts allowed to customers or received from suppliers are not recorded in cash book.
28. Cash discount allowed to customers appears on the _____ side of cash book. Cash discount received appears on the _____ side of cash book.
29. Discount columns are independently totaled and not balanced. (State True/False)
30. Contra entry is an entry where both cash account and bank account are affected. (State True/False)
31. Petty cash book is maintained in case of petty organization.
32. Imprest system of cash book is a system where the expenses incurred are reimbursed.
33. The closing balance in imprest system of petty cash book always remains the same.
34. Imprest system of cash book is also called analytical cash book.
35. Rules of debit and credit are different for different types of accounts. (State True/False)

36. The words "To Balance b/d" or "By Balance b/d" denote an opening entry.(State True/False)
37. _____ and _____ are balanced while _____ are closed by transfer to trading and profit and loss account.
38. In the ledger account during the beginning of the accounting period "To Balance b/d" denotes debit balance and "By balance b/d" denotes credit balance. (State True/False)

Answers:

1. False, 2. False, 3. True, 4. Purchases a/c Dr. to Ganesh account (Being purchases made), 5. True, 6. False, 7. Debtors, 8. True, 9. True, 10. True, 11. Debited, Credited, 12. True, 13. True, 14. True, 15. Businessman, the Customer, 16. True, 17. Owner of the business who is the seller, 18. Customer/debtor, 19. Debit, 20. Yes, 21. Bills payable, 22. Three, 23. Credit, 24. Liability, 25. Supplier's account/Creditor's account, 26. True, 27. True, 28. Debit, 29. Credit, 30. True, 31. False, 32. True, 33. False, 34. True, 35. True, 36. True, 37. Personal, real and nominal, 38. True.

3. Show the accounting equation for the Following Transactions:

- (a) Shri Ram commenced business with ` 50,000
- (b) Paid rent in advance ` 2,000
- (c) Purchased a typewriter for ` 7,000
- (d) Bought furniture from M/s Mohan Lal on credit for ` 3,000
- (e) Purchased goods from Sohan for cash ` 35,000
- (f) Sold goods to Shyam for cash ` 40,000 (costing ` 30,000)
- (g) Bought goods from Ramesh for ` 30,000
- (h) Sold goods to Shyam costing ` 30,000 for ` 50,000
- (i) Purchased household goods for ` 15,000 giving ` 5,000 in cash and the balance through a loan.
- (j) Goods destroyed by fire (cost ` 500, Sale Price ` 600)
- (k) Paid half the amount owed to Mohan Lal.
- (l) Paid cash ` 500 for loan and ` 300 for interest.
- (m) Withdrew goods for personal use (cost ` 500, sale price ` 600)
- (n) Received ` 49,500 from Shyam in full settlement
- (o) Paid ` 29,700 to Ramesh in full settlement
- (p) Paid salary ` 500 and salary outstanding ` 100
- (q) Charged depreciation of ` 300 on furniture and ` 100 on typewriter.

4. Classify the following accounts:

Goods A/c, Salaries a/c, State Bank of India A/c, Printing and Stationery a/c, Discount a/c, Capital a/c, Income Tax a/c, Vijaya's a/c, Carriage Inward a/c, Outstanding a/c, Prepaid Insurance a/c, Commission Received in Advance a/c, Loan a/c, Stock a/c, Loss of Goods by Fire a/c, Investment a/c, Tools a/c, Dadar Library's a/c, Repairs to Machinery a/c, Manager's Salary a/c, Copyright a/c,

Patents a/c, Shares a/c, Livestock a/c, Octroi a/c, Taxes a/c, Audit Fees a/c, Bad Debts a/c, Premises a/c, Leasehold Building a/c, Freehold Property a/c, M/s Sunita Textiles a/c, Proprietor's Wife a/c, State Government Securities a/c, Stock of Stationery a/c, Salary a/c, Outstanding Salary a/c, Unexpired Insurance a/c, Gas and Light a/c, Debtors a/c, Creditors a/c, Goodwill a/c, Trade Expenses a/c, Royalty a/c, Bills Receivable a/c, Bank Commission a/c, Bank Charges a/c, Packing Charges a/c, Brokerage a/c, Machinery a/c, Loan a/c, Interest on Loan a/c, Outstanding Interest a/c, Prepaid Interest a/c, Railway Freight a/c, Sales Tax a/c, Loose Tools a/c, Publicity a/c, Advertisement a/c, Profit on Sale of Furniture a/c, Loss on Sale of Machinery a/c, Study Circle a/c.

5. Journalise the following transactions in the books of Ashish.

2012

- Jan. 1 Commenced business with ` 20,000.
- Jan. 2 Deposited into bank ` 10,000.
- Jan. 3 Purchased goods of ` 5,000 from Rakesh
- Jan. 4 Bought goods from Ramesh ` 2,000 for cash.
- Jan. 5 Sold goods of ` 6,000 to Dinesh.
- Jan. 6 Sold goods to Mahesh ` 8,000 for cash.
- Jan. 7 Paid rent to Bhavesh ` 500.
- Jan. 8 Paid travelling expenses to salesman ` 200.
- Jan. 9 Dinesh returned goods worth ` 2,000.
- Jan. 10 Returned goods to Rakesh ` 600.
- Jan. 12 Withdrew cash from Bank for personal use ` 500.
- Jan. 13 Bought furniture on credit ` 2,000 from Bombay Furniture Mart.
- Jan.14 Received on account from Dinesh ` 1,000.
- Jan. 15 Paid on account ` 1,500 to Rakesh.
- Jan. 16 Paid salary of ` 1,000 to the employees.
- Jan. 17 Received interest ` 200 from Radha.
- Jan. 18 Purchased Postage Stamp ` 20.
- Jan. 19 Paid by Cheque to Naresh ` 500.
- Jan. 20 Received by Cheque ` 1,000 from Dinesh.
- Jan. 21 Gave ` 200 for the college fee of Proprietor's son.
- Jan. 22 Withdrew goods for personal use ` 100.
- Jan. 23 Bought Shares of X & Y Ltd. worth ` 2,000 by cheque.

Jan. 24 Sold private motor car for ` 30,000 and the amount is introduced in the business.

Jan. 25 Borrowed ` 2,000 from Anil.

6. Write the Journal of Miss Rupa for the month of July 2012.

1. She commenced the business with Cash ` 6,000, furniture ` 2,000 by borrowing from her friend Susan ` 8,000.
2. Paid salaries to the clerk in the office ` 200.
3. Purchased goods from Lalita ` 5,000 on credit at 10% trade discount.
4. Bought goods worth ` 4,000 for cash at 10% trade discount and 5% cash discount.
5. Sold goods for cash ` 5,000 at 20% trade discount and 2% cash discount.
6. Bought goods from Ramesh on credit ` 5,000 at 20% trade discount and 5% cash discount.
7. Received interest in cash ` 120.
8. Paid for the advertisement in Times of India ` 200.
9. Paid ` 500 to Tyrewala on behalf of Motorwala.
10. Sold goods to Muchiwala on credit ` 10,000
11. Muchiwala paid ` 980 in full settlement of his account.
12. ` 200 due from Mr. Bala written off as bad debt.
13. Purchased goods worth ` 10,000 less 20% trade discount and 5% cash discount for cash from Amir and supplied to Garib at list price less 5% trade discount.
14. Sold goods of ` 6,000 to Viju at 5% trade discount and 2% cash discount. He paid half the amount in cash.
15. Under advice from Ram supplied goods to Pawan for ` 1,500.
16. Goods worth ` 500 lost in fire.
17. Purchased 50 shares of Tata Ltd. at ` 100 per share and paid brokerage ` 250.
18. Received ` 2,000 from travelling salesman for the goods sold by him after deducting his travelling expenses ` 100.
19. Bought goods ` 1,000 from Mr. Mihir and supplied the same to Tulsi for ` 1,500.
20. Tulsi returned goods worth ` 750 which were returned to Mr. Mihir.
21. Paid cash to Mihir and earned a discount of 10%.
22. Received cash from Tulsi and allowed a discount of 5%.
23. Sent Miss Vanita on account ` 1,500.
24. Sold goods to Deepak for ` 1,000.
25. Deepak returned goods worth ` 200 and paid the balance amount.

7. The following are your transactions:

2012

- Jan. 1 Received cash from Sudesh ` 2,400.
- Jan. 2 Bought goods for Cash ` 1,200.
- Jan. 3 Sold goods to Sudesh on credit ` 170.
- Jan. 4 Paid cartage on behalf of Sudesh ` 30.
- Jan. 5 Invoiced goods to Sudesh ` 400.
- Jan. 6 Goods returned by Sudesh ` 250.
- Jan. 7 Goods bought for cash from Amin ` 310.
- Jan. 8 Received cash on account from Sudesh ` 370.
- Jan. 9 Sold goods to Raju for cash ` 930.

Journalise the above transactions and post them to ledger accounts. Also prepare trial balance.

8. Journalise the following transactions in a journal and post them to the Ledger accounts and prepare Trial Balance:

2012

- June 1 Shri Mathur invested in the business ` 6,000 cash, goods worth ` 3,000 and a building worth ` 12,000.
- June 2 Borrowed from Bank ` 8,000.
- June 3 Purchased goods for cash ` 5,000.
- June 4 Sold goods on credit to Rana Pratap ` 3,000.
- June 5 Cash received from Rana Pratap ` 1,000.
- June 6 Purchased goods on credit basis from Jeevan ` 6,000.
- June 9 Sold goods on credit to Jawahar ` 3,000.
- June 10 Paid Salaries ` 1,500.
- June 16 Paid Office Rent ` 350.
- June 17 Received commission ` 175.
- June 19 Paid Salary to Salesman ` 110.
- June 20 Paid commission ` 50.
- June 25 Paid on account to Jeevan ` 2,200.
- June 26 Received from Rana Pratap ` 690.
- June 27 Repaid loan to Bank ` 3,400.

June 29 Sold Building for cash ` 3,900.

June 29 Received on account from Rana Pratap ` 1,400.

June 30 Paid Cartage for Jawahar ` 220.

9. Draft Journal entries from the following information:

Cash Account

Dr.			Cr.		
<i>Date</i>	<i>Particulars</i>	<i>(`)</i>	<i>Date</i>	<i>Particulars</i>	<i>(`)</i>
2012			2012		
July 1	To Balance B/d	6,000	July 2	By Furniture	2,000
4	To Sales	1,300	4	By Purchases	1,500
9	To Ravi	600	13	By Kishan	500
17	To Commission	200	15	By Salaries	700
25	To Interest	300	18	By Rent	300
29	To Capital	10,000	25	By Drawings	200
			31	By Balance c/d	13,200
		18,400			18,400

10. Study the Patel's account in the books of Desai and answer the following questions given below:

**In the Books of Desai
Patel's Account**

Dr.			Cr.		
<i>Date</i>	<i>Particulars</i>	<i>(`)</i>	<i>Date</i>	<i>Particulars</i>	<i>(`)</i>
2012			2012		
July 1	To Balance b/d	2,400	July 6	By Returns	600
3	To Sales	2,200	7	By Cash	1,600
		9		By Cash	760
				By Discount	40
12	To Sales	1,400	15	By Returns	200
26	To Cash	1,600	16	By Cash	400
31	To Balance c/d	1,400	18	By Cash	200
		20	20	By Cash	540
				By Discount	60
		23	23	By Cash	1,600
		25	25	By Furniture	3,000
		9,000			9,000

1. What is the balance on Patel's a/c?
2. What is the relationship between Patel and Desai?
3. What are the total sales made by Desai to Patel?
4. How much cash is received by Desai from Patel?
5. Write the entry and the narration of July 25?
6. What is the rate of discount allowed by Desai to Patel on 9th and 20th?
7. What does the closing balance represent?

11. Record the following transactions in the Subsidiary Books of Shri Shankar and post them into respective Ledger Accounts:

July 2012

- 8th Bought from Balu goods worth ` 4,000 as per Purchase Invoice No. 7.
- 10th Sold to Chandrakant goods amounting to ` 2,500 as per sales Invoice No. 21.
- 15th Purchased goods from Ramdas of ` 1,750 as per Purchase Invoice No. 18.
- 17th Returned to Balu goods worth ` 300 as per Debit Note No. 3.
- 18th Bought goods from Ravi Shankar ` 750 as per Invoice No. 29.
- 20th Chandrakant returned goods worth ` 700. Sent him Credit Note 5.
- 20th Sold goods to Prasad Savkar ` 900 as per Outward Invoice No. 22.
- 23rd Returned goods to Ravi Shankar ` 50 as per Debit Note. No. 4
- 23rd Sold goods to Chandrakant on credit ` 500 as per Invoice No. 23.
- 25th Received back from Prasad Savkar goods ` 100 being damaged. Sent him Credit Note No. 6.

12. Post the following subsidiary books in the Ledger:

Purchase Book

<i>Sr. No.</i>	<i>Bill No.</i>	<i>Date</i>	<i>Particulars</i>	<i>L.F.</i>	<i>Amount</i>
1		12/1/03	Tina		2,000
2		20/1/03	Mina		7,000
3		25/1/03	Reena		1,000
4		28/1/03	Tina		3,000
5		31/1/03	Reena		2,000
					15,000

Purchase Return Book

<i>Date</i>	<i>Debit Note No.</i>	<i>Particulars</i>	<i>L.F.</i>	<i>Amount</i>
15/1/03		Tina		100
27/1/03		Mina		200
31/1/03		Reena		300
				600

Sales Book

<i>Sales</i>	<i>Bill No.</i>	<i>Date</i>	<i>Particulars</i>	<i>L.F.</i>	<i>Amount</i>
1		10/1/03	Rama		1,000
2		15/1/03	Sonu		1,200
3		20/1/03	Monu		1,500
4		25/1/03	Rama		800
5		28/1/03	Sonu		900
					5,400

Sales Return Book

<i>Date</i>	<i>Credit Note No.</i>	<i>Particulars</i>	<i>L.F.</i>	<i>Amount</i>
15/1/03		Rama		300
25/1/03		Sonu		400
31/1/03		Monu		500
				1,200

13. Enter the following transactions in a Cash Book with Cash, Bank and Discount columns and balance the cash book:

2012

- Sep. 1 Balances — Cash in hand ` 2,430 and balance at Bank ` 4,500.
- Sep. 2 Received from Vinayak cash ` 1,250 and a cheque of ` 450 on account.
- Sep. 3 Paid by cheque to Babul ` 350 in full settlement of ` 370.
- Sep. 4 A cheque received on 2nd September deposited in the bank.
- Sep. 5 Cash Sales ` 890.
- Sep. 6 Deposited in the bank ` 500.
- Sep. 7 Purchased goods from Mr. Unreliable for cash ` 1,300.
- Sep. 8 A cheque received from Vinayak returned dishonoured.
- Sep. 9 Received from Sita a cheque for ` 2,100 in full settlement of her account of ` 2,200 and endorsed the said cheque in favour of Rita in full settlement of her account of ` 2,150.
- Sep 10 Transferred ` 7,000 from Savings Bank account to Current account in the bank.
- Sep 12 Bank Commission debited by the bank in the Pass Book ` 17.

As advice received from the bank states that:

- (a) Trustworthy has directly deposited ` 3,500 in our Bank account.
- (b) The bank has collected interest on investment ` 250.
- (c) As per the standing instructions, the bank has paid on account of insurance premium ` 350.

- Sep. 16 Purchased goods for cash ` 900 and received a discount of ` 30.
- Sep. 17 Paid for salaries ` 500.
- Sep. 18 Paid sundry expenses ` 30.
- Sep. 19 Drew by cheque ` 450 for office use and ` 150 for personal use.
- Sep. 20 Deposited in the bank all cash in excess of ` 500.

14. Prepare a Three Column Cash Book from the following particulars and balance it:

2012

- Apr. 1 Balance of cash in hand ` 6,000 and Bank overdraft ` 8,000.
- Apr. 4 Brought additional capital in cash ` 10,000.
- Apr. 5 Deposited ` 7,500 into Bank.
- Apr. 6 Cash sale of goods ` 4,200.
- Apr. 7 Cash received from Devdas ` 10,800 and cash discount allowed ` 200.
- Apr. 10 Paid cash to Karamji ` 8,900 and cash discount received ` 100.
- Apr. 11 Commission paid to agents ` 850.
- Apr. 14 Purchased office furniture from Ram & Sons on credit ` 21,500.
- Apr. 14 Paid rent ` 650 through cheque.
- Apr. 15 Paid electricity charges ` 770 by cheque.
- Apr. 16 Drew cheque for personal expenses ` 840.
- Apr. 17 Cash sales ` 3,200.
- Apr. 20 Cash purchases ` 5,500.
- Apr. 21 Deposited ` 4,000 in Bank.
- Apr. 22 Drew ` 3,000 for office use from Bank.
- Apr. 23 Received cheque for ` 10,000 from Vivek and deposited into the Bank.
- Apr. 24 Received a crossed cheque of ` 560 towards dividend.
- Apr. 25 Received a cheque of ` 1,350 from Laxman.
- Apr. 26 Cheque received from Laxman deposited into the bank.
- Apr. 26 Cheque of ` 350 received from Ramdhan.
- Apr. 27 Cheque received from Ramdhan deposited in Bank.
- Apr. 28 Received a cheque of ` 1,300 received from Jaya and deposited in Bank.

Apr. 29 Cheque received from Jaya dishonoured.

Apr. 29 Issued a cheque of ₹ 1,150 from Ankit and received discount of ₹ 50.

Apr. 30 Deposited cash in the Bank ₹ 10,000.

15. Mr. Rohit operates two bank accounts — both of which were maintained in the Columnar Cash Book itself. You are required to draw up a Cash Book with necessary columns and show how the following transactions relating to 15th March, 2012 will appear therein and close the Cash Book for the day:

1. Opening balances: Cash ₹ 150, Bank of Baroda ₹ 11,240(cr), and Overseas Bank ₹ 35,460.
2. Received a cheque of ₹ 1,250 in respect of sales for realising which the Bank of Baroda charged ₹ 2 and credited the balance.
3. Purchased goods for ₹ 13,210 and cheque issued on the Overseas Bank. The bank charged ₹ 3 for collection of the cheque to the concerned party.
4. Paid office expenses of ₹ 45 and ₹ 15 for stationery.
5. Out of cash sales of ₹ 13,625, a sum of ₹ 10,000 was deposited in the Bank of Baroda.
6. Credit purchases of ₹ 15,000 were made from Mr. Sandy, who sent the documents relating to the goods through the Overseas Bank for 90% of their value. The bank charged ₹ 115 for realising the documents.
7. Withdrew ₹ 5,000 from the Overseas Bank.
8. Deposited ₹ 5,000 in Bank of Baroda.
9. A bill's receivable for ₹ 10,000 was discounted with the Overseas Bank which charged 1% towards discounting.
10. A demand draft was purchased for ₹ 3,000 from a bank after paying ₹ 2 towards their charges and paid to BSES deposit.
11. Interest of ₹ 122 and ₹ 50 was credited and debited respectively by the Overseas Bank and Bank of Baroda.
12. An amount of ₹ 1,500 was withdrawn from the Overseas Bank and salaries paid to that extent.
13. Manager's salary of ₹ 1,000 was paid by cheque drawn on the Bank of Baroda.
14. Overseas Bank collected dividend of ₹ 1,250 and sent a credit note.
15. An amount of ₹ 1,500 was transferred from the Overseas Bank to the Bank of Baroda.





DEPRECIATION

Depreciation is a permanent, continuing and gradual shrinkage in the value of a fixed asset. Except land, all other fixed assets has a specific useful life and they are subject to depreciation. Adequate provision of depreciation is necessary for financial soundness, successful operations and survival of the companies. Therefore, it is necessary on the part of the corporate management to establish a sound depreciation policy because it significantly affects the profits, profitability, production capacity, cash flows, rate of dividend, replacement of assets, etc. Depreciation policy depends to great extent, upon the views of the company's management.

Depreciation may be defined as "the permanent and continuing diminution in the quality, quantity or the value of an asset".

According to William Pickles "depreciation is the gradual and permanent decrease in the value of an asset from any cause whatsoever".

The above depreciation brings out the following facts about depreciation:

1. Depreciation is a part of the operating cost.
2. It is a reduction in the value of an asset.
3. The decrease in the value of an asset is due to its use, caused by wear and tear or any other reason.
4. The decrease in the value if an asset is gradual and continuous.
5. It is charged against the profit.
6. It is not sudden loss.
7. It is process of allocation of expired cost.

8. It can be simply estimated.
9. It may be physically estimated.
10. It may be physical and functional.
11. Its object is to maintain the nominal capital invested in fixed assets.
12. It is a must.
13. Market value of a fixed asset does not affect the amount of depreciation.
14. It is calculated in respect of fixed assets only.

Causes of Depreciation

Wear and Tear: Physical wear and tear of fixed assets like plant and machinery, furniture and fixtures, etc. due to their constant use reduces their technical capacity and earning capacity.

Exhaustion: Mineral or oil gets exhausted on account of continuous extraction and a stage comes when nothing is left.

Exposure: Assets deteriorate due to their exposure to elements like wind and weather.

Obsolescence: Due to innovations, inventions, change in techniques, etc., some assets are discarded before they are worn out completely, e.g., Computers.

Effluxion of Time: Assets like patents, copyrights, leasehold properties gets decreased their value with the passage of time.

Accident: Assets get decreased in their value due to damage or destruction on account of accidents like fire, flood, earthquake, explosion, lightning, mishandling, etc.

Need or Importance of Providing Depreciation

Determination of Time Profits: Like other business expenses, depreciation is also a payment in respect of the services rendered by an asset in earning revenues. Therefore, depreciation must be charged as an operating cost from the year so that correct profits can be ascertained.

True Financial Position: Assets gets depreciated in their values over a period of time on account of wear and tear, exhaustion, exposure to the elements, obsolescence, lapse of time, accident, etc. In order to disclose the true financial position of the business, it is necessary to show the various assets at their depreciated or real values in the balance sheet.

Replacement: The objective of depreciation is to replace an asset at the expiry of its economic life without any additional capital requirements.

Ascertain the Cost of Production: Depreciation just like any other costs such as wages, salaries, rent, etc. has to be considered to ascertain the exact cost of production.

Depreciation of Tax Liability: Depreciation on assets is an admissible deduction under the Income Tax Act, 1961. Depreciation acts as a tax shield and reduces the taxable profits and the tax liability of the enterprise.

Methods of Providing Depreciation

Straight Line Method or Fixed Installment Method: Depreciation is charged evenly every year throughout the useful life of the asset.

$$\text{Depreciation per annum} = \frac{\text{Original Cost} - \text{Salvage Value}}{\text{Estimated Useful Life}}$$

This method is simple to understand and easy to apply. This method involves greater charge for the use of asset on account of increasing cost of repairs in each subsequent year of its useful life.

Reducing Balance Method or Diminishing Balance Method: Depreciation is charged on the book value of the asset every year. As a result, the amount of depreciation goes on decreasing every year. This method puts equal burden for the use of the asset on each year and tends to realize the burden on the profit and loss account. This method fails to reduce the value of an asset to zero and some balance would always be left on the asset account even after the expiry of its useful life.

Annuity Method: Annuity method takes into consideration the interest factor. In this method, the amount of depreciation is determined in such a way that it takes into account not only the acquisition cost of an asset but also the interest thereon at an accepted rate. The amount of depreciation is calculate on the basis of annuity table. This method is most scientific.

Depreciation Fund Method or Sinking Fund Method or Redemption Fund Method or Amortization Method: In this method, the amount of depreciation is determined in such a way that if invested every year with compound interest, it will yield an amount equal to cost of the asset on the expiry of its useful life when replacement is required. The amount of depreciation from year after year is ascertained on the basis of sinking fund tables. The amount of depreciation is invested in certain securities carrying a particular rate of interest along with the amount of interest received on such securities. The securities are sold at the end of the useful life of the asset and the amount realized is used to buy a new asset in order to replace the old one.

Sum of Years Digits Method: Under this method, the depreciation for every year is calculated according to the following formula:

$$\frac{\text{Remaining useful life of the asset in years}}{\text{Sum of the digits of the life of the asset in years}} \times \text{Original cost}$$

Insurance Policy Method: This method is similar to the depreciation fund method. Instead of investing the money in securities, an insurance policy is taken every year at the beginning of each year and at the end of the period the insurance company makes a payment with which new asset can be purchased. In this method, there is a timely receipt of a definite sum of replacement of the asset.

Revaluation Method: This method is suitable for small and diverse items of very small values such as loose tools where the assets are revalued at the end of each year. The difference of the revaluation price of the two years is charged as depreciation.

Depletion Method: This method is useful in case of wasting assets like mines, quarries, etc. where it is not possible to make an estimate of the total output likely to be available.

$$\text{Depreciation} = \frac{\text{Cost of acquisition of the asset}}{\text{Estimated quantities of the output available}}$$

The amount of the depreciation will not be correct if the estimate of the output from the asset is not correct.

Machine Hour Rate Method: This method is suitable to charge depreciation on aircrafts, plant and machinery, etc.

$$\begin{aligned} \text{Depreciation for the year} = & \frac{\text{Acquisition cost of the asset} - \text{scrap value}}{\text{Life of the asset in hours}} \\ & \times \text{Number of hours the asset actually worked during the year} \end{aligned}$$

Rate of Return Method: Under this method, the future streams of anticipated proceeds for each period are discounted and then the depreciation charge of a particular year is related to the forecasted net cash proceeds from the investment.

Double Declining Balance Method: This method is prevailing in USA and is permitted under the federal tax laws. This method is similar to diminishing balance method except that the rate of depreciation is charged at the rate at which is twice the straight line rate. No allowances are made for the scrap value of the asset and the total cost is not reduced by charging the depreciation to an amount lower than the estimated scrap value of the asset.

Group Depreciation Method: All assets having similar average useful life are grouped together in a single asset category and depreciation is charged for the group and not for individual assets on the original cost of all the assets in the group. The management has to take into consideration the impact of depreciation on the business income since depreciation is an important operating cost of the business. During the period of the inflation, depreciation charged historical cost of assets will be lower than what is desirable. The management has to carefully consider the amount of depreciation chargeable as it affects the probable cash inflows, savings in tax liability to the extent of depreciation charged.

FIXED INSTALLMENT METHOD

Meaning: Fixed installment method is also known as straight line method or original cost method. Under this method, the expected life of the asset or the period during which a particular asset will render service is to be calculated. The cost of the asset less scrap value, if any, at the end of its expected life is divided by the number of years of its expected life and each year a fixed amount is charged in accounts as depreciation. The amount chargeable in respect of depreciation under this method remains constant from year to year. This method is also known as straight line method because if a graph of the amounts of annual depreciation is drawn, it would be a straight line.

Formula: The following formula or equation is used to calculate depreciation under this method:

$$\text{Annual Depreciation} = [(\text{Cost of Assets} - \text{Scrap Value}) / \text{Estimated Life of Machinery}]$$

The journal entries that will have to be made under this method are very simple. The journal entries will be as under:

Purchase of Fixed Assets

1. Asset account Dr.

To Cash account

(Being the assets purchased)

The above entries will be passed on the date of purchase. It includes cost and other charges like installation, wages etc.

2. Depreciation account Dr.

To Asset account

(Being the depreciation of the asset)

3. Profit and loss account Dr.

To Depreciation account

(Being the amount of depreciation charged to Profit and Loss account)

These entries will be passed at the end of each year so long as the asset lasts. In the last year, the scrap will be sold and with the amount that realized by the sale the following entry will be passed:

4. Cash account Dr.

To Asset account

(Being the sale price of scrap realized)

5. P&L account Dr.

To Asset account

(Being loss on sale)

6. Asset account Dr.

To P&L account

(Being profit on sale)

Features

Some important features of the fixed installment or straight line method can be stated as follows:

1. It is widely used method of charging depreciation.
2. It offers the advantage of simplicity in charging the depreciation on the asset.
3. Its another attribute is that of clarity of presentation in the balance sheet.
4. It reduces the book value of the asset to zero at the end of the economic life of the asset.

5. Under this method, the figures of periodic depreciation remain constant year after year.
6. Depreciation is charged at a certain rate on original cost of the asset every year.

Advantages

1. Fixed installment method of depreciation is simple and easy to work out.
2. The book value of the asset can be reduced to zero.
3. The provision for depreciation is spread equally over the estimated life of the asset.
4. Suitable for costing purposes, as there is no variation in depreciation charged from year to year.
5. It matches cost and revenue.

Disadvantages

1. This method, in spite of its being simplest, is not very popular because of the fact that whereas each year's depreciation charged is equal, the charge for repairs and renewals goes on increasing as the asset becomes older. The result is that the profit and loss account has to bear a light burden in the initial years of the asset but later on this burden becomes heavier.
2. Interest on money locked up in the asset is not taken into account as is done in some other methods.
3. No provision for the replacement of the asset is made.
4. Difficulty is faced in calculation of depreciation on additions made during the year.
5. It is illogical.
6. It ignores cost of capital.

SCOPE OF APPLICATION

On account of the above-mentioned advantages and disadvantages of fixed installment method, it is generally applied in case of those assets which have small value or which do not require many repairs and renewals, for example, copyright, patents, short leases etc.

Illustration 1: On 1st January 1991, X purchased a machinery for ` 21,000. The estimated life of the machine is 10 years. After this, its break-up value will be ` 1,000 only. Calculate the amount of annual depreciation according to fixed installment method (straight line method or original cost method) and prepare the machinery account for the first three years.

Solution:

Machinery Account

Dr.			Cr.		
<i>Date</i>	<i>Particulars</i>	`	<i>Date</i>	<i>Particulars</i>	`
1991 Jan. 1	To Bank a/c	21,000	1991 Dec. 31	By Depreciation a/c	2,000
			Dec. 31	By Balance c/d	19,000
		21,000			21,000

1992 Jan. 1	To Balance b/d	19,000	1992 Dec. 31	By Depreciation a/c	2,000
			Dec. 31		17,000
		19,000			19,000
1993 Jan. 1	To Balance b/d	17,000	1993 Dec. 31	By Depreciation a/c	2,000
			Dec. 31	By Balance c/d	15,000
		17,000			17,000

Try Yourself

From the books of a limited company, the following particulars regarding its machinery are available:

- Balance on 1st April 2006: ` 2,00,000.
- Purchase of new machinery on 1st October, 2006: ` 80,000.
- Installation charges on the purchase of new machinery: ` 16,000.
- Sale of machinery on 1st January 2007: ` 64,000 (the original cost of the machinery sold was ` 80,000 on 1st October, 2003.)
- Machinery being depreciated @ 15% p.a. on fixed installment basis.
- The opening balance includes ` 1,50,000 worth machinery purchased on 31st March, 2006.

Prepare the machinery account and depreciation account in the books of a limited company.

(*Answer:* Profit on sale of machinery ` 23,000; Depreciation ` 29,700; Depreciation on asset sold ` 9,000; Balance on machinery account ` 2,16,300)

REDUCING BALANCE METHOD OR WRITTEN DOWN VALUE METHOD

- Under the reducing balance method, the cost of the asset is depreciated at a constant rate each year. This method is based on the premise that an asset is more useful in its initial years than in its later years. So, instead of spreading the total cost of the asset over its productive lifespan, it is expensed at a constant rate.
- Depreciation is a systematic and rational process of distributing the cost of tangible assets over the life of assets.
- Depreciation is a process of allocation.
- Cost to be allocated = Acquisition cost – Salvage value.
- Allocated over the estimated useful life of assets.
- Allocation method should be systematic and rational.

Calculation Formula

The annual depreciation is calculated as the depreciation rate multiplied by the book value of the asset at the beginning of the year.

For example, if the asset’s cost when it was bought was ` 5,000, and the rate of depreciation is 40% annually, the depreciation at the end of the first year would be ` 2,000 and the book value at the end of the year would be ` 3,000.

At the end of the second year, that year’s depreciation would be ` 1,200 and the book value of the asset would be ` 1,800: ` 3,000 (book value at the beginning of the year) minus ` 1,200 (this year’s depreciation).

The accumulated depreciation at the end of the second year is ` 3,200: ` 2,000 + ` 1,200.

Advantage: By the reducing balance method, depreciation is accelerated so that in the early years, large portion of the asset is written off. The burden in later years is thus reduced. This is actually a wise thing to do as the value of the asset diminishes with the passage of time. The asset may not or may be subject to wear and tear, and newer and far superior products may be available in the market.

In that scenario, if the business assumes a greater value and price for this asset and on sale actually realizes much less than that, it has to face a loss. But, if the business writes off a large portion and realizes a greater price on sale, it stands to make a profit.

Flaw of This Method: There is only one visible flaw in this method. The reducing balance method never takes into account the scrap value of the asset. The asset is always written off during its productive lifespan.

Reducing Balance Depreciation method: Using the straight line depreciation method, the calculation of the annual depreciation charge is as follows:

31 December		`
	Original machine cost	75,000
2003	Depreciation in 2003 (40% cost)	30,000
	Written down value at 31st December 2003	45,000
2004	Depreciation in 2004 (40% of WDV @ 31st December 2003)	18,000
	Written down value at 31st December 2004	27,000
2005	Depreciation in 2005 (40% of WDV @ 31st December 2004)	10,800
	Written down value at 31st December 2005	16,200
2006	Depreciation in 2006 (40% of WDV @ 31st December 2005)	6,480
	Written down value at 31st December 2006	9,720
2007	Depreciation in 2007 (40% of WDV @ 31st December 2006)	3,888
	Written down value at 31st December 2007	5,832

The reducing balance method can result in significant differences in the annual depreciation charge, depending on the “percentage” of written down value that is used to calculate the charge.

In the example above, the total amount charged to depreciation in the first three years of owning the machine (2003-2005) was ` 58,800 (compared with ` 39,000 if a straight line depreciation method has been used).

Illustration 2: Johnson & Co., a building and construction firm, commenced trading on 1st January Year 6. During the three years to 31st December Year 8, the company bought and sold motor vehicles for use in the business as follows:

<i>Date</i>	<i>Registration No.</i>	<i>Cost (₹)</i>	<i>Date of Disposal</i>	<i>Disposal Proceeds (₹)</i>
1 Feb Yr 6	E762	12,000	12 Apr Yr 8	6,000
4 May Yr 7	F134	14,000		
12 Mar Yr 8	G915	16,000		

The firm provides for depreciation of its motor vehicles at the rate of 20% per annum of the straight line basis, with no residual value.

A full year’s depreciation is provided for motor vehicles bought before 1st July but no depreciation is provided in the year of disposal.

Required:

Prepared in the books of Johnson & Co. for the period 1st January Year 6 to 31st December Year 8, balancing the accounts each year, using the straight line basis for depreciation the following:

- (i) Motor Vehicles Account
- (ii) Provision for Depreciation Account
- (iii) Motor Vehicles Disposal Account

Solution:

(i)

Motor Vehicles Account

Dr.			Cr.		
<i>Date</i>	<i>Particulars</i>	<i>(₹)</i>	<i>Date</i>	<i>Particulars</i>	<i>(₹)</i>
Year 6			Year 6		
Feb 1	To Bank a/c (E762)	12,000	Dec 31	By Balance c/d	12,000
		12,000			12,000
Year 7			Year 7		
Jan 1	To Balance b/d	12,000	Dec 31	By Balance c/d	26,000
Sept 30	To Bank a/c (F134)	14,000			26,000
		26,000			
Year 8			Year 8		
Jan 1	To Balance b/d	26,000	Dec 31	By Balance c/d	42,000
Mar 12	To Bank a/c (G915)	16,000			42,000
		42,000			

(ii) Working Notes:

E762 - Depreciation on straight line basis

1. Year 6: $20\% \times \$12,000 = \$2,400$
2. Year 7: $20\% \times \$26,000 = \$5,200$
3. Year 8: $20\% \times \$30,000 = \$6,000$

4. Provision for Depreciation (E762)
 = 20% × \$12,000 × 2 years = \$4,800

(ii)

Provision for Depreciation Account

Dr.			Cr.		
<i>Date</i>	<i>Particulars</i>	()	<i>Date</i>	<i>Particulars</i>	()
Year 6 Dec. 31	To Balance c/d	2,400	Year 6 Dec. 31	By Profit & Loss (refer working no. 1)	2,400
		2,400			2,400
Year 7 Dec. 31	To Balance c/d	7,600	Year 7 Jan. 1	By Balance b/d	2,400
		7,600	Dec. 31	By Profit & Loss (refer working no. 2)	5,200
Year 8 Apr. 12	To Disposal (E762) (refer working no. 4)	4,800	Year 8 Jan. 1	By Balance b/d	7,600
Dec. 31	To Balance c/d	8,800		By Profit & Loss (refer working no. 3)	6,000
		13,600			13,600

(iii)

Motor Vehicle Disposal Account

Dr.			Cr.		
<i>Date</i>	<i>Particulars</i>	()	<i>Date</i>	<i>Particulars</i>	()
Year 8 Apr, 12	To Motor Vehicle Disposal (E762)	12,000	Year 8 Apr, 12	By Accumulated Depreciation	4,800
		12,000	Year 7 Jan, 1	By Bank	6,000
				By P& L (loss on disposal)	1,200
					12,000

Illustration 3: From the books of a limited company, the following particulars regarding its machinery accounts are available:

- (i) Balance on 1st Jan 2007 ` 25,000.
- (ii) Purchase of machinery on 1st July 2007 ` 10,000.
- (iii) Sale of machinery on 1st Oct 2007 ` 8,000. The original cost of machinery sold was ` 10,000 on 1st July 2004.
- (iv) Installation charges of ` 2,000 on the purchase of new machinery.

- (v) Machinery is being depreciated at 10% p.a. on fixed installment basis.
 (vi) The Opening balance includes ₹ 17,500 worth machinery purchased on 3rd December, 2006.

Prepare Machinery a/c in the books of the Limited company.

Solution:

Machinery Account

Dr.			Cr.		
<i>Date</i>	<i>Particulars</i>	<i>()</i>	<i>Date</i>	<i>Particulars</i>	<i>()</i>
2007			2007		
Jan. 1	To Balance b/d	25,000	Oct. 1	By Bank a/c	8,000
July 1	To Bank a/c	10,000	Oct. 1	By Depreciation a/c	750
	To Bank a/c (Installation)	2,000	Dec. 31	By Depreciation a/c	2,350
Oct. 1	To Profit/ Loss a/c	1,250	Dec. 31	By Balance c/d	27,150
	Total	38,250			38,250

Working Notes:

(i)	Cost of Machinery	10,000
	Depreciation	500
	WDV	9,500
	Depreciation	1,000
	WDV	8,500
	Depreciation	1,000
	WDV	7,500
	Depreciation for 9 months	750
	WDV	6,750
	Sale	8,000
	Profit on sale	1,250
(ii)	Depreciation for 2007	
	1. 10% on 17,500	1,750
	2. 10% on 12,000 for 6 months	600
	Total	2,350

Illustration 4: Akshay Publishers purchased a printing machine costing ₹ 1,00,000 including installation charges. The estimated life of a machine is three years. The scrap value at the end of its life is ₹ 12,500. The rate of depreciation is fixed at 50% p.a. Give journal and ledger entries in the books of Akshay Publishers assuming that the depreciation charged is on the basis of RBM.

Solution:

Journal Entries in the Books of Akshay Publishers

<i>Date</i>	<i>Particulars</i>	<i>L.F. No.</i>	<i>Dr. (₹)</i>	<i>Cr. (₹)</i>
1	First Year: Depreciation a/c Dr. To Machinery a/c (Being the depreciation charged @ 50%)		50,000	50,000
2	Profit and Loss a/c Dr. To Depreciation a/c (Being depreciation transferred to Profit & Loss A/c)		50,000	50,000
3	Second Year: Depreciation a/c Dr. To Machinery a/c (Being the depreciation charged @ 50%)		25,000	25,000
4	Profit and Loss a/c Dr. To Depreciation a/c (Being depreciation transferred to Profit & Loss a/c)		25,000	25,000
5	Third Year: Depreciation a/c Dr. To Machinery a/c (Being the depreciation charged @ 50%)		12,500	12,500
6	Profit and Loss a/c Dr. To Depreciation a/c (Being depreciation transferred to Profit & Loss a/c)		12,500	12,500
7	Cash a/c Dr. To Machinery a/c (Being sale realized on the sale of scrap machinery)		12,500	12,500

Machinery a/c

Dr.

Cr.

<i>Year</i>	<i>Particulars</i>	<i>Amount</i>	<i>Year</i>	<i>Particulars</i>	<i>Amount</i>
1st year	To Bank a/c	1,00,000	1st year	By Depreciation a/c	50,000
				By Balance c/d	50,000
		1,00,000			1,00,000
2nd year	To Balance b/d	50,000	2nd year	By Depreciation	25,000
				By Balance c/d	25,000
		50,000			50,000
3rd year	To Balance b/d	25,000	3rd year	By Depreciation	12,500
				By Balance c/d	12,500
		25,000			25,000

Illustration 5: Vishal Ltd. purchased a machine for ₹ 30,000 on 1st January, 2005. The company closes the accounts on 31st December every year. Depreciate machinery by 20% on WDV. Prepare Machinery a/c, Provision for Depreciation Account and show how depreciation will be shown in the final accounts (Write off machinery account for three years).

Solution:

In the Books of Vishal Ltd.

Machinery a/c

Dr.

Cr.

<i>Date</i>	<i>Particulars</i>	<i>Amount</i>	<i>Date</i>	<i>Particulars</i>	<i>Amount</i>
1/1/2005	To Bank a/c	30,000	31/12/2005	By Balance c/d	30,000
1/1/2006	To Balance b/d	30,000	31/12/2006	By Balance c/d	30,000
1/1/2007	To Balance b/d	30,000	31/12/2007	By Balance c/d	30,000
1/1/2008	To Balance b/d	30,000			

Provision for Depreciation a/c

Dr.

Cr.

<i>Date</i>	<i>Particulars</i>	<i>Amount</i>	<i>Date</i>	<i>Particulars</i>	<i>Amount</i>
31/12/2005	To Balance b/d	6,000	31/12/2005	By Depreciation a/c	6,000
		6,000			6,000
31/12/2006	To Balance b/d	10,800	1/1/2006	By Balance c/d	6,000
		10,800	31/12/2006	By Depreciation	4,800
					10,800
31/12/2007	To Balance b/d	14,640	1/1/2006	By Balance c/d	10,800
			31/12/2006	By Depreciation	3,480
	Total	14,640		Total	14,640

Note: Every year, the balance in this account will be shown in the balance sheet by way of deduction from the balance in the asset account, i.e., from the cost of the asset.

Illustration 6: The following plant and machinery were purchased by Satish & Co.

<i>Date</i>	<i>Specification of the Machine</i>	<i>Amount</i>
1/4/2001	A-1	60,000
1/10/2002	B-1	30,000
1/1/2003	B-2	40,000
1/10/2004	C-1	60,000
31/3/2004	D-1	1,00,000

Prepare Machinery account, provision for depreciation account and machinery sale account in the ledger of Satish & Co. for the year 2001-2002, 2002-03 and 2003-04 after considering the following points

- (i) He sold A-1 on 1.10.2003 for ₹ 50,000.
- (ii) Depreciation is charged at 10% on original value per annum.
- (iii) Also show disclosure on Balance sheet.

Solution:

Machinery a/c

Dr.			Cr.		
Date	Particulars	Amount	Date	Particulars	Amount
1/4/2001	To Bank a/c (A-1)	60,000	31/4/2002	By Balance c/d	60,000
		60,000			60,000
1/4/2002	To Balance b/d	60,000	31/12/2003	By Balance c/d	90,000
1/10/2002	To Bank a/c (B-1)	30,000			90,000
		90,000			
1/1/2003	To Balance b/d	90,000	1/10/2003	By Sale of Machinery (A-1)	60,000
1/1/2003	To Bank a/c (B-2)	40,000	31/12/2003	By Balance c/d	70,000
		1,30,000			1,30,000
1/4/2003	To Balance b/d	70,000	31/12/2004	By Balance c/d	2,30,000
1/10/2003	To Bank a/c (C-1)	60,000			
31/4/2004	To Bank a/c	1,00,000	31/4/2004	By Balance c/d	2,30,000
		2,30,000			2,30,000

Provision for Depreciation a/c

Dr.			Cr.		
Date	Particulars	Amount	Date	Particulars	Amount
31/12/2002	To Balance b/d	6,000	31/12/2002	By Depreciation a/c	6,000
			1/1/2003	By Balance c/d	6,000
31/12/2003	To Balance b/d	14,500	31/12/2003	By Depreciation a/c	8,500
1/10/2003	To Machinery (sale)	15,000	1/4/2003	By Balance c/d	14,500
			1/4/2003	By Depreciation a/c	3,000
31/12/2004	To Balance b/d	12,500	31/12/2004	By Depreciation a/c	10,000
	Total	27,500	Total		27,500

Machinery Sale a/c

Dr.			Cr.		
Date	Particulars	Amount	Date	Particulars	Amount
1/10/2003	To Machinery a/c	60,000	1/10/2003	By Bank a/c	50,000
	To Profit & Loss a/c	5,000		By Provision for Depreciation a/c	15,000
	Total	65,000		Total	65,000

Balance Sheet as on 31st March

Assets	2002 (`)	2003 (`)	2004 (`)
Machinery at Cost	60,000	1,30,000	2,30,000
Less: Provision for Depreciation	6,000	14,500	12,500
	54,000	1,15,500	2,17,500

Working Notes:

- | | |
|--|---------------|
| 1. Depreciation 2001-02 | |
| 10% on 60,000 for 1 year | 6,000 |
| 2. Depreciation 2002-03 | |
| (a) 10% on 60,000 12 months | 6,000 |
| (b) 10% on 30,000 for 6 months | 1,500 |
| (c) 10% on 40,000 for 3 months | 1,000 |
| | 8,500 |
| 3. Profit on sale of Machinery | |
| Cost on 1.4.2001 | 60,000 |
| <i>Less:</i> Depreciation @ 10% for 12 months on Original Cost | 6,000 |
| WDV on 1.4.2002 | 54,000 |
| <i>Less:</i> Depreciation @ 10% for 2002-2003 | 6,000 |
| WDV on 1.4.2003 | 48,000 |
| <i>Less:</i> Depreciation @ 10% on Original Cost upto Date of Sale | 3,000 |
| WDV as on 1.10.2003 | 45,000 |
| <i>Less:</i> Sales Proceeds | 50,000 |
| Profit on sale | 5,000 |
| 4. Depreciation 2003-04 | |
| (a) 10% on 30,000 for 1 year | 3,000 |
| (b) 10% on 40,000 for 1 year | 4,000 |
| (c) 10% on 60,000 for 6 months | 3,000 |
| | 10,000 |
| 5. It is assumed that the accounting year is the financial year. | |

Illustration 7: Furniture of a Businessman had a debit balance of ₹ 1,47,390 on 1/1/2004. He started business in the year 2001 on the last day of the calendar has been following the practice of charging full year's depreciation every year on written down value basis @ 15% p.a. In the year 2004, however, it was decided to change the method of straight line with retrospective effect from 2001 and to give of the change while depreciation was constant as before. On 1st Jan 2004, new furniture was purchased at a cost of ₹ 50,000. All other furniture was acquired in the year 2001. Prepare Furniture account, provision for depreciation a/c for the years ended 2001 to 2004 and make disclosures in Balance sheet.

Solution:

Furniture a/c

Dr.			Cr.		
Date	Particulars	Amount	Date	Particulars	Amount
1.1.2001	To Bank a/c	2,40,000	31.12.2001	By Balance c/d	2,40,000
		2,40,000			2,40,000
1.1.2002	To Balance b/d	2,40,000	31.12.2002	By Balance c/d	2,40,000
		2,40,000			2,40,000
1.1.2003	To Balance b/d	2,40,000	31.12.2003	By Balance c/d	2,40,000
		2,40,000			2,40,000
1.1.2004	To Balance b/d	2,40,000	31.12.2004	By Balance c/d	2,90,000
1.1.2004	To Bank a/c	50,000			
		2,90,000			2,90,000

Provision for Depreciation a/c

Dr.			Cr.		
Date	Particulars	Amount	Date	Particulars	Amount
31/12/2001	To Balance c/d	36,000	31/12/2001	By Depreciation a/c	36,000
		36,000			36,000
31/12/2002	To Balance c/d	66,600	1/1/2002	By Balance c/d	36,000
		66,600	31/12/2002	By Depreciation a/c	30,600
					66,600
31/12/2003	To Balance c/d	92,610	1/4/2003	By Balance c/d	66,600
		92,610	31/12/2003	By Depreciation a/c	26,010
					92,610
31/12/2004	To Balance b/d	1,51,500	1/1/2004	By Balance c/d	92,610
			31/12/2004	By Depreciation a/c	43,500
				By Depreciation a/c	15,390
				(short provision)	
	Total	1,51,500		Total	1,51,500

Disclosure in Balance sheet as on 31st December

Assets	2001 (`)	2002 (`)	2003 (`)	2004 (`)
Machinery at Cost	2,40,000	2,40,000	2,40,000	2,90,000
Less: Provision for Depreciation	36,000	66,000	92,610	1,51,500
	2,04,000	1,73,400	1,47,390	1,38,500

Working Notes:

- Cost on 1.1.2001 = $1,47,390 \times 100/85 \times 100/85 \times 100/85 = ` 2,40,000$
- Short provision for depreciation (due to change).
Depreciation as per SLM for 3 years = $2,40,000 \times 3 \times 15/100 = 1,08,000$

Less: Depreciation already charged as per WDV method:

2001	36,000				
2002	30,600				
2003	26,010				
				92,610	
				15,390	

Illustration 8: An enterprise whose accounting period ends on 31st March, purchased three cars for ₹ 90,000 each on 1st April, 19 × 1. Depreciation is charged @ 10%. On 1st January, 19 × 3, one car was damaged in an accident and was sold for ₹ 60,000. Another car was sold for ₹ 80,000 on 30th September, 19 × 3.

You are required to prepare necessary accounts on the basis of straight line method while:
 (a) charging to the Asset Account and (b) maintaining Provision for Depreciation Account.

Solution:

(a) Direct Charge to the Asset Account

Car's Account

Dr.			Cr.		
Date	Particulars	(₹)	Date	Particulars	(₹)
19×1 Apr.1	To Cash (Purchase car)	2,70,000	19×2 Mar. 31	By Depreciation a/c	27,000
				By Balance c/d	2,43,000
		2,70,000			2,70,000
19×2 Apr. 1	To Balance b/d	2,43,000	19×3 Jan. 1	By Car Disposal a/c (2)	74,250
			Mar. 31	By Depreciation a/c (1)	24,750
		2,43,000		By Balance c/d	1,44,000
					2,43,000
19×3 Apr.1	To Balance b/d (Purchase of car)	1,44,000	19×3 Sept. 1	By Car Disposal a/c (4)	67,500
			19×4 Mar. 31	By Depreciation a/c (3)	13,500
		1,44,000		By Balance c/d	63,000
					1,44,000
19×4 Apr.1	To Balance b/d	63,000			

Car Disposal Account*

Dr.			Cr.		
Date	Particulars	(₹)	Date	Particulars	(₹)
19×3 Jan.1	To Car's a/c (Purchase of car)	74,250	19×3 Jan. 1	By Cash/Bank a/c (4)	60,000
			Mar. 31	By Profit & Loss a/c	14,250
		74,250			74,250

Car Disposal Account*

Dr.			Cr.		
Date	Particulars	()	Date	Particulars	()
19×3 Sep. 1	To Cash a/c	67,500	19×3 Sept. 1	By Cash/Bank a/c	80,000
19×4 Mar. 1	Profit & Loss a/c (Profit)	12,500			
		80,000			80,000

* As two cars have been disposed of on two different dates, 'Car Disposal Account' has been opened twice.

Depreciation Account

Dr.			Cr.		
Date	Particulars	()	Date	Particulars	()
19×2 Mar. 31	To Car's a/c	27,000	19×2 Mar. 31	By Profit & Loss a/c	27,000
		27,000			27,000
19×3 Mar. 31	To Car's a/c	24,750	19×3 Mar. 31	By Profit & Loss a/c	24,750
		24,750			24,750
19×4 Mar. 31	To Car's a/c	13,500	19×4 Mar. 31	By Profit & Loss a/c	13,500
		13,500			13,500

Working Note:

1.	Depreciation for 19×2-×3: For two cars $9,000 \times 2$ For the third car for 9 months $9,000 \times 9/12$	() 18,000 6,750 24,750
2.	Determination of book value of car: Cost Less: Depreciation provided up to the date of disposal (9,000 + 6,750)	90,000 15,750 74,250
3.	Depreciation for 19×2-×4: For one car for one year Another car for six months	9,000 4,500 13,500
4.	Determination of book value of car sold in September, 19×3: Cost for the car Less: Depreciation provided up to the date of disposal (9,000 + 9,000 + 4,500)	90,000 22,500 67,500

(b) If Provision for Depreciation Account is maintained

Car's Account

Dr.			Cr.		
<i>Date</i>	<i>Particulars</i>	<i>()</i>	<i>Date</i>	<i>Particulars</i>	<i>()</i>
19×1 Apr. 1	To Cash/Bank a/c	2,70,000	19×2 Mar. 31	By Balance c/d	2,70,000
		2,70,000			2,70,000
19×2 Apr. 1	To Balance b/d	2,70,000	19×3 Jan. 1	By Sale of Car a/c	90,000
		2,70,000	Mar. 31	By Balance c/d	1,80,000
19×3 Mar. 31	To Balance b/d	1,80,000	19×3 Sep. 1	By Sale of Car a/c	90,000
		1,80,000		By Balance c/d	90,000
					1,80,000

Provision for Depreciation Account

Dr.			Cr.		
<i>Date</i>	<i>Particulars</i>	<i>()</i>	<i>Date</i>	<i>Particulars</i>	<i>()</i>
19×2 Mar. 31	To Balance b/d	27,000	19×2 Mar. 31	By Profit & Loss a/c	27,000
		27,000			27,000
19×3 Mar. 31	To Sale of Car a/c	15,750	19×2 Apr. 1	By Balance b/d	27,000
	To Balance c/d	36,000	Jan. 1	By Profit & Loss a/c	6,750
		51,750	Mar. 31	By Profit & Loss a/c	18,000
19×3 Sep. 1	To Sale of Car a/c (4)	22,500	19×3 Apr. 1	By Balance b/d	36,000
			Sep. 1	By Profit & Loss a/c	4,500
19×4 Mar. 31	To Balance c/d	27,000		By Profit & Loss a/c	9,000
		49,500	19×4 Apr. 1	By Balance b/d	27,000

Sale of Cars Account

Dr.			Cr.		
Date	Particulars	()	Date	Particulars	()
19×3 Jan. 1	To Car's a/c	90,000	19×3 Jan. 1	By Provision for depreciation a/c	15,750
				By Cash a/c	60,000
			Mar. 31	By Profit & Loss a/c	14,250
		90,000		(Loss)	90,000
19×3 Sep. 1	To Car's a/c	90,000	19×3 Sep. 1	By Provision for depreciation a/c	22,500
				By Cash a/c	80,000
19×4 Mar. 31	To Profit & Loss a/c (Profit)	12,500			
		1,02,500			1,02,500

Illustration 9: On 1st January 19×0, the Supreme Manufacturers purchased a machine for ₹ 2,50,000. Depreciation is provided annually according to the straight line method. The estimated useful life of the machine is 10 years and the scrap value is ₹ 10,000. You are required to find out the rate of depreciation and also show the machine account as on 31st December, 19×2.

Solution:

(a) Determination of amount of depreciation:

$$\begin{aligned} \text{Depreciation} &= \frac{\text{Machine Cost} - \text{Scrap Value}}{\text{Useful Line}} \\ &= \frac{2,50,000 - 10,000}{10} \\ &= 2,40,000/10 = ₹ 24,000 \end{aligned}$$

(b) Determination of rate of depreciation:

$$\begin{aligned} r &= \text{Amount of Depreciation} / \text{Cost of the Machine} \times 100 \\ &= \frac{24,000}{2,50,000} \times 100 \\ &= 9.6\% \end{aligned}$$

Machinery Account

Dr.			Cr.		
<i>Date</i>	<i>Particulars</i>	<i>()</i>	<i>Date</i>	<i>Particulars</i>	<i>()</i>
1990 Jan. 1	To Cash/Bank a/c (Purchase of Machinery)	2,50,000	1990 Dec. 31	By Depreciation a/c	24,000
		2,50,000		By Balance c/d	2,26,000
					2,50,000
1991 Jan. 1	To Balance b/d	2,26,000	1991 Dec. 31	By Depreciation a/c	24,000
		2,26,000	Dec. 31	By Balance c/d	2,02,000
					2,26,000
1992 Jan. 1	To Balance b/d	2,02,000	1992 Dec. 31	By Depreciation a/c	24,000
		2,02,000	Dec. 31	By Balance c/d	1,78,000
					2,02,000
1993 Jan. 1	To Balance b/d	1,78,000			

Illustration 10: Mac Ltd. machinery account shows a balance of ` 8,50,000 (original cost being 12,00,000) on 1st April 2000. On 1st July 2000, a new machine was purchased for ` 25,000. On 31st December, ` 2000 an old machine having the written down value of ` 40,000 on 1.4.2000 on its original cost of ` 60,000 was sold for ` 30,000. Show the machinery account for the year ended on 31st March 2001. Use straight line method of depreciation with depreciation rate of 10%.

Solution:

Machinery Account

Dr.			Cr.		
<i>Date</i>	<i>Particulars</i>	<i>Amount</i>	<i>Date</i>	<i>Particulars</i>	<i>Amount</i>
2000 April 1	To Balance b/d	8,50,000	2000 Dec 31	By Bank a/c (Sale of old machine)	30,000
July 1	To Bank a/c (new machine)	25,000	2001 March 31	By Depreciation a/c	4,500
				By Profit & Loss a/c	5,500
		8,75,000		By Depreciation a/c	1,15,875
					8,75,000
				By Balance c/d	7,19,125

Working Notes:

Calculation of depreciation for 1996-97:

Opening balance (original)	1 2,00,000
<i>Less:</i> Original cost of machine sold	60,000
	<u>11,40,000</u>
Depreciation @10% (old machine)	1,14,000
Depreciation for 9 months (new machine)	1,875
	<u>1,15,875</u>

Calculation of loss on sale of Machinery:

Written Down value	40,000
<i>Less:</i> Depreciation (@10% p.am on ` 60,000 for 9 months)	4,500
Written down value as on 31.1.2000	<u>35,500</u>
<i>Less:</i> Sale value	30,000
Loss	<u>5,500</u>

EXERCISES

Long Answer Questions

- What is depreciation?
 - What are objects of depreciation on asset?
- What are the factors causing depreciation? Explain them in brief.
- What are the different methods of calculating depreciation?
- What is depreciation? Why it should be brought into account?
- What are advantages of fixed installment method?
- What are advantages of reducing balance method?
- Write short notes on:
 - Fixed installment method
 - Reducing balance method
- Outline the main features of:
 - Fixed installment method
 - Reducing balance method
- Differentiate between the fixed installment method and the reducing balance method of charging depreciation.

Fixed Installment Method

10. On 1st July 2003, Vijay Ltd. Co. purchased second hand machinery for ₹ 20,000 and spent ₹ 3,000 on reconditioning and installing it. On 1st January 2004, the firm purchased new machinery worth ₹ 12,000. On 30th June, 2005, the machinery purchased on 1st January 2004 was sold for ₹ 8,000. On 1st July 2005, fresh machinery was purchased on installment basis. Payment for this machinery was to be made as follows:

1st July, 2005: ₹ 5,000; 30th June 26, 2006: ₹ 6,000; 30th June 2007: ₹ 5,500

Payments in 2006 and 2007 include interest ₹ 1,000 and ₹ 500 respectively.

The company writes off depreciation @ 10% p.a. on original cost. The accounts are closed every year on 31st March.

Show the machinery account for three years ending 31st March, 2007.

(Ans: Loss on sale ₹ 2,200; Book value: Machine I - ₹ 16,675; Machine III - ₹ 13,875; Cost of machinery purchased on 1.7.2005: ₹ 15,000)

11. A firm bought a machine for ₹ 20,000 which is expected to be used for 5 years and then sold for ₹ 2,000. What is the annual amount of depreciation if the straight line method is used?

(Ans: ₹ 3,600)

12. A machine costing ₹ 10,000 has an expected life of 4 years and estimated residual value of ₹ 500. Calculate the depreciation charged per year.

A machine costing ₹ 25,650 depreciates to a scrap value of ₹ 500 in 10 years.

Calculate:

- (a) The annual rate of depreciation if the reducing balance method of depreciation is to be used.
(b) The book value at the end of the sixth year.

A firm estimates that office equipment depreciates in value by 40% in its first year of use, by 25% of its value at the beginning of that year during its second year of use, and thereafter each year 10% of its value at the beginning of that year.

Calculate:

- (a) The value after eight years of new equipment costing ₹ 550.
(b) The value when new equipment valued at ₹ 100 after five years of use.

(Ans: ₹ 2,375, (a) 32.55% (b) ₹ 2,415.34, (a) ₹ 131.53, ₹ 304.83, 35.56%)

13. The total cost of a fleet of lorries is ₹ 18,000 and the residual value after five years is ₹ 2,000. Using the diminishing balance method, find the rate of annual depreciation. Five word processors are brought for an office, the total cost of the equipment being ₹ 12,000. The residual value of the machine after five years is estimated to be ₹ 3,000. Find the annual percentage depreciation to be charged if:

- (a) the fixed installment method is used
(b) the diminishing balance method is used (answer to 2 decimal places).

(Ans: (a) 15% (b) 24.21%)

14. A second hand boiler was purchased on 1st January, 2002 from abroad for ₹ 20,000; shipping and forwarding charges amounted to ₹ 4,000; import duty ₹ 14,000 and expenses of installation and repairs amounted to ₹ 2,000. On 31st December, 2005, this boiler was sold for ₹ 8,100 and ₹ 100 was paid as brokerage.

Prepare the Machinery Account for the first four calendar years, if it was decided to depreciate @ 10% p.a. according to the Written Down Value Method.

15. A company purchased a machinery for ₹ 97,500. The company paid duty and carriage charges for ₹ 5,000. The company also incurred ₹ 15,000 for installation of the machine. The estimated life of the machine is 15 years with a scrap value of ₹ 5,000 at the end.

Show machinery account, provision for depreciation account for 3 years and show the presentation in final accounts.

16. The following balances appear in the books of M/s Kushawaha & Sons:

1.1.06 machinery account ₹ 40,000

Provision for depreciation ₹ 18,000

On 1st Jan 06; they decided to sell a machinery for ₹ 4,350. The machine was purchased in Jan 02 for ₹ 8,000.

You are required to prepare machinery a/c and provision for depreciation a/c on 31st Dec 06. Depreciation is charged @ 10% p.a. on Straight line method.

17. M/s Sharad Agency showed a debit balance of ₹ 36,000 to the machinery account on 1-7-1988. The original cost of the machinery was ₹ 60,000. On 1st January 1989, Sharad agency bought additional machinery for ₹ 48,000 and spent ₹ 2,000 for its installation. One more machine costing ₹ 25,000 was purchased on 30-6-1989.

On 30-6-1980, a part of the machinery acquired on 1st January 1989 was sold for ₹ 7,250, the original cost of which was ₹ 10,000. On 31-12-91, the agency sold out the machinery for ₹ 16,000, which was purchased on 30-6-1989. Agency charged 10% depreciation on fixed installment basis and their financial year closes on 30th June every year.

Show machinery account for the years 1988-89, 1989-90, 1990-91 and 1991-92.

18. A partnership firm imported a printing machine on 1st January 1986 for ₹ 1,00,000 and paid ₹ 10,000 as shipping charges, ₹ 20,000 as import duty and license fees and another ₹ 20,000 spent on erection. The firm provided depreciation @ 10% p.a. on the original cost on 31st December every year. On 1st July 1987, another machine was brought in India for ₹ 80,000 and spent ₹ 10,000 on octroi duty and ₹ 10,000 towards installation charges. The first machine was sold on 1st October 1988, for a sum of ₹ 90,000 and the second one was auctioned on 31st December, 1988 at a loss of ₹ 10,000.

Prepare the machinery account up to 31st December 1988 and pass the journal entries for the year 1988.

19. A company's Machinery Account showed a balance of ` 3,00,000 on 1.1.85 and the machinery was bought on 1st July, 1982. The company provides depreciation @ 10% on original cost on 31st December every year. On 1st October, 1985, the company bought another machinery for ` 80,000 and on 1st April 1986 one more machinery was bought on for ` 1,00,000. On 1st July 1987, the machinery purchased on 1st July 1982 was totally destroyed by fire and the scrap was sold for ` 5,000 and the insurance company admitted a claim of ` 1,50,000 only.

Prepare the machinery account upto 31st December 1987 and pass the entries for the year 1987.

20. A Limited company purchased on 1st January 1985 a small plant for ` 10,000. On 1st July, in the same year, additional plant was purchased costing ` 5,000. On 1st July 1986, the plant purchased on 1st January 1985 having become obsolete was sold off for ` 4,000. On 1st July, 1987 a fresh plant was purchased for ` 12,000 and the plant purchased on 1st July 1985 was sold at ` 4,200 on the same date.

Depreciation is to be provided at 10% p.a. on the written down value every year. Show machinery account upto 31st December 1987.

21. On 1-4-89, Shirish Enterprise purchased machinery for ` 36,000 installed it at a cost of ` 4,000 and decided to charge depreciation at 10% p.a. on the straight line method.

On 1-10-91, a part of the machinery with an original price of ` 6,000 (including the installation charges) was sold for ` 3,200 and new machinery costing ` 10,000 was purchased on the same date.

Prepare machinery account and depreciation account for the years 1989-90, 1990-91 and 1991-92 assuming that the firm closes its books of accounts on 31st March every year.



CHAPTER 4

Rectification of Errors



Errors and their Rectification: An error is an unintentionally committed mistake. When the Trial Balance does not tally, it is a clear indication that there are some errors in the preparation of accounts. The errors may be committed at various stages:

- Journalizing,
- Posting,
- Casting (totaling),
- Balancing,
- Transferring to trial balance and so on.

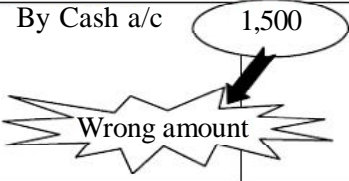
Mere tallying of the trial balance does not ensure an error-free statement. There are certain errors such as errors of omission, error of principle and compensating errors are not disclosed by trial balance while errors of casting, posting to wrong side of an account or posting a wrong amount can be detected by trial balance.

Errors whether disclosed or not disclosed by trial balance have to be corrected or rectified in order to obtain the correct picture of profit or loss. It should be remembered that errors will have their impact not only on profit but also on the asset and liability position of the business organization.

Errors Disclosed by Trial Balance: Those errors that can be disclosed by trial balance can easily be located. As soon as the trial balance does not tally, the accountant can proceed to find out the spots where the errors might have been committed. The total amount of difference in the trial balance is temporarily transferred to a 'Suspense Account' so that it can be mitigated as and when the errors get rectified. Therefore, the suspense account gets debited or credited as the case may be on rectification of these types of errors. The following are the errors which are disclosed by trial balance:

- (a) **Posting a Wrong Amount:** This mistake may occur while posting an entry from subsidiary book to ledger.

Example: Cash received from Rama ₹ 1,150 is posted to Rama's ledger account as ₹ 1,500 while it is correctly recorded in cash account.

		By Cash a/c	1,500
			

Rectification entry


Rama's account	Dr.	₹ 350	
To Suspense account		₹ 350	

(Being excess credit given to Rama's account rectified)

- (b) **Posting to the Wrong Side of an Account:** This error is committed while posting entries from subsidiary books to ledger.

Example: Sales made to Krishna ₹ 5,000 is transferred to credit side of the Krishna's account in the ledger.

KRISHNA'S ACCOUNT

		By Sales a/c	₹ 5,000
			

Rectification entry

Krishna's account	Dr.	₹ 10,000	
To Suspense account		₹ 10,000	


(Being excess in Krishna's account rectified)

- (c) **Wrong Totaling:** Both undercasting and overcasting are detected by trial balance. If any account is wrongly totaled, it gets reflected in the trial balance.

Example: Purchase book total is ₹ 5,800. If it is totaled as ₹ 5,700 or ₹ 5,900, the difference will be shown in the trial balance.

PURCHASE BOOK	
ABC Ltd.	xxxx
MNC Ltd.	xxxx
PQR Ltd.	xxxx
Total	5,800

TRIAL BALANCE		
	Debit	Credit
Cash		
Sales	xxx	xxx
Purchase	5,700	



- (d) **Omitting to Post an Entry from Subsidiary Book to Ledger:** If an entry made in the subsidiary book does not get posted to ledger, the trial balance does not tally.


Example: Rent paid ₹ 2,000 recorded in cash account but is not posted to rent account at all.

RENT ACCOUNT			
To Cash a/c	2,000		
Omitted			

Rectification entry

Rent a/c	Dr. ₹ 2,000	
To Suspense a/c		₹ 2,000

(Being the error of omitted to post rent paid in rent account rectified.)



Example: Furniture purchased should be debited to furniture account only. If it is posted to furniture account and purchases account, then the difference arises in the trial balance.

FURNITURE ACCOUNT

		By Cash a/c	xxxx
--	--	-------------	------

PURCHASE ACCOUNT

		By Cash a/c	xxxx

Rectification entry

Suspense a/c	Dr. xxxx
To Purchases a/c	xxxx

(Being wrong debit given to purchases account rectified)

Errors Not Disclosed by Trial Balance: There are four errors regarded as those which do not affect trial balance and it is difficult to locate them. A brief description of the four errors is offered in the following paragraphs:

- (a) **Error of Omission:** Error of omission occurs when a transaction is completely omitted from the books of accounts.

Example: If purchase of goods from Jairam on credit is not recorded at all either in the general journal or in the purchases book, it is termed as error of omission.

PURCHASE BOOK			
Date	Suppl- iers' Name	L.F.	Inv No.
	Jairam		

PURCHASE ACCOUNT			
To			
Jairam	xxx		

Example:

Wages paid to workers engaged in the construction of building????

- Wages paid to workers engaged in the construction of building should be debited to building account but not wages account.
- If the building account is debited, the value of the asset appears in the balance sheet and the expenditure is actually capitalized.
- In case the wages are treated as usual revenue expenditure, they are deducted from profit.
- The error here is wages account is debited and not building account.

Rectification entry	
Building a/c	Dr.
To Wages a/c	` 10,000
(Being wrong debit given to wages account rectified)	

Similarly, treating incomes as liabilities, providing insufficient provision for bad and doubtful debts, inadequate depreciation against assets etc., come under errors of principle. They must be rectified by applying the correct principles of accounting.

(d) Compensating Errors: It is also called off-setting error. Compensating error is one which is counterbalanced by another error.

Example:

- Mr. X account was debited for ` 100 as against ` 1,000 while the account of Mrs. X account was debited ` 1,000 against the correct amount of ` 100.
- The first error is compensated by the second error and therefore the trial balance is not affected. This comes to light only at a later stage or on receipt of the complaint.

<table border="1" style="width: 100%; border-collapse: collapse;"> <tr><th colspan="4" style="text-align: center;">Mr. X account</th></tr> <tr><td style="width: 15%;">Dr.</td><td style="width: 15%;"></td><td style="width: 15%;"></td><td style="width: 15%;"></td></tr> <tr><td>To Cash</td><td style="text-align: center;">100</td><td></td><td></td></tr> </table> <p style="text-align: center; margin-top: 10px;">↓</p> <p style="text-align: center; border: 1px solid black; border-radius: 50%; padding: 5px;">Instead of ` 1,000</p>	Mr. X account				Dr.				To Cash	100			<table border="1" style="width: 100%; border-collapse: collapse;"> <tr><th colspan="4" style="text-align: center;">Mrs. X account</th></tr> <tr><td style="width: 15%;">Dr.</td><td style="width: 15%;"></td><td style="width: 15%;"></td><td style="width: 15%;"></td></tr> <tr><td>To Cash</td><td style="text-align: center;">1000</td><td></td><td></td></tr> </table> <p style="text-align: center; margin-top: 10px;">↓</p> <p style="text-align: center; border: 1px solid black; border-radius: 50%; padding: 5px;">Instead of ` 100</p>	Mrs. X account				Dr.				To Cash	1000		
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<table border="1" style="width: 100%; border-collapse: collapse;"> <tr> <td colspan="2" style="text-align: center;">Rectification entry</td> </tr> <tr> <td style="width: 60%;">Mr. X account</td> <td style="text-align: right;">Dr. 900</td> </tr> <tr> <td style="padding-left: 20px;">To Mrs. X account</td> <td style="text-align: right;">900</td> </tr> <tr> <td colspan="2" style="text-align: center;">(Being deficit amount debited in Mr. X account and excess amount debited in Mrs. X account rectified)</td> </tr> </table>		Rectification entry		Mr. X account	Dr. 900	To Mrs. X account	900	(Being deficit amount debited in Mr. X account and excess amount debited in Mrs. X account rectified)																	
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Steps to Locate the Errors: The following steps help to locate the errors. In spite of the efforts, if the difference in the trial balance persists, a suspense account may be created and subsequently the suspense account can be eliminated as and when the errors are located and rectification is made.

- Check the totals of both debit side and credit side of the trial balance.
- Check the totals of debtors and creditors accounts.
- Find out whether all ledger balances are carried to trial balance.
- Verify the totals of all the ledger accounts.
- Divide the amount of difference in the trial balance by 2 and see if any item of the debit or credit side, equal to that amount has been posted to the opposite side.
- Check whether the opening balances are brought down correctly from the previous accounting period.
- Make a comparison with trial balance of the previous year to find out if there are any items missing.
- Where the difference in the trial balance is divisible by 9 then the difference is likely to be due to misplacement of figures like 12 for 21; 24 for 42; 36 for 63 and so on.

When errors are located, they should be rectified. It is not a good practice nor do we have the legal right to erase the mistakes and rewrite the correct ones. Rectification entries are recorded in General journal or journal proper.

Illustration 1: Goods ` 3,000/- sold to Nishikant has been debited to M/s Nishi & Co. a/c.

Solution:

<i>Entry</i>	<i>Dr.</i>	<i>Cr.</i>
Wrong Entry		
M/s Nishi & Co. a/c	Dr.	
To Sales a/c		3,000
Reverse Entry		
Sales A/c	Dr.	
To M/s Nishi & Co. a/c		3,000
Correct Entry		
Nishikant's a/c	Dr.	
To Sales a/c		3,000
Rectification Entry		
Nishikant's a/c	Dr.	
To M/s Nishi & Co. a/c		3,000

Illustration 2: A credit purchase of ₹ 3,000 from Nishikant is posted to his account as ₹ 30,000.

Solution:

<i>Entry</i>	<i>Dr.</i>	<i>Cr.</i>
Wrong Entry		
Purchase a/c	Dr.	3,000
To Nishikant's a/c		3,000
Reverse Entry		
Nishikant's a/c	Dr.	3,000
To Purchase a/c		3,000
Correct Entry		
Purchase a/c	Dr.	3,000
To Nishikant's a/c		3,000
Rectification Entry		
Nishikant's a/c	Dr.	3,000
To Purchase a/c		3,000

Illustration 3: A credit purchase from Nishi & Co. has been wrongly recorded in sales book ₹ 3,000/.

Solution:

<i>Entry</i>	<i>Dr.</i>	<i>Cr.</i>
Wrong Entry		
M/s Nishi & Co. a/c	Dr.	3,000
To Sales a/c		3,000
Reverse Entry		
Sales a/c	Dr.	3,000
To M/s Nishi & Co. a/c		3,000
Correct Entry		
Purchase a/c	Dr.	3,000
To M/s Nishi & Co. a/c		3,000
Rectification Entry		
Purchase a/c	Dr.	3,000
Sales a/c	Dr.	3,000
To M/s Nishi & Co. a/c		6,000

Illustration 13: An accountant finds that the trial balance of his client did not tally and it showed an excess credit of ₹ 69.74. He transferred it to a suspense account and later discovered the following errors.

- (a) ₹ 44.37 paid to Anand has been credited to his account as ₹ 34.37.
- (b) A purchase of ₹ 145.50 has been posted as ₹ 154.50 to the purchases account.

- (c) An expenditure of ₹ 158 on repairs has been debited to the Buildings account.
 (d) ₹ 80 was allowed by B as discount which has not been entered in the books.
 (e) A sum of ₹ 125.05 realized on the sale of old furniture has been posted to the sales account.

Give journal entries to rectify the errors.

Solution:

<i>Date</i>	<i>Particulars</i>	<i>L.F.</i>	<i>Debit (₹)</i>	<i>Credit (₹)</i>
1	Anand's account Dr. To Suspense account (Being wrong amount, wrongly credited to Anand's a/c rectified)		78.74	78.74
2	Suspense account Dr. To Purchases account (Being over debit of Purchase a/c rectified)		9.00	9.00
3	Repairs account Dr. To Buildings account (Being wrong debit given to buildings account rectified)		158.00	158.00
4	B's account Dr. To Discount received account (Being discount received from B, omitted earlier, brought to account)		80	80
5	Sales account Dr. To Old furniture account (Being sales of old furniture wrongly transferred to sales account rectified)		125.05	125.05

Note:

1. The entry should have been:

Anand a/c	Dr.		44.37	
		To Cash a/c		44.37

(Being cash paid to Anand accounted)

When amount is paid to Anand, his account should have been debited. On the other hand, his account was credited for a wrong amount of ₹ 34.37. Hence, there has been excess credit to the extent of ₹ 78.74 (44.37 + 34.37). To rectify this double error, we need to debit Anand's account to the extent of ₹ 78.74 and credit suspense account.

2. Purchases account was overdebited by ₹ 9 (₹ 154.50 – ₹ 145.50). To rectify this error, we need to credit purchase account to the extent of ₹ 9 and debit suspense account.
 3. Repairs spent on building are by mistake debited to building account. This is error of principle. Repairs account is debited and buildings account is credited to rectify the error.

4. Discount received from B has not been taken to records. This is an error of omission. Therefore, it is now brought to accounts. This has not affected the trial balance.
5. When old furniture is sold, the furniture account should have been credited. On the other hand, sales account was credited against to the principle of accounting. To rectify the error, sales account is debited and old furniture account is credited.

Illustration 5: The trial balance of Evergreen Co. Ltd. taken out as on 31st December, 2002 did not tally and the difference was carried to suspense account. The following errors were detected subsequently.

- (a) Sales book total for November was undercast by ` 1,200.
- (b) Purchase of new equipment costing ` 9,475 has been posted to Purchases a/c.
- (c) Discount received ` 1,250 and discount allowed ` 850 in September 2002 have been posted to wrong side of discount account.
- (d) A cheque received from Mr. Longford for ` 1,500 for goods sold to him on credit earlier, though entered correctly in the cash book has been posted in his account as ` 1,050.
- (e) Stocks worth ` 255 taken for use of Mr. Dayananda, the Managing Director, has been entered in sales day book.
- (f) While carrying forward, the total in Return Inwards Book has been taken as ` 674 instead of ` 647.
- (g) An amount paid to cashier, Mr. Ramachandra, ` 775 as salary for November month has been debited to his personal account as ` 757.

Pass journal entries and draw up the suspense account.

Solution:

Journal Proper of Evergreen Co Ltd.

<i>Date</i>	<i>Particulars</i>	<i>L.F.</i>	<i>Debit (`)</i>	<i>Credit (`)</i>
31-12-2002	Suspense account Dr. To Sales account (Being undercasting of sales book rectified)		1,200	1,200
31-12-2002	New Equipment account Dr. To Purchases account (Being wrong debit given to purchase account rectified)		9,475	9,475
31-12-2002	Discount allowed account Dr. Suspense account Dr. To Discount received account (Being discount received and discount allowed posted to wrong side of discount account rectified)		1,700 800	2,500
31-12-2002	Suspense account Dr. To Longford's account (Being short credit given to Longford's account)		450	450

31-12-2002	Sales account To Suspense account (Being stock used for personal purpose wrongly credited to sales account rectified)	Dr.	255	255
31-12-2002	Suspense account To Return Inwards account (Being excess debit given to return inwards account to the extent of ` 27 now rectified)	Dr.	27	27
31-12-2002	Salary account To Ramachandra's account To Suspense account (Being the wrong debit of salary to the personal account of Ramachandra now rectified)	Dr.	775	757 18

Note:

In Q. No.(c): Discount received ` 1,250 is posted on the wrong side of discount account. Discount received (income) should be credited and discount allowed (expenses) should be debited. Instead of crediting the discount received account, it has been wrongfully debited. To rectify this error, we need to credit discount received account to the extent of ` 2,500 ($\text{` } 1,250 + \text{` } 1,250$).

In the same context, discount allowed which is an expense should be debited instead, it is credited. To rectify the error, we need to debit discount allowed to the extent of ` 1,700 ($850 + 850$). The difference between discount received and discount allowed account is transferred to suspense account.

Illustration 6: The trial balance of M/s J Ltd. on 31st March, 19x1 did not balance. The difference amount of ` 76 was transferred to the credit of suspense account, and the accountant proceeded with the preparation of final accounts. Before completion of final accounts, the following errors were discovered:

- Total of sales figure was taken as ` 58,726 instead of ` 58,762.
- A discount of ` 52 allowed to Mr. X was not recorded in the discount allowed account.
- The total of purchases returns book was undercast by ` 43.
- Sale of old furniture for ` 130 was wrongly entered in Machinery a/c.
- A credit purchase for ` 49 made from Mr. Y was recorded in purchases book, but was omitted to record in Y's account.
- ` 320 received from P was posted to the credit of R.
- A credit sale made to Mr. S for ` 250 was recorded twice in his account.
- Depreciation on plant and machinery was wrongly recorded as ` 750, instead of ` 950.
- ` 50 wages paid on 30th March, 19x1, are not debited to wages account.

Give journal entries to rectify the above errors, and prepare suspense account.

Solution:**Rectification of Errors**

<i>Particulars</i>		<i>Debit (`)</i>	<i>Credit (`)</i>
(a)	Suspense a/c To Sales a/c (Being the sales figure undercast by ` 36)	Dr. 36	36
(b)	Discount allowed a/c To Suspense a/c (Being the discount allowed not recorded earlier)	Dr. 52	52
(c)	Suspense a/c To Purchase returns a/c (Being the total of purchase returns undercast by ` 43)	Dr. 43	43
(d)	Machinery a/c To Furniture a/c (Being the sale of furniture wrongly credited to Machinery a/c earlier)	Dr. 130	130
(e)	Suspense a/c To Y's a/c (or Creditor's a/c) (Being the credit purchase made from Y was not recorded in his account)	Dr. 49	49
(f)	R's a/c To P's a/c (Being the entry to rectify the wrong credit given to R instead of P)	Dr. 320	320
(g)	Suspense a/c To S's a/c (Being the entry to rectify the error of debiting S twice)	Dr. 250	250
(h)	Depreciation a/c To Suspense a/c (Being the entry to record depreciation figure correctly)	Dr. 200	200
(i)	Wages a/c To Suspense a/c (Being the entry to record the wages, which was not recorded earlier)	Dr. 50	50

Illustration 7: The accountant of Jay Ltd. has reconciled the trial balance by putting the difference in a suspense account and has prepared a trading and profit and loss account and balance sheet. Subsequent scrutiny of the books disclosed the following errors:

- A credit sale of goods to Mr. Roshan for ` 2,100 has been credited to his account.
- Goods purchased from Mr. Kanithkar amounting to ` 1,200 were entered in the purchase day book, but were omitted to be entered in the name of Mr. Kanithkar in the creditor's ledger.

- (c) Office furniture purchased for ₹ 2,100 has been passed through the purchase account.
 (d) Repairs to office car amounting to ₹ 850 were debited to the office car account.

You are required to:

- (a) Pass the journal entries for rectification of the above errors.
 (b) Prepare suspense account.

Solution:

Jay Ltd.
Journal Entries

<i>Particulars</i>	<i>Dr. (₹)</i>	<i>Cr. (₹)</i>
(a) Mr. Roshan's account (₹ 2,100 × 2) Dr. To Suspense account (Being sales to Mr. Roshan wrongly credited to his account, now rectified)	4,200	4,200
(b) Suspense account Dr. To Mr. Kanithkar's account (Being purchase from Mr. Kanithkar omitted to be posted to his account in the ledger, now rectified)	1,200	1,200
(c) Office Furniture account Dr. To Profit and Loss Adjustment account (Being purchase of office furniture wrongly passed through the purchase day book, now rectified)	2,100	2,100
(d) Profit and Loss Adjustment account Dr. To Office Car account (Being repairs to office car wrongly debited to office car account, now rectified)	850	850

Illustration 8: In the month of April 2002, the accountant of Mapani & Co. found the following errors in the books of accounts for the year 2001-2002 in spite of the agreed balance sheet:

- (a) A sale of ₹ 20,050 to Mr. Dutta was entered in the sales day book as ₹ 20,500 and it has been debited to Mr. Dutta's account as ₹ 25,000.
 (b) A purchase of ₹ 16,000 from Mr. Philip on 30th March 2002 was taken in stock, but the invoice was not passed through the purchase day book.
 (c) Goods to the value of ₹ 2,750 returned by Mr. Rajkumar had been debited to his account and also to sales return account.
 (d) The purchase day book for the month of March 2002 was undercast by ₹ 10,000.
 (e) Bank interest on overdraft for the month of March 2002, amounting to ₹ 3,750 has not been recorded in the books of accounts.
 (f) A credit sale of ₹ 20,000 on 29th March 2002, has been completely omitted from the sales day book.

You are required to pass the necessary journal entries to rectify the above errors.

Solution:**Mapani & Co.
Journal entries**

<i>Particulars</i>	<i>Dr. ()</i>	<i>Cr. ()</i>
(i) Profit & Loss Adjustment a/c Suspense a/c To Mr. Dutta's a/c (Being sale to Mr. Dutta of ` 20,050 wrongly entered in the sales book as ` 20,500 and posted to his account as ` 25,000 now rectified)	Dr. Dr.	450 4,500 4,950
(ii) Profit & Loss Adjustment a/c To Mr. Philip's a/c (Being goods purchased on 30th March 2002 were included in stock but not recorded in the purchase book, now rectified)	Dr.	16,000 16,000
(iii) Suspense a/c To Mr. Rajkumar's a/c (` 2,750 × 2) (Being goods returned by Mr. Rajkumar wrongly debited to his account, now rectified)	Dr.	5,500 5,500
(iv) Profit & Loss Adjustment a/c To Suspense a/c (Being error caused by undercasting of the purchase book in the month of March 2002, now rectified)	Dr.	10,000 10,000
(v) Profit & Loss Adjustment a/c To Bank a/c (Being bank interest previously not recorded now rectified)	Dr.	3,750 3,750
(vi) Sundry Debtors a/c To Profit & Loss Adjustment a/c (Being credit sales completely omitted from sales day book, now rectified)	Dr.	20,000 20,000

EXERCISE**Self Assessment Questions:**

- Normally, a trader's cash book shows a _____ balance while his bank statement shows a _____ balance.
- A debit balance of the Pass Book represents _____ .
- Cheques deposited by a trader and cleared by the bank appear on the _____ side of his Pass Book.
- Cheques issued by a trader and encashed by his creditors are _____ in his Pass Book.
- Interest on overdraft is _____ by the bank in the Pass Book.
- Balance as per Cash Book and Pass Book are always equal.

7. A bank reconciliation statement is not prepared when the trader has no bank account.
8. Errors in the Cash Book or Pass Book cannot be found by preparing a Reconciliation Statement.
9. While reconciling the Cash Book and Pass Book Balance of the debit side, Cash Book is compared with the credit side of Pass Book and *vice versa*.
10. If the bank gives a bank statement instead of the Pass Book, no reconciling statement is necessary.
11. Errors can be committed at all stages, beginning from journal entries, posting of entries in ledger accounts, while balancing the closing balances etc. (True/False)
12. Errors of omission, error of principle and compensating errors are not disclosed by trial balance, (True/False)
13. Errors of casting, posting to wrong side of an account or posting a wrong amount etc. can be detected by trial balance, (True/False)
14. Suspense account is the difference between debit total and credit total of a trial balance, (True/False)
15. Suspense account is created temporarily and later, it is removed as and when errors are detected and suitable rectified. (True/False)
16. If amount paid to Rama ` 500 is credited to Ramanan's account, what type of error has occurred and give the rectification entry.
17. Instead of putting ` 1,500 to debit of wages account, ` 15,000 is recorded. Identify the type of error and tell what impact it has on profit?
18. Refer Q. No.17. How do you rectify the above error?
19. If error of wrong posting, wrong casting, wrong calculation are committed in the books of original entry or secondary books, such errors are called _____.
20. Error of commission affects trial balance. (True/False)
21. Furniture purchased for cash ` 5,000/- is not recorded in journal. Mention the type of error?
22. Error of omission can be detected only after a careful review of ledger balances of previous years (True/False).
23. Error of principle affects the value of revenue and capital items. (True/False)
24. It is very difficult to find out the compensating errors. (True/False)
25. Summary of all ledger balances is called _____.
26. Trial balance is necessary to prepare _____.
27. The broad two categories of errors are: (a) _____ (b) _____.
28. Is casting error, an error of principle or error of commission?
29. Purchase of machinery is included in the purchases book. What type of error is it?
30. What is error of omission? Illustrate.
31. What are the errors that cannot be disclosed by trial balance?

32. The sum of errors in accounting is transferred temporarily to _____ account.
33. In which journal do you make rectification entries?
34. State any four steps to locate errors.
35. If sales account is undercast by ` 45, what is the rectification entry?
36. Return inwards book is overcast by ` 9. Write the rectification entry.
37. Salary paid to Gopal is debited to his personal account. What is the rectification entry to correct the error?
38. Discount received ` 50 is transferred to the debit side of discount account. Write the rectification entry.
39. An invoice of purchase for ` 760 is entered as ` 670. What type of error is this? How to rectify this error?

Answers: 1. debit, credit, 2. overdraft, 3. credit, 4. debited, 5. debited, 6. False,
 7. True, 8. False, 9. True, 10. False, 11. True, 12. True,
 13. True, 14. True, 15. True,

16. It is a wrong posting and hence it is error of commission.

Rama's a/c	Dr.	500
Ramanan's a/c	Dr.	500
To Suspense a/c		1,000

(Being amount paid to Rama wrongly credited to Ramanan's account rectified)

17. Posting of wrong amount - Trial balance is affected. Profit (gross) is reduced by ` 13,500,

18. Suspense a/c	Dr.	13,500
To Wages a/c		13,500

(Being excess debit to wages account rectified)

19. Error of commission, 20. False, 21. Error of omission,
22. True, 23. True, 24. True,
25. Trial balance, 26. final accounts,
27. Error that are disclosed by trial balance and those which cannot be disclosed by trial balance,
28. Error of commission, 29. Error of principle,
30. Omitting completely a transaction from books of original entry. Sales made to Raghu of ` 12,000 completely ignored,
31. Error of omission, commission, principle, compensating error,
32. Suspense account, 33. Journal proper,

2. Correct the following errors found in the books of Mr. Dutt. The trial balance was out by ` 493/- excess credit the difference has been posted to Suspense Account.
- (a) An amount of ` 100 was received from Dhiraj on 31st December, 2012 but had been entered in the cash book on 3rd Jan 2013.
 - (b) The total of Return inward book for December had been cast ` 100 short.
 - (c) The purchase of an office table costing ` 300/- had been passed through the purchase book.
 - (d) ` 375 paid for the wages to workmen for making showcases had been charged to wages account.
 - (e) A purchase of ` 67 had been posted to the creditors account as ` 60/-.
 - (f) A cheque for ` 200/- received from P.C. Joshi had been dishonoured and was passed to the debit of allowances account.
 - (g) ` 1000 paid for the purchase of a motor cycle for Mr. Dutt's personally use had been charged to miscellaneous expenses account.
 - (h) Goods amounting to ` 100 had been returned by the customers and were taken to stock, but no entry in respect thereof was made into the books.
 - (i) A sale of ` 200/- to Sanghvi & Co. was wrongly credited to their account.

Concept Tester

- Q.1. Name different classes of errors?
Ans: (i) Bookkeeping errors (ii) Trial balance errors.
- Q.2. Define bookkeeping errors?
Ans: Errors which are committed in the books of original entry or ledgers are called book-keeping errors.
- Q.3. Name different classes of bookkeeping errors?
Ans: (i) Errors of omission (ii) Errors of commission
- Q.4. Define errors of omission?
Ans: The errors resulting from the complete failure of entry of transaction in the books are called errors of omission.
- Q.5. Name different classes of errors of omission.
Ans: (i) Complete errors (ii) Partial errors.
- Q.6. What do you mean by complete errors and gives its two examples?
Ans: When any particular transaction has not at all been entered in the book of original entry, it is known as complete errors. **Examples:** (i) Cash received from Ali was not recorded in cash book. (ii) Goods sold to Shahid were not recorded in cash book.
- Q.7. What do you men by partial errors and give its two examples?
Ans: If a transaction has been recorded in a book of original entry but has not been posted in ledger account, it is called partial error. **Examples:** (i) Cash received from Ali was not recorded in cash book. (ii) Goods sold to Shahid were not recorded debited to his account.

Q.8. Define error of commission.

Ans: Error which occurs when a transaction is wholly or partially incorrectly recorded in the books of account are called errors of commission.

Q.9. What are different classes of errors of commission?

Ans: (i) Errors of principle, (ii) Compensating errors, (iii) Errors of posting and (iv) Errors of casting.

Q.10. Define compensating errors.

Ans: Compensating errors means errors which are cancelled by other errors of same amount in the same account or error of same amount on the opposite side. These errors are of a neutralizing nature.

Q.11. Define error of posting.

Ans: If a transaction has been recorded in the book of original entry but has been posted wrongly in the ledger account, it is known as error of posting.

Q.12. Define errors of casting and give its two examples.

Ans: The errors which may occur due to shortcasting or excess casting in any book of original entry or in the ledger account. **Examples:** (i) Sales day book was undercast, (ii) Purchases day book was overcast.

Q.13. What do you know about the "Trial balance errors"?

Ans: Errors which are made in the preparation of Trial balance are called trial balance errors.

Q.14. What is suspense account?

Ans: A ledger account in which entries are made on a temporary basis when the correct account cannot be immediately identified is called suspense account.

Q.15. Give any three examples of trial balance errors.

Ans: (i) Transfer or balance to the wrong column of the trial balance, (ii) Omission of balance from trial balance and (iii) Wrong casting of trial balance.

Q.16. Give any two examples of errors of principle.

Ans: (i) Incorrect application of capital and revenue expenditures, (ii) Wrong estimation of depreciation etc.

Q.17. Pass the rectifying entry, sale of old furniture has been credited to sales account of ₹ 200.

Ans: Sales Account Dr. 200
 To Furniture Account 200

Q.18. What rectifying entry will be passed, if sales book was undercast by ₹ 300?

Ans: Suspense Account Dr. 300
 To Sales Account 300

Q.19. Name different stages available for rectifying errors in account.

Ans: (i) Before the preparation of trial balance, (ii) After the preparation of trial balance but before the preparation of final accounts and (iii) After the preparation of final accounts.

Q.20. Write down the procedure for correcting errors?

Ans: There are three questions which must be answered before an error can be corrected. They are: (i) What should have happened, and (ii) What has happened? (iii) What action will correct the error.

Q.21. Differentiate between errors of omission and errors of commission.

Ans: Errors of omission Errors of commission

- | | |
|---|--|
| 1. They represent absolute omission. | 1. They represent incorrect recording |
| 2. They have no effect on agreement of trial balance. | 2. They may effect agreement of trial balance. |

Q.22. Give any four types of errors which do not affect the trial balance agreement?

Ans: (1) Errors of principle, (2) Compensating errors, (3) Wrong posting in the same head of account, and (4) Errors of complete omission.

Q.23. Write any two examples of errors which affect agreement of Trial balance?

Ans: (1) Partial omission, and (2) Posting to wrong side of ledger.

Q.24. Differentiate between errors of posting and errors of casting.

Ans: Errors of posting Errors of casting

- | | |
|---|---|
| 1. They represent wrong posting. | 1. They represent wrong casting. |
| 2. They involved transferring of transactions from Journal to ledger. | 2. They normally consist on wrong casting of books of original entry or ledger's account. |

Q.25. What rectifying entry will be passed, if sales book was overcast by ` 1,500?

Ans: Sales a/c ` 1,500
 To Suspense a/c ` 1,500
 (Being casting error in sales book rectified)

Q.26. What rectifying entry will be passed, if purchases day book was overcast?

Ans: Suspense a/c
 To Purchases a/c
 (Being casting errors in purchases book rectified)

Q.27. What rectifying entry will be passed Rs. 2000 if freight paid on machinery was charged to freight a/c.

Ans: Machinery a/c 2000
 To Freight a/c 2000
 (Being error in freight recording rectified).



CHAPTER 5

Trial Balance and Final Account



INTRODUCTION

The primary function of accounting is to accumulate accounting data in a manner that the amount of profit made or loss suffered during a period can be determined. The manner in which the amount of profit or loss has been arrived at is disclosed in the statement of accounts, prepared at the end of the accounting year. The various items of income and expenditure which arose during the accounting period are detailed out, bothering, grouped under significant heads. It is also accompanied by a balance sheet, exhibiting assets and liabilities of the business as at the close of the period. In addition, for showing the nature of economic activity to which the account pertains, the revenue account as well as different sections in which it is set up are invariably headed as manufacturing trading and profit and loss account or simply as profit and loss account. These two statements, i.e., trading and profit and loss account and balance sheet are prepared to give the final results of the business. That is why both are collectively called final accounts.

Thus, preparation of final accounts is the last step in the accounting cycle. In fact, final accounts include a number of accounts such as: (i) trading accounts, (ii) profit and loss account and (iii) balance sheet. Though balance sheet is a statement, for all practical purposes, it is treated as one of the final accounts.

Once the "trial balance" is extracted and 'errors' rectified, a trader prepares the "final accounts" so as to know the final results (i.e., net profits or loss) and the financial position (i.e., assets and liabilities) of his business. Trading account and profit and loss account concerning goods by passing entries are known as "closing entries". All remaining accounts, viz., real and personal accounts pertaining to property, assets, debtors and creditors are just shown in a statement called balance sheet.

This procedure is discussed in detail in the following pages.

MANUFACTURING ACCOUNT

Those concerns which are converting raw materials into finished goods and then sell the finished goods are required to prepare manufacturing account besides preparing trading and profit and loss account. This account is prepared to calculate the cost of goods manufactured, which is transferred to the trading account. The expenses relating to the factory are transferred to manufacturing 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.

Features of Manufacturing Account

- (a) **Stock of Finished Goods:** Since the main purpose of preparing this account, is to find out the cost of goods produced during the year, the opening and closing stock of finished goods are not to be shown in this account. They will be shown in the trading account.
- (b) **Raw Material Consumed:** The cost of raw materials consumed during the year is to be debited in the account. It can be found out as follows:

Cost of raw material consumed

Opening stock of raw materials	xxx	
Add: Purchase of raw materials	xxx	
	xxx	
Less: Closing stock of raw materials	xxx	xxx

- (c) **Work-in-Progress (partly finished stock):** In a manufacturing business concern, there are always some unfinished goods, the cost of closing work-in-progress is credited in the account, shown in the balance sheet and debited to the manufacturing account of the next year as an opening balance.
- (d) **Factory Expenses:** All factory expenses are debited to this account factory rent, rates, salaries of supervising staff, light, heat and fuel, repairs and renewals, depreciation relating to factory property (i.e., machinery) etc.
- (e) **Sale of Scrap:** Scrap is the incidental residue from certain types of manufacture. The value realized from the sale of scrap is credited to the manufacturing account.
- (f) **Cost of Production:** At this stage, the difference between the two sides of the manufacturing account shows the cost of goods produced during the year. The balancing figure in the account is the cost of goods manufactured which will be debited to trading account. The trading account therefore, will comprise only the opening stock of finished goods, cost of goods manufactured, sales (less sales returns), and the closing stock of finished goods.

A Proforma of manufacturing account is given below:

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

<i>Particulars</i>	()	<i>Particulars</i>	()
To Work-in-progress (opening)	xxx	By Sale of scrap	xxx
To Material used		By Work-in-progress (closing)	xxx
Opening stock	xxx	By Cost of goods produced transferred	
<i>Add:</i> Purchases	xxx	to Trading a/c (bal. fig.)	xxx
<i>Less:</i> Closing stock	xxx		
	xxx		
To Wages	xxx		
To Factory expenses	xxx		
To Purchase expenses	xxx		
To Import duty	xxx		
To Carriage inward	xxx		
To Depreciation on machinery	xxx		
To Repairs to machinery	xxx		
	xxx		xxx

TRADING ACCOUNT

Trading account is prepared for specific period to know the trading results of the business. It contains in a summarized form all the transactions occurring during a trading period which have direct relation to the goods dealt in by the business. It is prepared usually by merchandising concerns which purchase goods and sell the same during a particular accounting period. It is mainly prepared to ascertain the gross profit or gross loss. Gross profit or gross loss is the difference between actual sale proceeds and the cost of goods sold (Gross profit = Excess of sale proceeds over cost of goods sold and Gross Loss = Excess of cost of goods sold over sale proceeds). The 'cost of goods sold' includes the "purchase value" of such goods plus the "buying and bringing" expenses and the "conversion expenses of raw materials into saleable finished goods. Thus, 'cost of goods' consists of:

- (i) The opening stock of goods plus net purchases (i.e., purchases less returns) less closing stock of such goods and
- (ii) All expenses of bringing the goods into saleable condition and also to the point of sale, i.e., all manufacturing expenses, carriage, cartage, freight, duty, etc.

Preparation of Trading Account

Trading account is a ledger account. Therefore, its form and construction conform to the rules of double entry principles of debit and credit.

As the trading account contains the results of operations over a period, the heading should be "Trading account for the year (or any period) ended.....".

A Proforma of a trading account is given below:

Trading account for the year ended.....

<i>Particulars</i>	()	<i>Particulars</i>	()
To Opening stock of Fin. Goods	xxx	By Sales	xxx
To Purchases	xxx	Less: Sales returns	xxx
Less: Purchase returns	xxx	By Closing stock of Fin. Goods	xxx
To Cost of production (from Manufacturing Account)	xxx	By Gross Loss c/d (tranf. to Profit & Loss a/c)	xxx
To Gross profit c/d (tranf. to Profit & Loss a/c)	xxx		
	xxx		xxx

Note: Balancing figure will be either gross profit or loss.

Closing Entries in Respect of Trading Account

The following entries are passed in the journal to transfer the relevant ledger balances to the trading account.

- (i) For transferring opening stock, net purchases and direct expenses to trading account:

Trading a/c	Dr.	xxx	
To Opening stock a/c			xxx
To Purchases (net) a/c			xxx
To Direct expenses a/c			xxx

- (ii) For transferring net sales and closing stock to trading account:

Sales (net) a/c	Dr.	xxx	
Closing stock a/c	Dr.	xxx	
To Trading a/c			xxx

- (iii) (a) For gross profit

Trading a/c	Dr.	xxx	
To Gross profit a/c			xxx

- (b) For gross loss

Gross loss a/c	Dr.	xxx	
To Trading a/c			xxx

PROFIT AND LOSS ACCOUNT

According to Prof. Carter, "profit and loss account is an account into which all gains and losses are collected in order to ascertain the excess of gains and losses or *vice versa*". Profit and loss account is prepared in order to calculate the net profit or net loss of the business. This account starts with the credit from the trading account in respect of gross profit (or debit if there is gross loss).

From gross profit, operating and non-operating expenses are deducted and operating and non-operating income is added in order to calculate the net profit. When total of all the expenses is more than gross profit and other income, there remains a deficit and this is called net loss. The net profit or net loss ultimately transfers to capital account of the proprietor's capital accounts.

Preparation of Profit and Loss Account

As in the case of a trading account, the profit and loss account is an account and hence, its form and construction conform to the rules of ledger account and principles of double entry system.

Since the profit and loss account is prepared to show the net profit earned or net loss incurred during a particular period, it should be headed as under:

Profit and Loss A/c of..... for the year ended

<i>Particulars</i>	<i>(₹)</i>	<i>Particulars</i>	<i>(₹)</i>
To Gross loss b/d	xx	By Gross profit b/d	xx
To Office & Admin expenses:		By Interest received	xx
Office salaries	xx	By Discount received	xx
Rent, rates and taxes	xx	By Commission received	xx
Printing & stationery	xx	By Rent from tenants	xx
Postage & telegrams	xx	By Income from investments	xx
Telephone charges	xx	By Apprenticeship premium	xx
Legal charges	xx	By Interest on debentures	xx
Audit fees	xx	By Miscellaneous revenue receipts	xx
Insurance	xx	By Net loss transferred to Capital a/c	xx
General expenses	xx		
Office lightning	xx		
To Financial expenses:			
Interest on capital	xx		
Interest on loans	xx		
Discount allowed	xx		
Discount on bills	xx		
To Selling and Distribution Expenses:			
Advertising	xx		
Traveller's salaries	xx		
Expenses and commission	xx		
Bad debts	xx		
Godown rent	xx		
Carriage outwards	xx		
Agent's commission	xx		
Upkeep of motor vans	xx		
Export expenses	xx		

BALANCE SHEET

It is a classified summary of balances remaining open in the general ledger after all the income and expenditure accounts have been closed off by transfer to trading and profit & loss account. It shows readily the financial position of the business at a given date by disclosing the amount of capital contributed and how the same has been invested and the values of assets and liabilities and their nature. The capital and liabilities of the business are shown on the left hand side and assets and other debit balances are shown on the right hand side. It is a statement containing all the unclosed balance "real" and "personal" accounts.

Balance sheet is prepared with a view to measure the correct financial position of a business enterprise on a certain fixed date. It is a device for describing the financial position of a business in systematic standard form. By putting the financial position into such a form, it is possible to tell a complicated story of the enterprise in less time and space than if the same story were to be written as an extended narration. "Balance Sheet is a snapshot of the financial condition of the business". At one glance, the situation of the enterprise at certain date can be understood. Therefore, it is rightly called as "Mirror" of the business wherein the business can see its face, i.e., its true position.

An important thing to note about the balance sheet is that it always balances, that is to say, the total value of the assets is always equal to the total value of the claims or liabilities. In other words,

$$\text{Assets} = \text{Liabilities} + \text{Capital (or)}$$

$$\text{Assets} - \text{Liabilities} = \text{Capital}$$

In the other words of Francis R. Stead, "Balance sheet is a screen picture of the financial position of a going business at a certain moment."

According to R.N. Antony, "Balance sheet is a statement which reports the property values owned by the enterprise and the claims of the creditors and owners against the properties. It shows the status of the business as at a given moment of time, insofar as a counting of figures can show its status."

A Proforma of balance sheet in the order of permanency is given below:

Balance Sheet ofas on.....

<i>Liabilities</i>	()	<i>Assets</i>	()
Capital		Fixed assets:	
<i>Add:</i> Net profit		Goodwill	
<i>Add:</i> Interest on capital		Land & building	
<i>Less:</i> Drawings		Loose tools	
<i>Less:</i> Interest on drawings		Furniture & fixtures	
<i>Less:</i> Loss if any		Vehicles	
		Patents	
		Trade marks	

<p>Long-term liabilities: Loan on mortgage Bank loan</p> <p>Current liabilities: Sundry creditors Bills payable Bank overdraft Creditors for outstanding expenses Income received in advance</p>	<p>Long-term loans (advances): Investments</p> <p>Current assets: Closing stock Sundry debtors Bills receivable Prepaid expenses Accrued income Cash at bank Cash in hand</p> <p>Fictitious assets: Preliminary expenses Advertising expenses Underwriting commission Discount on issue of shares Discount on issue of debentures</p>
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ADJUSTMENTS AND CLOSING ENTRIES

Final accounts are prepared for a completed period. It must be kept in mind that expenses and incomes for the full accounting period are to be taken while preparing final accounts. If an expense has been incurred but not paid during the period, a liability for the unpaid amount should be created before finding out the operating results and financial position of a concern. In order to prepare the final accounts on mercantile system of accountancy, all expenses and incomes relating to the period whether incurred or not, received or not should be brought into account. For doing this, a concern is required to pass certain entries at the end of the year to adjust the various items of incomes and expenses. Such entries are called adjusting entries. The various adjustments required are given below:

Closing Stock: It refers to the value of unsold goods lying in stock at the end of the accounting period. It should be valued either at cost price or market whichever is lower. It consists of three items, i.e., raw materials, work-in-progress and finished goods. The adjustment entry is:

Closing stock a/c	Dr.	xxx	
To Trading a/c			xxx

The value of closing stock will appear on the assets side of balance sheet and on the credit side of trading account.

Outstanding Expenses: These are certain expenses which relate to a particular accounting period but they are not paid in that accounting period due to certain reasons, i.e., all expenses which are due for payment in one accounting year but actually paid in future accounting years or payment on which is postponed are all outstanding or unpaid expenses. At the end of the accounting year, all

such expenses must be brought into books, otherwise the profit will be overstated. The adjustment entry is:

Expenses a/c	Dr.	xxx	
			To Expenses outstanding a/c
			xxx

Expenses outstanding are added to the respective expenses account in trading or profit & loss a/c and also shown on the liabilities side of the balance sheet. Next year, the expenses outstanding account will be transferred to the expenses account.

If the outstanding expenses a/c appears in the trial balance, it means that the adjustment has already been made and hence nothing has to be done in trading or P & L account. But the liability already appearing in the trial balance should be shown in the balance sheet.

Prepaid Expenses: Prepaid expenses are those expenses which have been paid in advance but relating to the future accounting period. These are also called the unexpired expenses. The adjustment entry is:

Prepaid expenses a/c	Dr.	xxx	
			To Expenses a/c
			xxx

Prepaid expenses account is shown on the assets side of balance sheet and expenses account is shown as a deduction from the respective expenses account in trading and P & L a/c. If prepaid expenses appear in the trial balance, it means that the adjustments has already been made nothing is to be done in trading and P & L accounts. But the prepaid expenses will appear as an asset in the balance sheet. Generally, insurance, taxes, telephone subscription, etc. are paid in advance thus, requiring adjustments.

Accrued Income: Outstanding or accrued income is the income which has been earned but not received during the accounting period. The adjustment entry is:

Accrued income a/c	Dr.	xxx	
			To Income a/c
			xxx

Accrued income is shown on the assets side of balance sheet and it is added to the respective income account in P & L a/c credit side. No adjustment is required in the P & L a/c if accrued income a/c appears in the trial balance, but such an account must be shown as an asset in balance sheet.

Income Received in Advance: Many a time, traders receive money during a particular trading period for the work to be done in future period. Thus, without rendering any service, they receive income. Such an income is known as income received in advance, i.e., the income received but not earned during the accounting period. The adjustment entry is:

Income a/c	Dr.	xxx	
			To Income received in advance a/c
			xxx

Income received in advance is shown as deduction from the respective income in P & L a/c and is shown on the liabilities side of balance sheet. No treatment is required in the P & L account if income received in advance account appears in the trial balance. But such account must be shown as a liability in the balance sheet.

Depreciation of Assets: Depreciation is a permanent decrease or reduction in the value of a fixed asset. The asset may reduce in value due to its constant use or even sometimes due to its non-use, i.e., merely by passage of time. Whatever may be the cause for decline, the fact is that such reduction is a loss to the business. Therefore, it must be written off from the asset so as to arrive at the true results of the business. The adjustment entry for depreciation of assets is:

Depreciation a/c	Dr.	xxx	
			xxx
To Asset a/c			

Depreciation is shown on the debit side of profit and loss account and is deducted from the asset in the balance sheet. Depreciation account (Dr.) appearing in the trial balance has to be debited to profit and loss account and no deduction from asset balance is required because this has already been done.

Interest on Capital: In order to see the real profitability of the business, it is desirable to charge interest on capital treating it as a business expense. In order to bring this interest books, the following adjustment entry is passed:

Interest on capital a/c	Dr.	xxx	
			xxx
To Capital a/c			

Interest on capital is shown on the debit side of profit and loss account and is added to the capital on the liabilities side of balance sheet. Interest on capital account appearing in the trial balance is only to be shown in P & L a/c on debit side and it is not required to be included in capital account because this has been already included.

Interest on Drawings: When the proprietor withdraws money from the business for personal use almost to temporary loan by the business to the proprietor. This should be treated on par with loan to an outsider from whom interest is receivable by the business. Therefore, the business charges the proprietor with interest on amounts drawn by him. Thus, interest on drawings is a business income. The following adjustment entry is to be passed to bring this item into account:

Capital a/c	Dr.	xxx	
			xxx
To Interest on drawings a/c			

Interest on capital is shown on the credit side of profit and loss account and it is deducted from the capital account on the liabilities side of balance sheet. Interest on drawings account appearing in the trial balance has to be transferred to profit and loss account on credit side alone.

Bad Debts: When a claim against a debtor becomes irrecoverable, it is called bad debt. If a person files a petition in bankruptcy, his creditors generally write off the irrecoverable amount due as a bad debt. The entry in the books of the creditor is:

Bad debts a/c	Dr.	xxx	
To Debtor's a/c			xxx

Bad debts is shown on the debit side of P & L a/c and also deducted from debtors in the balance sheet. Alternatively, bad debts amount is closed by transfer to the debit of provision for bad & doubtful debts.

Provision for doubtful debts a/c	Dr.	xxx	
To Bad debts a/c			xxx

If the bad debt amount is recovered in future years, the cash is debited and bad debts recovered a/c is credited in that year. The balance in the later account is closed by transferring it to the credit of P & L a/c as revenue in that year. If the bad debt appears in the trial balance, it means that an adjustment has already been made and this will appear only on the debit side of the profit and loss account. It need not be reduced from debtors in the balance sheet.

Provision for Bad and Doubtful Debts: Sometimes, a merchant feels that there are certain debtors from whom the money may or may not be realizable. As there is a possibility of anticipated losses and in order to provide for such loss in the accounts, a provision for doubtful debts is required to be made. It is generally a percentage on the debtors and the percentage are fixed on the basis of past experience. The following adjusting entry will be made in order to bring the provision for doubtful debts into the books:

Profit and loss a/c	Dr.	xxx	
To Provision for doubtful debts a/c			xxx

This provision is shown as a deduction from existing debtors on the assets side of balance sheet.

If the net existing provision is in excess of required provision and bad debts, the excess should be credited back to profit and loss account with the following entry:

Provision for doubtful debts a/c	Dr.	xxx	
To Profit & loss a/c			xxx

In this case also, the amount of 'provision required' should be shown as a deduction from the existing debtors on the assets side of the balance sheet. The object of making the provision is to show the debtors on the balance sheet at a realizable value.

Sometimes, bad debts may be written off during the year. Some additional bad debts are to be written off at the time of finalizing accounts. There may be existing provision for doubtful debtors (old provision). Provision is required on the debtors as on the closing date. The following is the usual way of dealing with all these items:

Profit & loss a/c (debit side)		
Bad debts (as per trial balance)		xxx
Add: Bad debts (as per adjustments)		xxx

Add: New provision required	xxx	

	xxx	
Less: Existing provision (given in trial balance)	xxx	
Net debit to P & L a/c	----	xxx

The new provision required is to be reduced from the debtors in the balance sheet along with additional bad debts as per adjustments.

Provision for Discount on Debtors: The provision for discount on debtors is calculated at a certain percentage on good debtors. No discount is allowed on doubtful debtors. This is to provide a certain amount for allowing discount to customers for prompt payment. The adjustment entry is:

Profit & loss a/c	Dr.	xxx	
To Provision for discount on debtors a/c			xxx

The provision for discount on debtors is shown as a deduction from good debtors on the assets side of balance sheet and is debited to profit and loss account.

Provision for Discount on Creditors: The creditors may offer some discount for prompt payment by the firm. This is calculated at a certain percentage on sundry creditors. The adjustment entry is:

Provision for discount on creditors a/c	Dr.	xxx	
To Profit & loss a/c			xxx

The provision for discount on creditors is shown as a deduction from sundry creditors on the liabilities side of balance sheet and is credited to P & L A/c.

Loss of Stock by Accident, Fire etc.: Stock of goods destroyed due to abnormal causes must be treated as abnormal loss. If there is no insurance, the entire stock lost should be treated as abnormal loss. The entry is:

Abnormal loss a/c	Dr.	xxx	
To Trading a/c			xxx

Since there will be no recovery, the abnormal loss has to be closed.

Profit & loss a/c	Dr.	xxx	
To Abnormal loss a/c			xxx

If there is insurance, amount recoverable from insurance company has to be debited to insurance company and the balance of abnormal loss is written off to P & L a/c.

Profit & loss a/c	Dr.	xxx	
Insurance company a/c	Dr.	xxx	
To Abnormal loss a/c			xxx

Illustration 1: Prepare Trading Account of Archana for the year ending 30-12-12 from the following information:

<i>Particulars</i>	(₹)
Opening stock	80,000
Purchases	8,60,000
Freight inward	52,000
Wages	24,000
Sales	1,44,0000
Purchase Returns	10,000
Sales Returns	3,16,000
Closing stock	1,00,000
Import duty	30,000

Solution:

Trading Account of Archana for the year ending 30-12-2012

<i>Particulars</i>	(₹)	<i>Particulars</i>	(₹)
To Opening stock	80,000	By Sales	14,40,000
To Purchases	8,60,000	Less: Sales returns	3,16,000
Less: Purchase returns	10,000	By Closing stock	1,00,000
To Freight inward	52,000		
To Wages	24,000		
To Import duty	30,000		
To Gross Profit c/d	1,88,000		
	12,24,000		12,24,000

Illustration 2: From the following particulars, prepare Manufacturing account for the year ended 31st March, 2009.

Raw materials (1-4-2008)	33,000
Work-in-progress (1-4-2008)	17,000
Finished goods (1-4-2008)	27,000
Purchases:	
Raw materials	1,00,000
Finished goods	10,000
Carriage inwards:	
on Raw materials	2,500
on Finished goods	100
Purchases returns:	
on Raw materials	5,000
on Finished goods	200

Freight & octroi:

on Purchases of Raw materials	500
on Purchases of Finished goods	100

Sales:

Sales of scrap	150
Sales of Finished goods	3,00,000
Rent (3/4th for factory)	4000
Insurance (20% for factory)	1,000
Productive wages	6000
Repairs to building (40% on office building)	1000
Depreciation on machinery	2,100
Factory supervisor's salary	2,400
Manager's salary (1/4th for factory)	5000
Raw materials (31-3-2009)	22,000
Work-in-progress (31-3-2009)	13,500
Finished goods (31-3-2009)	40,000

Solution:

Manufacturing account for the year ended 31-3-2009

<i>Particulars</i>	()	()	<i>Particulars</i>	()	()
To Opening stock			By Sales of scrap		150
Raw materials (1-4-2008)	33,000		By Cost of production		1,27,900
Work-in-progress (1-4-2008)	17,000	50,000	(trfd to trading a/c (b/f))		
To Purchases of:			By Closing stock		
Raw materials	1,00,000		Raw materials	22,000	
Less: Purchases returns	5,000	95,000	Work-in-progress	13,500	35,500
To Carriage inwards		2,500			
To Freight & octroi		500			
To Rent (3/4th for factory)		4000			
To Insurance (20% for factory)		1,000			
To Productive wages		6,000			
To Repairs to building (60%)		600			
To Depreciation on machinery		2,100			
To Factory supervisor's salary		2,400			
To Manager's salary (1/4th)		1,250			
		1,63,550			1,63,550

Illustration 3: From the following balance extracted at the close of the year ended 31st Dec. 2012, prepare and loss account of Mr. Raj as at that date:

<i>Particulars</i>	(<i>₹</i>)	<i>Particulars</i>	(<i>₹</i>)
Gross profit	55,000	Repairs	500
Carriage on sale	500	Telephone expenses	520
Office rent	500	Interest (Dr.)	480
General expenses	900	Fire insurance premium	900
Discount to customers	360	Bad debts	2,100
Interest from Bank	200	Apprentice premium (Cr.)	1,500
Travelling expenses	700	Printing & Stationery	2,500
Salaries	900	Trade expenses	300
Commission	300		

Solution:**Profit & loss Account of Mr. Raj for the year ending 30-12-2012**

<i>Particulars</i>	(<i>₹</i>)	<i>Particulars</i>	(<i>₹</i>)
To Carriage on sales	500	By Gross profit b/d	55,000
To Office rent	500	By Bank Interest	200
To General expenses	900	By Apprentice Premium	1,500
To Discount to customers	36		
To Travelling expenses	700		
To Salaries	900		
To Commission	300		
To Repairs	500		
To Telephone expenses	520		
To Interest paid	480		
To Fire Insurance Premium	900		
To Bad debts	2,100		
To Printing & stationery	2,500		
To Trade expenses	300		
To Net Profit transferred to Capital a/c	45,240		
	56,700		56,700

Illustration 4: The following are the balances in the Ledger of Mr. Sherif for the year ended 31st March, 2012.

Opening stock	
Raw materials	20,000
Work-in-progress	3,000
Finished goods	10,800
Purchase of raw materials	50,000
Sales	2,40,000
Fuel and coal	1,000
Wages	32,000
Factory expenses	40,000
Office expenses	30,000
Depreciation on Plant & Machinery	3,000
Closing Stock	
Raw materials	2,000
Work-in-progress	4,000
Finished goods	8,000

Prepare Manufacturing and Trading Account for the year ended 31st March, 2012.

Solution:

Manufacturing and Trading Account of Mr. Sherif for the year ending 31.3.12

<i>Particulars</i>	()	()	<i>Particulars</i>	()	()
To Opening work-in-progress		3,000	By Closing work-in-progress		4,000
To Cost of Materials consumed			By Cost of goods manufactured transferred to Trading a/c		1,25,000
Opening stock	20,000				
Add: Purchases	50,000				
	70,000				
Less: Closing stock	20,000	50,000			
To Wages		32,000			
To Fuel & Coal		1,000			
To Factory expenses		40,000			
To Depreciation on Plant & machinery		3,000			
		1,29,000			1,29,000
To Opening stock of finished goods		1,08,000	By Sales		2,40,000
To Cost of goods manufactured		1,25,000	By Closing stock of finished goods		8,000
To Gross Profit c/d		1,12,200			
		2,48,000			2,48,000

Illustration 5: From the following adjusted Trial Balance, prepared after Trading and Profit & loss Accounts are drafted, prepare Balance Sheet of Ramagopalan as at 31st December, 2012 under:

<i>Particulars</i>	<i>Dr. (₹)</i>	<i>Cr. (₹)</i>
Capital		10,000
Closing stock	40,000	-
Fixed assets (less depreciation ` 16,000)	72,000	-
Sundry debtors	1,00,000	-
Provision for bad debts	-	5,000
Profit & loss account	-	42,000
Sundry creditors	-	80,000
Liabilities for expenses	-	11,000
Drawings	6,000	
Cash & Bank	20,000	
	2,38,000	2,38,000

Solution:

Balance Sheet of Ramagopalan as on 30-12-12

<i>Liabilities</i>	<i>(₹)</i>	<i>(₹)</i>	<i>Assets</i>	<i>(₹)</i>	<i>(₹)</i>
Capital (opening balance)	1,00,000		Fixed assets	88,000	
Add: Net profit	42,000		Less: Depreciation	16,000	72,000
	1,42,000		Stock		40,000
Less: Drawings	6,000	1,36,000	Debtors	1,00,000	
Sundry Creditors		80,000	Less: Provision for bad debts	5,000	95,000
Liabilities for expenses		11,000	Cash & bank		20,000
		2,27,000			2,27,000

Illustration 6: The following is the trial balance of Dhandapani of Madras as on 31st December, 2010:

<i>Particulars</i>	<i>(₹)</i>	<i>Particulars</i>	<i>(₹)</i>
Debit balances:		Credit balances:	
Opening stock	6,200	Sales	82,920
Buildings	34,000	Capital	24,000
Furniture	2,000	Bank loan	6,000
Purchases	42,400	Sundry creditors	9,840
Salaries	4,400	Return outwards	840
Rent	1,200	Interest	260
Miscellaneous expenses	1,000	Dividend	220

Trial Balance and Final Account 131

Postage	560	
Stationery	520	
Wages	10,400	
Freight on purchases	1,120	
Carriage on sales	1,600	
Repairs	1,800	
Sundry debtors	12,000	
Bad debts	240	
Cash in hand	2,600	
Return inwards	2,040	
	1,24,080	1,24,080

The value of stock on 31-12-2010 was estimated at ₹ 5960. You are required to make the necessary closing and prepare Trading and Profit & loss account and a Balance Sheet as on 31st December, 2010.

Solution:

<i>Date</i>	<i>Particulars</i>	<i>Dr.</i>	<i>Cr.</i>
2010	Trading a/c Dr.	62,160	
	To Opening stock a/c		6,200
	To Purchases a/c		42,400
	To Wages a/c		10,400
	To Return Inwards a/c		2,040
	To Freight on purchase a/c		1,120
	(Being transfer)		
	Sales a/c Dr.	82,920	
	Return outwards a/c Dr.	840	
	To Trading a/c		83,760
	(Being transfer)		
	Closing stock a/c Dr.	5,960	
	To Trading a/c		5,960
	(Being incorporation of closing stock in trading a/c)		
	Trading a/c Dr.	27,560	
	To Profit & loss a/c		27,560
	(Being gross profit transferred)		
	Profit & loss a/c Dr.	11,320	
	To Salaries a/c		4,400
	To Rent a/c		1,200
	To Miscellaneous expenses a/c		1,000

To Postage a/c			560
To Stationery a/c			520
To Carriage on sales a/c			1,600
To Repairs a/c			1,800
To Bad debts a/c			240
(Being the various expenses transferred)			
Interest a/c	Dr.	260	
Dividend a/c	Dr.	220	
To Profit & loss a/c			480
(Being interest and dividend transferred)			
Profit & loss a/c	Dr.	16,720	
To Capital a/c			16,720
(Being net profit transferred)			

Trading and P & L a/c of Dhandapani for the year ending 31-12-10

<i>Particulars</i>	()	<i>Particulars</i>	()
To Opening stock	6,200	By Sales	82,920
To Purchases	42,400	Less: Return inwards	2,040
Less: Return outwards	840		
To Wages	10,400	By Closing stock	59,60
To Freight on purchase	1,120		
To Gross profit c/d	27,560		
	86,840		86,840
To Salaries	4,400	By Gross profit b/d	27,560
To Rent	1,200	By Interest	260
To Miscellaneous expenses	1,000	By Dividend	220
To Postage	560		
To Stationery	520		
To Carriage on sales	1,600		
To Repairs	1,800		
To Bad debts	240		
To Net profit transferred to Capital a/c	16,720		
	28,040		28,040

(d) Profit & loss a/c To Provision for doubtful debts a/c (Being creating provision for doubtful debts)	Dr.	400	400
(e) Closing stock a/c To Trading a/c (Being bringing stock into account)	Dr.	55,000	55,000
(f) Accrued interest a/c To Interest a/c (Being interest accrued on investment)	Dr.	500	500
(g) Commission a/c To Commission received in advance a/c (Being commission received in advance)	Dr.	1,000	1,000
(h) Interest on capital a/c To Capital a/c (Being interest on capital)	Dr.	25,000	25,000
(i) Capital a/c To Interest on drawings a/c (Being interest charged on drawings)	Dr.	520	520
(j) Drawings a/c To Purchases a/c (Being goods taken from business for personal use)	Dr.	200	200
(k) Abnormal loss account a/c To Trading a/c (Being abnormal loss credited to trading a/c)	Dr.	8,000	8,000
(l) Insurance company a/c Profit & loss a/c To abnormal loss a/c (Being stock destroyed admitted by insurance company to the extent of ` 6,000)	Dr. Dr.	6,000 2,000	8,000
(m) Profit & loss a/c To Reserve fund a/c (Being transferring to reserve fund)	Dr.	2,000	2,000
(n) Advertising a/c To Purchase a/c (Being goods distributed as free sample)	Dr.	2,000	2,000

Illustration 8: The sundry debtors on 31st Dec. 2010 are ` 40,000. On analysis, it is found that debtors for ` 36,000 are good. The debtors for ` 3,000 are doubtful and are estimated to realize 2/3rds of the amount and the doubts for ` 1,000 are bad. Make a provision for doubtful debts. Show the journal, profit & loss a/c and Balance Sheet.

Solution:

Journal

Dr.		Cr.	
<i>Date</i>	<i>Particulars</i>	(`)	(`)
2010 Dec. 31	Profit & loss a/c Dr. To Provision for bad debts & doubtful debts a/c (Being amount of provision for bad debts & doubtful debts – 1/3rd of ` 3,000, i.e., ` 1,000 doubtful and ` 1,000 bad)	2,000	2,000

Ledger

Provision for bad debts & doubtful debts a/c

Dr.			Cr.		
<i>Date</i>	<i>Particulars</i>	(`)	<i>Date</i>	<i>Particulars</i>	(`)
2010 Dec. 31	To balance b/d	2,000	2010 Dec. 31	By Profit & loss a/c	2,000
		2,000			2,000
			1996 June 1	By Balance b/d	2,000

Profit & loss a/c for the year ended 31-12-10

Dr.			Cr.		
<i>Date</i>	<i>Particulars</i>	(`)	<i>Date</i>	<i>Particulars</i>	(`)
	To Provision for doubtful debts	2,000			
		2,000			2,000

Balance Sheet as on 31-12-2010

<i>Liabilities</i>	(`)	<i>Assets</i>	(`)
		Sundry debtors 40,000	
	38,000	<i>Less:</i> Provision for bad and doubtful debts <u>2,000</u>	38,000

Illustration 9: The provision for bad and doubtful debts account shows a balance of ` 2,000 on 1st January 2004. The bad debts during the year 2004 amount to ` 1,600. The sundry debtors on 31st December 2004 are ` 32,000. Create a new provision for bad debts @ 5%. Show the journal, ledger, profit & loss account and balance sheet.

Solution:**Journal**

Dr.		Cr.	
<i>Date</i>	<i>Particulars</i>	()	()
2004 Dec. 31	Provision for bad debts & doubtful debts a/c Dr. To Bad debts a/c (Being transfer of bad debts)	1,600	1,600
	Profit & loss a/c Dr. To Provision for bad debts & doubtful debts a/c (Being amount of additional reserve required to raise it to ` 1,600)	1,200	1,200

Ledger
Bad debts a/c

Dr.			Cr.		
<i>Date</i>	<i>Particulars</i>	()	<i>Date</i>	<i>Particulars</i>	()
2004 Dec. 31	To Balance b/d	1,600	2004 Dec. 31	By Provision for bad debts & doubtful debts a/c (transfer)	1,600
		1,600			1,600

Provision for bad debts and doubtful debts a/c

Dr.			Cr.		
<i>Date</i>	<i>Particulars</i>	()	<i>Date</i>	<i>Particulars</i>	()
31-12-04	To Bad debts a/c	1,600	1-1-04	By Balance b/d	2,000
31-12-04	To Balance c/d	1,600	31-12-04	By Profit & loss a/c	1,200
		3,200			3,200
			1-1-05	By Balance b/d	1,600

Profit & loss a/c for the year ended 31-12-04

<i>Particulars</i>	()	()	<i>Particulars</i>	()	()
To Bad debts	1,600				
Add: New provision for bad debts	1,600				
	3,200				
Less: Existing provision for bad debts	2,000				
		1,200			

Balance Sheet as on 31-12-04

<i>Liabilities</i>	()	<i>Assets</i>	()
		Sundry debtors	32,000
		Less: Provision for bad debts	<u>1,600</u>
			30,400

Illustration 10: The provision for bad and doubtful debts shows a balance of ₹ 1,600 on 1st January 2007. The bad debts during the year 2007 amount to ₹ 600. The sundry debtors on 31st December 2007 are ₹ 16,000. Create a provision of 5% for bad and doubtful debts.

Solution:

Journal

Dr.		Cr.	
<i>Date</i>	<i>Particulars</i>	(₹)	(₹)
2007 Dec. 31	Provision for bad debts & doubtful debts a/c Dr. To Bad debts a/c (Being transfer of bad debts)	600	600
Dec. 31	Provision for bad & doubtful debts a/c Dr. To Profit & loss a/c (Being amount credited back to P & L a/c to reduce old reserve from (1,600 – 1,600), i.e., 1,000 to 800)	200	200

Ledger

Bad debts a/c

Dr.		Cr.			
<i>Date</i>	<i>Particulars</i>	(₹)	<i>Date</i>	<i>Particulars</i>	(₹)
2007 Dec. 31	To Balance b/d	600	2007 Dec. 31	By Provision for bad & doubtful debts a/c (transfer)	600
		600			600

Provision for bad & doubtful debts a/c

Dr.		Cr.			
<i>Date</i>	<i>Particulars</i>	(₹)	<i>Date</i>	<i>Particulars</i>	(₹)
2007 Dec. 31	To Bad debts	600	2007 Jan. 1	By Balance b/d	1,600
Dec. 31	To P&L a/c	200			
	To Balance c/d	800			
		1,600			1,600

Profit & Loss a/c for the year ended 31-12-07

Dr.		Cr.	
<i>Particulars</i>	(₹)	<i>Particulars</i>	(₹)
		By Provision for bad & doubtful debts (old)	1,600
		<i>Less:</i> Bad debts	600
		New provision	<u>800</u>
			<u>1,400</u>
			200

Balance Sheet as on 31-12-07

<i>Liabilities</i>	()	()	<i>Assets</i>	()	()
			Sundry Debtors	16,000	
			<i>Less:</i> Provision for B.D.	<u>800</u>	15,200

Illustration 11: The following particulars are extracted from the books of Kalyani.

2006			
Jan. 1	Provision for bad & doubtful debts	12,000	
	Provision for discount on debtors	5,600	
Dec. 31	Provision allowed during the year	9,300	
	Bad debts written off during the year		4,700
	Bad debts recovered during the year		250
	Debtors		1,00,600

Write off further ` 2,400 (definitely bad). Provision for discount allowed at 2% and for doubtful debts 10% are to be maintained.

Show how the relevant items would appear in ledger, P & L a/c and balance sheets as on Dec. 31, 2006.

Solution:

Bad debts a/c

Dr.			Cr.		
<i>Date</i>	<i>Particulars</i>	()	<i>Date</i>	<i>Particulars</i>	()
2006			2006		
Dec. 31	To Balance b/d	4700	Dec. 31	By Provision for Bad Debts a/c	7100
Dec. 31	To Sundry debtors a/c	2400			

Provision for bad & doubtful debts a/c

Dr.			Cr.		
<i>Date</i>	<i>Particulars</i>	()	<i>Date</i>	<i>Particulars</i>	()
2006			2006		
Dec. 31	To Bad debts a/c	7,100	Jan. 1	By Balance b/d	12,000
	To Balance c/d	9,820	Dec. 31	By P & L (bal. fig. a/c)	4,920
		16,920			16,920
			2007		
			Jan. 1	By Balance b/d	9,820

Bad debts recovered a/c

Dr.			Cr.		
<i>Date</i>	<i>Particulars</i>	()	<i>Date</i>	<i>Particulars</i>	()
2006			2006		
Dec. 31	To Profit & loss a/c	250	Dec. 31	By Balance b/d	250
		250			250

Discount on Debtors a/c

Dr.			Cr.		
Date	Particulars	()	Date	Particulars	()
2006 Dec. 31	To Balance b/d	9,300	2006. Dec. 31	By Provision for discount on debtors a/c	9,300
		9,300			9,300

Provision for discount on debtors a/c

Dr.			Cr.		
Date	Particulars	()	Date	Particulars	()
2006 Dec. 31	To Discount on debtors a/c	9,300.00	2006 Jan. 1	By Balance b/d	5,600.00
	To Balance c/d	1,767.60	Dec. 31	By P & L a/c	5,467.60
		11,067.60			11,067.60
			2007 Jan. 1	By Balance b/d	1,767.60

Working Note:

Debtors 1,00,600

Less: Further bad debts 2,400

98,200

Provision at 10% 9,820

Provision for discount = $(98,200 - 9,820) \times 2/100 = 1767.60$

Profit & loss a/c for the year ended 31-12-06

Dr.			Cr.		
Particulars	()	()	Particulars	()	()
To Provision for bad debts.			By Bad debts recovered		250
Provision required	9,820				
Add: Bad debts	7,100				
	16,920				
Less: Existing provision	12,000	4,920.00			
To Provision for discount on debtors					
Provision required	1,767.60				
Add: Discount allowed	9,300.00				
	11,067.60				
Less: Existing provision	5,600.00	5,467.60			

Balance Sheet as on 31-12-06

Liabilities	()	()	Assets	()	()
			Sundry debtors	1,00,600	
			Less: Bad debts	2,400	
				98,200	
			Less: Provision for bad debts	9,820	
				88,380	
			Less: Provision for discount	1,767	86,613

Illustration 12: The following is the schedule of balance on 31-3-2012 extracted from the books of Manikandan.

Cash in hand	22,800	Capital account	3,24,000
Cash at bank	5,200	Discount received from creditors	3,200
Sundry debtors	1,72,000	Purchase returns	5,200
Stock as on 1-4-11	1,24,000	Sales	4,60,000
Furniture & fixtures	42,800	Provision for bad debts	6,000
Office equipments	3,200	Loan from Gopu	60,000
Buildings	1,20,000	Sundry creditors	1,06,000
Motor car	40,000		
Purchases	2,80,000		
Sales returns	8,400		
Salaries	22,000		
Rent for godown	11,000		
Interest on loan from Gopu	5,400		
Rates and taxes	4,200		
Discount allowed to debtors	4,800		
Freight on purchases	2,400		
Carriage outwards	4,000		
Drawings	24,000		
Printing & stationery	3,600		
Electric charges	4,400		
Insurance premium	11,000		
General office expenses	6,000		
Bad debts	4,000		
Bank charges	3,200		
Motor car expenses	7,200		
	9,64,400		9,64,400

Prepare trading and profit and loss a/c for the year ended 31-3-2012 and the balance sheet as at that date after making provision for the following:

- (i) Value of stock on 31-3-2012 was ` 88,000.
- (ii) One month's rent for godown is outstanding.
- (iii) One month's salary is outstanding.
- (iv) Interest on loan from Gopu is payable at 12%. This loan was taken on 1-5-2011.
- (v) A provision for bad debt is to be maintained at 5% on Sundry Debtors.
- (vi) Insurance premium includes ` 8,000 paid towards proprietor's life insurance policy and the balance of the insurance charges covers the period from 1-4-12 to 30-6-12.
- (vii) Depreciate:
 - (a) Buildings used for business by 5%.
 - (b) Furniture & fixtures by 10%. One steel table purchased during the year for ` 2,800 was sold for same price but the sale proceeds were wrongly credited to Sales a/c.
 - (c) Office equipments by 15%. Purchase of a typewriter during the year for ` 8,000 has been wrongly debited to Purchase a/c.
 - (d) Motor car by 20%.

Solution:

Trading and Profit & Loss a/c of Manikandan for the year ended 31-3-12

<i>Particulars</i>	()	()	<i>Particulars</i>	()	()
To Opening stock		1,24,000	By Sales	4,60,000	
To Purchases	2,80,000		Less: Sale of fittings	2,800	
Less: Purchase of office equipment	8,000			4,57,200	
	2,72,000		Less: Returns	8,400	44,88,000
Less: Returns	5,200	2,66,800	By Closing stock		8,800
To Freight on purchases		2,400			
To Gross Profit c/d		1,43,600			
		536,800			5,36,800
To Salaries	22,000		By Gross profit b/d		1,43,600
Add: Outstanding	2,000	24,000	By Discount received		3,200
To Rent for godown	11,000				
Add: Outstanding	1,000	12,000			
To Interest on loan	5,400				
Add: Outstanding	1,200	6,600			
To Rates & taxes		4,200			
To Discount allowed		4,800			
To Carriage outward		4,000			
To Printing & stationery		3,600			
To Electric charges		4,400			
To Insurance premium	11,000				
Less: Premium on own life policy	8,000				
	3,000				
Less: Prepaid	3,000	Nil			
To General office expenses		6,000			
To Bad debts	4,000				
Add: New provision	8,600				
	12,600				
Less: Existing provision	6,000	6,600			
To Bank charges		3,200			
To Motor car expenses		7,200			
To Depreciation on:					
Building		3,000			
Furniture & fittings		4,000			
Office equipments		6,000			
Motor car		8,000			
To Net profit transferred to Capital a/c		39,200			
		1,46,800			1,46,800

Balance Sheet as on 31.3.12

<i>Liabilities</i>	()	()	<i>Assets</i>	()	()
Capital	3,24,000		Buildings	1,20,000	
<i>Add:</i> Net profit	39,200		<i>Less:</i> Depreciation	3,000	1,17,000
	3,63,200				
<i>Less:</i> Drawings			Furniture & fittings	42,800	
(24,000 + 8,000)	32,000	3,31,200	<i>Less:</i> Sale	2,800	
Loan from Gopu	6,000			40,000	
<i>Add:</i> Outstanding interest	1,200	61,200	<i>Less:</i> Depreciation	4,000	36,000
Sundry creditors		1,06,000	Office equipments	32,000	
<i>Outstanding expenses:</i>			<i>Add:</i> Purchase	8,000	
Salaries	2,000			40,000	
Rent for godown	1,000	3,000	<i>Less:</i> Depreciation	6,000	34,000
			Motor car	40,000	
			<i>Less:</i> Depreciation	8,000	32,000
			Stock		88,000
			Sundry debtors	1,72,000	
			<i>Less:</i> Provision for B.D.	8,600	1,63,400
			Cash at Bank		5,200
			Cash at Hand		22,800
			Prepaid Insurance		3,000
		5,01,400			5,01,400

Illustration 13: From the following particulars presented by Mr. S. Tendulkar, prepare a Trading a/c, Profit & Loss a/c for the year ended 31st Dec. 2012 and Balance sheet as on that date.

<i>Debit balances</i>	()	<i>Credit balances</i>	()
Plant & machinery	1,00,000	Sales (net)	4,00,000
Drawings	36,000	Capital	1,00,000
Purchases	1,20,000	Creditors	40,000
Sundry debtors	80,000	Bank overdraft	20,000
Wages	20,000	Provision for debts	4,000
Carriages	6,000	Cash credit	20,000
Salaries	14,000	Bills payable	16,000
Rent	12,000		
Repairs	6,000		
Insurance	10,000		
Opening stock	24,000		
Land & buildings	80,000		

Furniture	20,000		
Discount	40,000		
Suspense A/c	32,000		
	6,00,000		6,00,000

Adjustment:

- (i) Closing stock ` 60,000.
- (ii) Purchases include purchase of materials used for the construction of buildings ` 10,000.
- (iii) Sales include sale of furniture at a selling prices of ` 2,000 (book value ` 4,000).
- (iv) Purchased a plant for ` 10,000, wrongly debited to purchases a/c.
- (v) A sale of goods to a customer not debited to customers account ` 32,000
- (vi) Stock destroyed by fire amounted ` 20,000. Insurance company admitted only ` 16,000 as its liability.
- (vii) Wages include ` 6,000 incurred for the erection of machinery.
- (viii) The proprietor Mr. S. Tendulkar took goods for his own from the business amounted to ` 2,000.
- (ix) Rent included ` 2,000 paid for Mrs. S. Tendulkar’s residential portion.
- (x) Purchase of stationery for ` 200 was debited to Repairs a/c.
- (xi) A customer’s cheque returned dishonoured wrongly debited to Discount a/c ` 2,000.

Solution:

Trading and Profit & Loss a/c of S. Tendulkar for the year ended 31-12-12

<i>Particulars</i>	()	()	<i>Particulars</i>	()	()
To Opening stock		24,000	By Sales	4,00,000	
To Purchases	1,20,000		Less: Furniture	2,000	3,98,000
Less: Buildings	10,000		By Closing stock		60,000
	1,10,000		By Stock destroyed by fire		2,000
Less: Drawings	2,000				
	1,08,000				
Less: Plant & Machinery	10,000	98,000			
To Wages	20,000				
Less: Plant & Machinery	6,000	14,000			
To Carriage		6,000			
To Gross profit c/d		3,36,000			
		4,78,000			4,78,000

To Salaries		14,000	By Gross profit b/d		3,36,000
To Rent	12,000		By Provision for bad debts		4,000
<i>Less:</i> Drawings	2,000	10,000			
To Repairs	6,000				
<i>Less:</i> Stationery	200	5,800			
To Insurance		10,000			
To Discount	40,000				
<i>Less:</i> Cheque dishonoured	2,000	38,000			
To Loss on sale of furniture		2,000			
To Stationery		200			
To Loss of stock by fire		4,000			
To Net profit transferred to Capital a/c		2,56,000			
		3,40,000			3,40,000

Balance Sheet of Mr. S. Tendulkar as on 31-12-12

<i>Liabilities</i>	(₹)	(₹)	<i>Assets</i>	(₹)	(₹)
Capital	1,00,000		Plant & Machinery	1,00,000	
<i>Add:</i> Net profit	2,56,000		<i>Add:</i> Wages	6,000	
	3,56,000			1,06,000	
<i>Less:</i> Drawings	36,000		<i>Add:</i> Additions	10,000	1,16,000
Purchases	2,000		Land & Buildings	80,000	
Rent	2,000	40,000	<i>Add:</i> Additions	10,000	90,000
Creditors		40,000	Furniture	20,000	
Bank Overdraft		20,000	<i>Less:</i> Sale of furniture	4,000	1,600
Cash credit		20,000	Stock		60,000
Bills Payable		16,000	Sundry debtors	80,000	
			<i>Add:</i> Cheque dishonoured	2,000	
				82,000	
			<i>Add:</i> Suspense a/c	32,000	1,14,000
			Suspense a/c	32,000	
			<i>Less:</i> Debtors	32,000	Nil
			Insurance claim		16,000
		4,12,000			4,12,000

Illustration 14: The following figures have been extracted from the records of Fancy Stores, a proprietor concern as at 31st December 2005.

<i>Particulars</i>	(`)	<i>Particulars</i>	(`)
Furniture	15,000	Insurance	60,000
Capital	5,40,000	Rent	2,20,000
Cash in hand	30,000	Sundry Debtors	6,00,000
Opening stock	5,00,000	Sales	60,00,000
Fixed Deposits	13,46,000	Advertisements	1,00,000
Drawings	50,000	Postage & telephone	34,000
Provision for bad debts	30,000	Bad debts	20,000
Cash at Bank	1,00,000	Printing & stationery	90,000
Purchases	30,00,000	General charges	1,30,000
Salaries	1,90,000	Sundry creditors	4,00,000
Carriage Inwards	4,10,000	Deposit from customers	60,000

Prepare Trading & Profit & Loss a/c and Balance Sheet after taking into consideration the following further information:

- (i) The closing stock as on 31-12-2005 was ` 1,00,000.
- (ii) A sale of ` 2,50,000 made for cash had been credited to the Purchases a/c.
- (iii) Salary of ` 20,000 paid to an employee had been entered in the cash book bank column as ` 10,000.
- (iv) Charge depreciation on furniture at 10%.
- (v) Furniture had been sold during the year for ` 1,00,000 and the proceeds had been credited to furniture account. The written down value of furniture sold was ` 50,000.
- (vi) A sum of ` 1,00,000 received from a party which had purchased some stock belonging to a separate business of the proprietor was credited to the Sundry debtors account.
- (vii) The proceeds of a matured fixed deposits amounting to ` 2,54,000 had been credited to the fixed deposit account. The original amount of the deposit was ` 2,00,000.
- (viii) There was an outstanding liability for rent of ` 20,000.
- (ix) An advance of ` 10,000 paid to an employee against his salary of January 1996 had been debited to the Salary a/c.
- (x) The office premises were sublet from December 1995 for a monthly rental of ` 10,000, but the rent for December has not yet been received.

Solution:

Trading and Profit & Loss a/c of Fancy Stores for the year ended 31-12-05

<i>Particulars</i>	()	()	<i>Particulars</i>	()	()
To Opening Stock		5,00,000	By Sales		62,50,000
To Purchases		32,50,000	By Closing Stock		1,00,000
To Carriage Inwards		4,10,000			
To Gross profit c/d		21,90,000			
		63,50,000			63,50,000
To Salaries	19,000		By Gross Profit b/d		21,90,000
<i>Add:</i> Under recording in Cash book	10,000		By Interest on deposit		54,000
	20,000		By Rent from subletting		10,000
<i>Less:</i> Advance Salary	10,000	19,000	By Profit on sale of furniture		50,000
To Insurance		60,000			
To Rent		2,40,000			
To Advertisement		1,00,000			
To Postage & telephone		34,000			
To Bad debts		20,000			
To Printing & stationery		90,000			
To General charges		1,30,000			
To Depreciation on furniture		20,000			
To Net profit transferred to Capital a/c		14,20,000			
		23,04,000			23,04,000

Balance Sheet of Fancy Stores as on 31-12-05

<i>Liabilities</i>	()	()	<i>Assets</i>	()	()
Deposits from customers		60,000	Cash in hand		30,000
Sundry creditors		4,00,000	Cash in Bank (1,00,000 – 10,000)		90,000
Outstanding Rent		20,000	Stock		1,00,000
Capital	5,40,000		Sundry debtors	7,00,000	
<i>Add:</i> Addition	1,00,000		<i>Less:</i> Provision for B.D.	30,000	6,70,000
	6,40,000		Advance Salary		10,000
<i>Less:</i> Drawings	50,000		Rent outstanding		10,000
	5,90,000		Furniture	2,00,000	
<i>Add:</i> Net Profit	14,20,000	20,10,000	<i>Less:</i> Depreciation	20,000	1,80,000
			Fixed Deposits		14,00,000
		24,90,000			24,90,000

Illustration 15: Sasikala is a manufacturer. From the following details, prepare:

- (i) Sasikala’s manufacturing account to show the cost of goods manufactured during the year ended 31st December 2004 and
- (ii) Sasikala’s Trading and Profit & Loss Account for the same period.

Stock as on 1st Jan 2004			
Raw materials	7,000	Travelling expenses	5,400
Work-in-progress	10,000	Manufacturing expenses	5,400
Finished goods	25,400	Miscellaneous:	
Purchase of raw materials	90,000	Return outwards	4,000
Carriage of raw materials	2,000	Discount allowed	1,000
Sale of finished goods	3,80,000	Discount received	600
Stock on 31st Dec. 2004:		Import duty on raw materials	24,000
Raw materials	13,000	Sale of waste materials	6,000
Work-in-progress	12,000	Carriage outwards	1,600
Finished goods	28,000	Factory insurance, rent & taxes	12,000
Factory wages	60,000	Bad debts	1,200
Factory expenses	4,800	Salaries (including Sasikala’s salary ` 9600)	25,600
Return inwards	4,600	Salary of works manager	14,400
Depreciation on machinery	10,800	Office rent & insurance	3,000
Repairs to machinery	9,200	Motive power	7,000
Interest on Bank Overdraft	600		
Miscellaneous expenses	2,600		
Depreciation on office furniture	2,200		
Selling expenses	10,400		

Sasikala’s salary is to be allocated 2/3 to factory and 1/3 to office.

Solution:

Manufacturing a/c of Sasikala for the year ended 31-12-04

<i>Particulars</i>	(`)	<i>Particulars</i>	(`)
To Work-in-progress on 1-1-04	10,000	By Sale of waste material	6,000
To Material consumed during the year (opening stock + net purchases – closing stock [7,000 + 86,000 (i.e., 9,000 – 4,000) – 13,000])	80,000	By Work-in-progress on 31-12-04	12,000
To Carriage on raw materials	2,000	By Cost of finished goods transferred to Trading a/c	2,28,000
To Import duty on raw materials	24,000		
To Factory wages	60,000		
To Salary of works manager	14,400		

To 2/3 of Sasikala's salary	6,400		
To Motive power	7,000		
To Factory expenses	4,800		
To Factory insurance, rent and taxes	12,000		
To Manufacturing expenses	5,400		
To Depreciation of machinery	10,800		
To Repairs of machinery	9,200		
	2,46,000		2,46,000

Trading and Profit & Loss a/c of Sasikala for the year ended 31-12-04

<i>Particulars</i>	(₹)	<i>Particulars</i>	(₹)
To Stock of finished goods (1-1-04)	25,400	By Sales	3,80,000
To Manufacturing a/c (cost of finished goods)	2,28,000	<i>Less:</i> Returns inwards	<u>4,600</u>
To Gross profit c/d	1,50,000	By Stock of finished goods (on 31-12-04)	28,000
	4,03,400		4,03,400
To Depreciation on office furniture	2,200	By Gross profit b/d	1,50,000
To Interest on bank overdraft	600	By Discount received	600
To Miscellaneous expenses	2,600		
To Travelling expenses	5,400		
To Selling expenses	10,400		
To Discount allowed	1,000		
To Carriage outwards	16,000		
To Bad debts	1,200		
To Salaries	25,600		
<i>Less:</i> 2/3 of Sasikala's salary	<u>6,400</u>		
To Office rent & insurance	3,000		
To Net profit transferred to Capital a/c	1,03,400		
	1,50,600		1,50,600

Illustration 16: From the following particulars of Ajay Sharma, prepare the manufacturing, trading and profit and loss a/c for the year end 31st Dec. 2006 and a balance sheet as on that date.

Capital a/c (1-1-06)	7,32,000	Factory buildings	2,00,000
Drawings a/c	1,00,000	Furniture & fixtures	51,500
Purchases	21,05,000	Plant & machinery	95,000
Rates & taxes	25,000	Sundry debtors	1,87,000
Salaries	1,00,000	4% Govt. Promissory Notes (subscribed on 1-1-06)	20,000
Carriage	20,000	Sundry creditors	1,05,000

Fuel & coal	14,000	Sales	25,33,000
Factory insurance	6,000	Cash in hand	45,500
Advertisement	20,000	Cash in bank	1,94,500
Factory power	16,000		
Bad debts written off	10,000		
Cash discount allowed	2,000		
Sundry expenses	3,500		
Opening stock:			
Raw materials	60,000		
Finished goods	50,000		
Patents	12,000		
Postage & telegram	13,000		
Wages	35,000		
Cash discount received	15,000		

Additional information:

- (i) Depreciation to be provided at the following rates:
Plant & machinery – 10%; patents – 10%; buildings – 2.5%; furniture 5%.
- (ii) Provide 2.5% on debtors for doubtful debts.
- (iii) Purchases invoices aggregating ` 25,000 were omitted to be entered in the purchase day book.
- (iv) Debtors include ` 5,000 due from the proprietor.
- (v) An amount of ` 5,000 received in respect of a private loan advanced by the proprietor which was wrongly credited to Sundry debtors a/c.
- (vi) Purchase invoices of the value of ` 75,000 were entered in the purchase day book on 29th December 2006 but the goods in respect thereof were received on 3rd January 2007.
- (vii) An amount of ` 3,500 received from a debtor was wrongly credited to Sales a/c.
- (viii) The annual interest on government promissory notes accrued due on 31st Dec. 2006 but was collected only in 2007.
- (ix) Carriages include ` 8,000 towards outwards charges.
- (x) Stock in trade as on 31-12-06:
Raw material ` 50,000; finished goods ` 40,000.

Solution:

Manufacturing, Trading and Profit & Loss a/c of Ajay Sharma for the year ended 31.12.2006.

<i>Particulars</i>	()	<i>Particulars</i>	()
To Cost of materials consumed (opening stock + purchase + carriage inwards – closing stock) (60,000 + 2,13,000 + 12,000 - 1,25,000)	20,77,000	By cost of finished goods transferred to Trading a/c	21,63,700
To Wages	35,000		
To Factory expenses:			
Fuel & coal	14,000		
Factory insurance	6,000		
Factory power	16,000		
To Depreciation on:			
Plants & machinery	9,500		
Patents	1,200		
Factory buildings	5,000		
	21,63,700		21,63,700
To Opening stock	50,000	By Sales (25,33,000 – 3,500)	25,29,500
To Cost of finished goods	21,63,700	By Closing stock	40,000
To Gross profit c/d	3,55,800		
	25,69,500		25,69,500
To Rent, rates & taxes	25,000	By Gross profit b/d	3,55,800
To Salaries	1,00,000	By Discount	15,000
To Carriage outwards	8,000	By Interest on Govt. Promissory notes	800
To Advertisement	20,000		
To Bad debts	10,000		
Add: Provision for B.D.	4,588		
To Depreciation on furniture	2,576		
To Discount	2,000		
To Sundry expenses	3,500		
To Postage & telegrams	13,000		
To Net profit – transferred to Capital a/c	1,82,936		
	3,71,600		3,71,600

Balance Sheet of Ajay Sharma as on 31-12-06

<i>Liabilities</i>	()	()	<i>Assets</i>	()	()
Capital	7,32,000		Factory buildings	2,00,000	
Add: Additional capital	5,000		Less: Depreciation	5,000	1,95,000
Add: Net profit	1,82,936		Plant & Machinery	95,000	
	9,19,936		Less: Depreciation	9,500	85,500
Less: Drawings			Furniture & fittings	51,500	
(1,00,000 + 5,000)	1,05,000	8,14,936	Less: Depreciation	2,576	48,924

Sundry Creditors (1,05,000 + 25,000)	1,30,000	Patents	12,000	
		<i>Less:</i> Depreciation	1,200	10,800
		4% govt. promissory notes		20,000
		Stock-in-trade:		
		Raw materials (50,000 + 75,000)		1,25,000
		Finished goods		40,000
		Sundry debtors (1,87,000 – 5,000 + 5,000 – 3,500)	1,83,500	
		<i>Less:</i> Provision for B.D.	4,588	1,78,912
		Accrued Interest on Govt promissory notes		800
		Cash in bank		1,94,500
		Cash in hand		45,500
	9,44,936			9,44,936

EXERCISE

Self Assessment Questions:

- Expenses due but not yet paid are known as _____.
- Prepaid expenses appear on the assets side of balance sheet. (State True/False).
- Income earned but not received is called _____.
- Any income received in advance is a liability. (State True/False).
- Advertisement expenses outstanding for the year ending March 2005 is Rs.5000. Give the journal entry.
- Depreciation is for _____ of an asset.
- What entry is drawn if furniture costing ` 50,000 is depreciated at 5% under straight line method?
- Calculate the depreciation amount charged for the second year under written down or reducing balance method for Plant and Machinery costing ` 7,50,000. The depreciation rate is 10%.
- Unrecovered debts are called _____.
- Bad debts are not expenses but they incur loss to the firm. (State True/False)
- If bad debts are recovered, what entry can be drawn?
- What is the difference between bad debts and doubtful debts?
- Provision for Doubtful debts is a charge against the profits of the firm. (State True/False).
- Bad debts incurred in the subsequent period are written off against reserve for bad debts. (State True/False)
- Give the journal entry for writing off of bad debts against RBD?

16. Provision for Discount on Debtors is a charge against P & L a/c. (State True/False)
17. Provision for discount on debtors appears as a liability in the Balance Sheet. (State True/False)
18. Discount on creditors is an item of income. (State True/False)
19. Provision for discount on creditors is shown as an anticipated income. (State True/False)
20. What is the entry for adjusting the closing stock?
21. Closing stock always appears as an asset in balance sheet. (State True/False)

Ans.: 1. Outstanding expenses, 2. True, 3. Accrued or Outstanding income, 4. True
 5. Advertisement expenses a/c Dr. To Outstanding Advertisement expenses a/c, 6. Wear and Tear
 7. Depreciation a/c Dr. 2,500 To Furniture a/c 2,500 (Being furniture depreciated) 8. $(7,50,000 - 75,000) = 6,75,000 \times 10\% = 67,500$. 9. Bad debts. 10. True. 11. Cash a/c To Bad debts recovered a/c,
 12. Bad debts are totally not recoverable, doubtful debts may be recovered, 13. True, 14. True,
 15. Reserve for Bad debts a/c Dr. To Bad debts a/c, 16. True, 17. True, 18. True, 19. True,
 20. Closing stock a/c Dr. To Trading a/c, 21. True.

Theory Questions

(a) Short Answer Questions:

1. What do you understand by final accounts?
2. What are the distinct stages in final accounts and what are the results of each such stage?
3. What is the purpose of preparation of financial statements?
4. What is gross profit?
5. When do you prepare a 'manufacturing account'?
6. Are adjustments necessary for the preparation of final account? If yes, why?
7. What are the situations in which purchases account is credited?
8. What is balance sheet?
9. Explain the meaning of "liquidity order" in arranging balance sheet items.
10. Explain the meaning of 'permanency order' in arranging the balance sheet items.
11. What are all the items added to and reduced from the capital of a sole trader in balance sheet?
12. How do you treat stock when it is given in (a) trial balance and (b) adjustments?
13. How do you treat outstanding and prepaid expenses when they are given in (a) trial balances and (b) adjustments?
14. How do you treat accrued incomes and incomes received in advance when they are given (a) in trial balance (b) in adjustments?

(b) Long Answer Questions

1. "Preparation of final accounts is the culmination of the accounting process." Explain.
2. Describe the procedure for preparation of the final accounts of a sole trader, step by step.

3. Distinguish between 'trial balance' and 'balance sheet'.
4. What are the differences between trading account and profit and loss accounts?
5. "The accrual concept is the basis for final accounts." Explain.
6. What do you understand by 'liquidity order' and 'permanency order' in the context of preparing balance sheet? When should usage of each of them be appropriate?
7. What is 'grouping and marshalling' of assets and liabilities? How is it done?

Concept Tester

(A) Short Answer Problems

1. Pass necessary adjusting in Mr. X's journal on 31st December 1998:
 - (i) ` 20,000 for wages was outstanding.
 - (ii) Write off depreciation on machinery ` 50,000
 - (iii) ` 15,000 was received in advance as interest.
2. Pass adjustment entries for the following:
 - (i) Closing stock ` 49,280;
 - (ii) Provide depreciation on vehicles @ 10% on cost of ` 1,40,000.
 - (iii) Materials purchased and received from Mr. X for which no entry is passed register ` 10,000.
3. Pass necessary journal entries for the following while finalizing the annual accounts:
 - (i) Debtors include ` 500 receivable from the proprietor for goods drawn by him.
 - (ii) Trade debtors of ` 1,05,000 include ` 5,000 which are considered bad. Provide for doubtful debts at 2.5%.
 - (iii) Provide for discount on creditors on closing day @ 2.5% on ` 85,000.
4. The trial balance of a trader shows ` 3000 to the debit of general expenses a/c included in that are:
 - (a) Travelling expenses ` 1,000
 - (b) School fees of his children ` 30
 - (c) Subscription and other fees ` 500 paid to the Ladies Club on behalf of the trader's wife.

Make the necessary adjusting journal entry.

(Ans: Debit ` 1,000 to Travelling Expenses a/c and ` 800 to Drawings a/c, crediting General Expenses a/c ` 1,800)

5. Dawson, a businessman, has invested on 1-4-2010 ` 10,000 in government securities on which he gets a net interest of 6% p.a. after 31st March every year. His accounts are closed on 31st December every year. Find out the interest earned by him but not yet received and show by means of journal entry the necessary adjustment.

(Ans: Accrued interest ` 450)

6. Pass journal entries for the following transactions:
- Samples worth ` 5,000 distributed during a sale campaign programme.
 - Proprietor brought his personal car into the business and the value of the same is ` 1,00,000.
 - Interest of ` 9,000 received on investment amounting to ` 50,000 (20% Govt. of India Bonds).

The above interest was net of income tax.

7. Show the necessary adjustments in Trading a/c and Balance Sheet from the following information.

31.12.98 Value of goods still with customers', sold on sale or return basis,
treated as sales ` 40,000
G.P. on cost – 25%

(Ans: Cost of stock with customer: ` 32,000)

8. Which of the following items of expenditure and income belong to the current accounting year?
- Cash sales;
 - Outstanding expense;
 - Credit purchases;
 - Salaries paid to employees;
 - Rent received in advance;
 - Commission received but not yet earned.

(Ans: (i); (ii); (iii); (iv))

9. Mr. Gotham has ` 50,000 to the credit of his capital account on 1-1-2002. His drawings during the same year amounted to ` 7,000. You are to charge interest on capital at 5% p.a. and ` 430 on drawings. Ascertain his closing capital, assuming that his net profit for the year after all adjustments is ` 12,400.

(Ans: ` 57,470)

10. Form the following, calculate the amount of provision for doubtful debts to be debited to P & L a/c:

Opening provision for doubtful debts	` 2,400
Closing sundry debtors	` 42,000
Bad debts yet to be written off	` 2,000
Provide for doubtful debts at 10% on debtors.	

(Ans: Amount to be debited to P & L a/c: ` 3,600)

11. On 1st Jan 1995, the provision for doubtful debts account in the books of a firm which maintain it at 5% had a credit balance of ` 3,300. During the year, the Bad debts amounted to ` 2,400 and the debtors at the end of the year were ` 60,000. Show provision for doubtful debts a/c and bad debts a/c for the year 1995.

(Ans: Debit to P & L a/c – ` 2,100)

12. Make adjustments from the information given below while preparing P & L account:

	Dr.	Cr.
Loan @ 15% p.a.		20,000
Interest on loan	2,000	
Deposit @ 14% p.a.	15,000	
Interest on deposit		1,000

(Ans: Add ` 1,000 interest outstanding to ` 2,000 on the debit side of P & L a/c; add ` 1,100 to interest on deposit of ` 1,000 and show the total on the credit side of P & L a/c)

13. During the year ended 31-12-2002, a firm suffered the following losses. Explain how you would treat them in the accounts on 31-12-2002:

- (a) Stock lost ` 15,000
- (b) A machinery of the value of ` 21,000 was discarded, being totally out of order.
- (c) A portion of the buildings worth ` 12,000 became completely useless.

(Ans: (a) Credit Trading a/c ` 15,000 and debit P & L ` 15,000 assuming no insurance; (b) Debit P & L a/c and credit Machinery a/c ` 21,000; (c) Debit P & L a/c and credit Building a/c with ` 12,000)

14. A manager gets 5% commission on net profit after charging such commission. What shall be his commission if gross profit is ` 96,000 and expenses of indirect natures other than manager's commission are ` 12,000?

(Ans: Manager's Commission ` 4,000, i.e., $84,000 \times 5/105$)

15. Calculate gross profit and cost of goods sold from the following information:

Net sales ` 2,00,000
Gross Profit is 25% on cost.

(Ans: G.P. = ` 40,000; C.O.G.S. = ` 1,60,000)

16. Ascertain the cost of goods sold from the following:

Opening stock	17,000	Indirect expenses	10,400
Purchases	61,400	Closing stock	18,000
Direct expenses	9,600		

(Ans: C.O.G.S. = ` 70,000)

17. Calculate Net Profit from the following:

Purchase (200 units)	10,000
Freight and carriage	1,200
Rent and advertising	600
Sales (150 units)	10,800

(Ans: N.P. = ` 180; Closing stock = ` 2,800) **Hint:** Closing stock = ` $11,200 \times 50 / 200$

18. The drawings of a proprietor for the year 2002 are ₹ 30,000. Profit for the year ₹ 50,000 and capital at the end ₹ 1,40,000. Calculate the capital at the beginning.

(Ans: Opening capital: ₹ 1,20,000)

19. Prepare trading account of a trader for the year ending 31st December 1996 from the following data:

Opening stock (1.1.06)	50,000
Goods purchased during 2006	2,80,000
Freight and packing on the above	20,000
Closing stock (31.12.06)	60,000
Sales	3,80,000
Packing expenses on sales for distribution	12,000

(Ans: Gross profit – ₹ 90,000) *Hint:* Ignore packing expenses.

20. From the information given below, prepare Trading Account.

Opening stock	1,00,000
Purchases	1,50,000
Purchases returns	25,000
Direct expenses	10,000
Carriages inwards	5,000
Sales	4,00,000
Closing stock	50,000

(Ans: Gross profit: ₹ 2,10,000)

(B) Adjustments for Final Accounts:

1. Show the necessary entries to adjust the following:
 - (a) Outstanding salaries ₹ 1,200; Rent ₹ 300
 - (b) Prepaid insurance premium ₹ 450
 - (c) Income outstanding: interest on investments ₹ 400; dividend ₹ 350
 - (d) Discount received in advance ₹ 150
 - (e) Bad debts written off ₹ 200
 - (f) Interest on securities received in advance ₹ 500
2. Show the necessary entries to adjust the following in the books of X on 30th June 2008:
 - (a) Salaries for the month of June 2008 ₹ 1,500 unpaid.
 - (b) Insurance includes annual premium of ₹ 170 on a policy, expiring on 31-12-08.
 - (c) Wages include a sum of ₹ 2,000 spent on the erection of a cycle shed for employees.

- (d) Goods issued as samples ` 200.
 - (e) Rent paid in advance ` 250.
3. Pass journal entries to incorporate the following at the time of preparing final accounts:
- (a) Provide 2.5% for discount on debtors and a bad debts provision at 10% of debtors (debtors ` 30,000).
 - (b) Closing stock was valued at ` 43,000.
 - (c) Wages owing ` 2,500.
 - (d) Insurance paid in advances ` 1,500.
 - (e) Included in debtors is ` 1,000 owing by the proprietor.
 - (f) Plant which stood at ` 75,000 in the books on the first day of the year was disposed of for ` 30,000 in part exchange for a new machine costing ` 60,000. A net invoice of ` 30,000 was passed through the purchases book.

Provision on debtors and creditors

4. From the following figures, you are required to prepare:

- (a) Provision for doubtful debts a/c
- (b) Bad debts a/c
- (c) Profit & loss a/c

Jan. 1 2000	Provision for bad debts	` 2,500
Dec. 31 2000	Bad debts	` 2,870
Dec. 31 2000	Debtors	` 20,000

Information: Make provision for bad debts at 5% on debtors.

(Ans: Debit to P & L a/c: ` 370)

5. The provision for bad and doubtful debts stood at ` 3,200 on 31st December 2003. On 31st December 2004, debtors stood at ` 1,42,250 out of which ` 2,250 had to be written off. On December 1995, the debtors were ` 76,900 out of which ` 1,900 had to be written off as bad debts. The firm creates a bad debts provision to the extent of 5% on the debtors. Make the necessary journal entries and show the provision for bad and doubtful debts a/c for 2004 and 2005.

(Ans: In 1994, debit P & L a/c = ` 6,050 and in 1995 credit P & L a/c = ` 1,350)

6. On 1st Jan 2002, M/s Kamakshi had a bad debt provision of ` 2,600. On 31st December 2002, the total debtors amounted to ` 73,600 out of which ` 1,600 were bad and had to be written off. The firm wants to maintain a provision for bad debts at 5% of the debtors. On 31st December 2003, the total debtors amounted to ` 1,280 out of which ` 1,280 had to be written off as bad debts. The provision for bad debts is to be maintained at 5% of debtors.

Show the bad debts account and the provision for bad debts account for 1992 and 1993.

(Ans: In 2002, debit P & L a/c = ` 2,600 and in 2003, credit P & L a/c = ` 320).

7. The books of a firm had the following balance on Jan. 1, 2007.

Sundry debtors	85,000
Sundry creditors	60,000
Provision for doubtful debts	1,700
Provision for discount debtors	1,666
Provision for discount on creditors	600

The sundry debtors and creditors at December 31, 2007 stand at ` 1,25,000 and ` 83,000 respectively. Bad debts during the year were ended ` 1,500 and discounts allowed and earned were ` 166 and ` 500 respectively. You are required to show relevant ledger accounts and create provision for doubtful debts at 3% and provision for discounts on debtors and creditors at 2%.

(Ans: Transfer of provision for bad debts to P & L a/c = ` 3,550; Transfer of provision for discount on debtors to P & L a/c = ` 925; Transfer of provision for discount on creditors to P & L a/c = ` 1,560)

Preparation of final accounts:

8. Prepare trading and profit and loss account from the information given below:

<i>Particulars</i>	₹	<i>Particulars</i>	₹
Opening stock	3600	Rent (factory)	400
Purchases	18260	Rent (offices)	500
Wages	3620	Sales return	700
Closing stock	4420	Purchase returns	900
Sales	32000	General expenses	900
Carriage on purchases	500	Discount to customers	360
Carriage on sales	400	Interest from bank	200

(Ans: Gross profit: ` 1,240; Net profit: ` 8,280)

9. From the following balances of Arvind, prepare a Trading a/c. Profit & Loss a/c and Balance Sheet as at 31st December 2005.

<i>Particulars</i>	₹	<i>Particulars</i>	₹
<i>Credit balances:</i>		Postage	546
Capital	72,000	Bad debts	574
Creditors	17,440	Interest	2,590
Bills payable	5,054	Insurance	834
Sales	1,56,364	Machinery	20,000
Loan	24,000	Stock (1.1.05)	19,890
<i>Debit balances:</i>		Purchases	1,24,184
Debtors	7,770	Wages	8,600
Salaries	8,000	Buildings	47,560
Discount	2,000	Furniture	32,310

Value of goods on hand on 31.12.05 ` 28,600

(Ans: Gross Profit – ` 32,290; Net Profit – ` 17,746; Balance Sheet total – ` 1,36,240)

10. The following balances were extracted from the books of Prasad on 31st March 2004.

<i>Particulars</i>	(`)	<i>Particulars</i>	(`)
Capital	50,000	Creditors	50,001
Drawings	4,000	Bad debts	100
General expenses	5,000	Loan	15,760
Buildings	22,000	Sales	13,020
Machinery	18,680	Purchases	94,000
Stock	32,400	Motor car	4,000
Power	4,480	Reserve Fund (Cr.)	180
Taxes & insurance	2,630	Commission (Cr)	2,640
Wages	14,400	Car expenses	3,600
Debtors	12,560	Bills payable	6,700
Bank overdraft	6,600	Cash	160
Charity	210		

Stock on 31st March 2004 was valued at ` 47,000. Prepare the final accounts for the year ended on 31st March 2004.

(Ans: Gross Profit – ` 32,440; Net Profit – ` 22,540; Balance Sheet total – ` 1,04,400)

11. From the following trial balance of Ravi, prepare trading and profit & loss account for the year ended 31st December 2003 and a balance sheet as on that date.

Trial Balance

<i>Particulars</i>	(`)	(`)
Capital		40,000
Sales		25,000
Purchases	15,000	
Salaries	2,000	
Rent	1,500	
Insurance	300	
Drawings	5,000	
Machinery	28,000	
Bank balance	4,500	
Cash	2,000	
Stock 1.1.93	5,200	
Debtors and Creditors	2,500	1,000
	66,000	66,000

Adjustment required:

- (i) Stock on 31.12.03 ` 4,900
(ii) Salaries unpaid ` 300
(iii) Rent paid in advance ` 200
(iv) Insurance prepaid ` 90

(Ans: G.P. = ` 9,700 , N.P. = ` 5,890; B/S Total = ` 42,190)

12. From the following trial balance, prepare trading, profit & loss a/c for the year ended 31.12.2001 and a balance sheet as on that date:

Trial Balance

Purchases	11,870	Capital	8,000
Debtors	7,580	Bad debts recovered	25
Return inwards	450	Creditors	1,250
Bank deposit	2,750	Return outwards	350
Rent	360	Bank overdraft	1,570
Salaries	850	Sales	14,690
Travelling expenses	300	Bills payable	1,350
Cash	210		
Stock	2,450		
Discount allowed	40		
Drawings	600		
	27,460		27,650

Adjustments:

- (i) The closing stock on 31.12.01 was ` 4,200.
(ii) Write off ` 80 as bad debts and create a reserve for bad debts at 5% on sundry debtors.
(iii) Three month's rent is outstanding.

(Ans: Gross Profit = ` 4,470, Net profit = ` 2,595; Balance Sheet total = ` 14,285)

13. From the following balances as at 31st December 2004 of a trader, prepare a trading and profit & loss a/c for the year 2004 and a balance sheet as on that date:

<i>Particulars</i>	()	<i>Particulars</i>	()
Salaries	5,500	Creditors	9,500
Rent	1,300	Sales	32,000
Cash	1,000	Capital	30,000
Debtors	40,000	Loans	10,000
Trade expenses	600		
Purchases	25,000		
Advances	2,500		
Bank balance	5,600		
	81,500		81,500

Adjustments:

- (i) The closing stock amounted to ` 9,000
- (ii) One month's salary is outstanding.
- (iii) One month's rent has been paid in advance.
- (iv) Provide 5% for doubtful debts.

(Ans: Gross Profit = ` 16,000; Net profit = ` 6,200; Balance Sheet total – ` 56,200)

14. Prepare a trading and profit & loss a/c for the year ended 31st December, 2005 and a balance sheet as on that date from the following trial balance of Mr. Akilan:

<i>Particulars</i>	(`)	<i>Particulars</i>	(`)
Drawings	45,000	Creditors	1,60,000
Goodwill	90,000	Capital	35,000
Buildings	60,000	Bills payable	70,000
Machinery	40,000	Purchase returns	2,650
Bills receivable	6,000	Sales	2,18,000
Opening stock	40,000		
Purchase	51,000		
Wages	26,000		
Carriage outwards	500		
Carriage inwards	1,000		
Salaries	35,000		
Rent	3,000		
Discount	1,100		
Repairs	2,300		
Bank	25,000		
Cash	1,600		
Debtors	45,000		
Bad debts	1,200		
Sales returns	2,000		
Furniture	6,000		
Advertisements	3,500		
General expenses	450		
	4,85,650		4,85,650

Adjustments:

- (i) Closing stock was ` 35,000.
- (ii) Depreciate machinery and furniture by 10%.
- (iii) Outstanding wages ` 1,500.

- (iv) Prepaid advertisement ` 500.
 (v) Create 5% on debtors for bad debts as provision.
 15. From the following trial balance of Thiru Rehman as on 31st March 2005, prepare trading and profit & loss a/c and balance sheet taking into account the adjustments:

<i>Debit balance</i>	()	<i>Credit balance</i>	()
Land and buildings	42,000	Capital	62,000
Machines	20,000	Sales	98,780
Patents	7,500	Return outwards	500
Stock 1-4-1994	5,760	Sundry creditors	6,300
Sundry debtors	14,500	Bills payable	9,000
Purchases	40,675		
Cash in hand	540		
Cash at bank	2,630		
Return inwards	680		
Wages	8,480		
Fuel & power	4,730		
Carriage on sales	3,200		
Carriage on purchases	2,040		
Salaries	15,000		
General expense	3,000		
Insurance	600		
Drawings	5,245		
	1,76,580		1,76,580

Adjustments:

- (i) Stock on 31-3-2005 was ` 6,800.
 (ii) Salary outstanding ` 1,500.
 (iii) Insurance prepaid ` 150.
 (iv) Depreciate machinery at 10% and patents at 20%.
 (v) Create a provision of 2% on debtors for bad debts.

(Ans: Gross profit = ` 43,715; Net profit = ` 16,775; Balance Sheet total = ` 90,330)

16. The following are the balances extracted from the books of Ganesh as on 31-12-2009. Prepare trading and profit and loss a/c for the year ending 31-12-2009 and a balance sheet as on that date.

Trial Balance as on 31-12-2009

<i>Debit balance</i>	()	<i>Credit balance</i>	()
Drawings	4,000	Capital	20,000
Cash at bank	1,700	Sales	16,000
Cash in hand	6,500	Sundry creditors	4,500
Wages	1,000		
Purchases	2,000		
Stock (1-1-99)	6,000		
Buildings	10,000		
Sundry debtors	4,400		
Sills receivable	2,900		
Rent	450		
Commission	250		
General expense	800		
Furniture	500		
	40,500		40,500

Adjustments:

- (i) Stock on 31-12-09 was ` 4,000.
- (ii) Interest on capital at 6% to be provided.
- (iii) Interest on drawings at 5% to be provided.
- (iv) Wages yet to be paid ` 100.
- (v) Rent prepaid ` 50.

(Ans: Gross profit = ` 10,900; Net profit = ` 8,450; Balance Sheet total = ` 30,050)

17. Below is given the trial Balance of Tripathi Brothers of Ahmedabad as on 31st December, 2002:

<i>Debit balance</i>	()	<i>Credit balance</i>	()
Opening stock	3,100	Capital	12,000
Buildings	17,000	Bank loan	3,000
Furniture	1,000	Sundry creditors	4,920
Purchases	21,200	Return outwards	420
Salaries	2,200	Interest	130
Bad debts	120	Dividends	110
Cash in hand	1,300	Sales	41,460
Returns inwards	1,020		
Rent	600		
Miscellaneous expenses	500		

Postage	280		
Stationery	260		
Wages	5,200		
Freight and carriage on purchase	560		
Carriage on Sales	800		
Repairs	900		
Sundry debtors	6,000		
	62,040		62,040

In addition, the following information is given:

- A provision at 5% for doubtful debts has to be made.
- The value of stock on 31st December 2002 was estimated at ` 2,980.
- In the miscellaneous expenses included is an yearly insurance premium of ` 120. The yearly premium falls due every year on 31st March.
- Depreciation on building is to be charged at 10%.
- Salaries for December 2002 amounting to ` 200 were not paid till the date of preparing Trial Balance.

Prepare Trading Account and Profit & Loss Account of Tripathi Brothers for the year 2002 and Balance Sheet as on that date.

(Ans: Gross Profit = ` 13,780; Net Profit = ` 6,190; Balance Sheet total = ` 26,310)

18. Prepare Trading & Profit and Loss Account and Balance Sheet as on 31st March, 2004.

<i>Debit balance</i>	(`)	<i>Credit balance</i>	(`)
S. Chandra's Capital a/c	1,19,400	Manufacturing wages	40,970
S. Chandra's Drawings a/c	10,550	Sales	3,56,430
Sundry Creditors	59,630	Return Inwards	2,780
6% Loan a/c (Credit)	20,000	Salaries	11,000
Cash in hand	3,030	Rent & taxes	5,620
Cash at Bank	18,970	Interest & Discount (Dr.)	5,870
Sundry debtors (including Kalpana for dishonoured bill of ` 1,000)	62,00	Travelling Expenses	1,880
Bills Receivable	9,500	Repairs & Renewals	3,370
Provision for doubtful debts	2,500	Insurance (including premium of ` 300 p.a. Paid up to 30 th Sep. 2004	400
Fixtures & fittings	8,970	Bad debts	5,620
Stock 1 st April, 2003	89,680	Commission received	5,640
Purchases	2,56,590	Plant & Machinery	28,800

Adjustments:

- (i) Stock on hand on 31st March 1994 was ` 1,28,960.
- (ii) Write off half of Kalpana's dishonoured bill.
- (iii) Create a provision of 5% on sundry debtors.
- (iv) Charge 5% interest on capital.
- (v) Manufacturing wages include ` 1,200 for erection of new machinery purchased last year.
- (vi) Depreciate plant and machinery by 5% and fixtures and fittings by 10% p.a.
- (vii) Commission earned but not received amount to ` 600.
- (viii) Interest on loan for the last two months is not paid.

(Ans: Gross Profit = ` 96,570; Net Profit = ` 61,583, Balance Sheet Total = ` 2,56,233)

19. The following are the balances extracted from the ledger of Karikalan as on December 31, 2003:

<i>Particulars</i>	(`)	<i>Particulars</i>	(`)
Karikalan's Capital a/c	20,000	Reserve for discount on debtors	200
Drawings	3,500	Loans @ 9%	5,000
Buildings	10,000	Salaries	4,400
Machinery	2,500	Wages	7,500
Furniture & fittings	600	Rent	2,750
Opening stock	12,500	Travelling expenses	1,250
Cycle	400	Postage & telegrams	135
Purchases	75,000	Rates & taxes	90
Sales	1,25,000	Carriage Inwards	2,500
Sales Returns	5,000	Carriage Outwards	750
Duty paid on purchases	15,000	Interest paid	375
Sundry Debtors	10,000	General charges	900
Sundry Creditors	7,500	Bad debts	300
Reserve for bad & doubtful debts	400	Cash in hand	250
		Cash at Bank	2,400

The following adjustments are necessary:

- (a) Stock on 31-12-03 ` 14,00.
- (b) Provide the following outstanding:
Salary ` 400; Rent ` 250; Wages ` 600 and Interest ` 75.
- (c) Maintain the reserve for doubtful debts at 5% and the reserve for discount on debtors at 2.5% on sundry debtors.
- (d) Provide depreciation for Building 2.5%, Furniture 6% and Cycle 15%.

Prepare Trading and Profit and Loss a/c and the Balance Sheet for the year ended 31-12-03.

(Ans: Gross Profit = ` 20,900; Net Profit = ` 8,491.50, Balance Sheet Total = ` 38,816.50)

20. Edward's books show the following balances. Prepare his Trading and Profit & Loss a/c for the year ended 31st December, 2002 and a Balance Sheet as at that date:

<i>Debit balance</i>	(`)	<i>Credit balance</i>	(`)
Drawings	5,000	Capital	1,08,850
Bills Receivable	4,500	Loan at 6% p.a.	20,000
Land & Buildings	37,770	Sales	3,50,000
Sundry Debtors	62,000	Interest on investments	5,640
Wages and Salaries	40,970	Sundry Creditors	59,000
Return Inwards	2,780	Commission received	630
Purchases	2,56,590	Return outwards	6,430
Postage & telegrams	5,620		
Stock on 1-1-92	89,680		
Printing & Stationery	880		
Travelling expenses	12,000		
Interest on loan paid	300		
Petty Cash	70		
Bank Balance	8,800		
Repairs	3,620		
Commission	470		
Furniture	500		
Investments	19,000		
	5,50,550		5,50,550

Adjustments:

- (i) Closing Stock was ` 1,28,960 on 31-12-2002.
- (ii) Commission received but not earned ` 130.
- (iii) Travelling expenses were overdrawn by the employees to the extent of ` 2,000.
- (iv) Create a 5% reserve on sundry debtors and allow 2% discount on debtors and creditors.
- (v) Interest on loan due for 9 months.
- (vi) 1/4th of wages and salaries should be charged to Trading Account.

(Ans: Gross Profit = ` 1,26,097.50; Net Profit = ` 76,622, Balance Sheet Total = ` 2,59,322)

21. From the following Trial Balance of Mr. Xavier as on 31-3-2003, prepare Trading a/c, Profit & Loss a/c for the year ended 31-3-2003 and a Balance Sheet as on that date after making necessary adjustments:

Trial Balance

<i>Debit balance</i>	()	<i>Credit balance</i>	()
Xavier's Drawings	12,000	Xaviers's Capital	60,000
Furniture & fixtures	4,000	Returns Outward	2,000
Plant & Machinery	30,000	Sales	1,30,000
Opening Stock	20,000	Creditors	12,000
Purchases	80,000	Loan at 6% p.a. taken from P. Abdul on 1-1-93	10,000
Salaries & Wages	22,400	Discount	600
Debtors	20,400		
Returns Inward	5,000		
Postage & telegrams	1,500		
Rent, rates, and taxes	3,600		
Bad debts written off	400		
Trade Expenses	200		
Interest on loan from P. Abdul	150		
Insurance	800		
Travelling expenses	500		
Sundry Expenses	300		
Cash in hand	3,050		
Cash at Bank	10,300		
	214600		214600

Adjustments:

- (i) Closing Stock: Cost price – ` 21,000 and Market Price – ` 25,000.
- (ii) Of the debtors, ` 400 are bad and should be written off. Create a reserve for discount on debtors 2.5%.
- (iii) Interest on Capital is to be calculated at 6% p.a. and on drawings ` 330.
- (iv) Prepaid insurance amounted to ` 100.
- (v) Depreciate furniture & fixtures by 5% and Plant and Machinery by 10%.
- (vi) Make a reserve for discount on creditors at 2%.

(Ans: Gross Profit = ` 48,000; Net Profit = ` 10,920; Balance Sheet Total = ` 84,750)

22. From the following Trial Balance of Appu as on 31st March 2004, prepare a Trading and Profit and Loss a/c for the year and a Balance Sheet as on that date:

<i>Debit balance</i>	(₹)	<i>Credit balance</i>	(₹)
Stock on 1-4-1993:		Sundry Creditors	23,500
Raw materials	21,000	Bills Payable	7,500
Work-in-progress	9,500	Sale of scrap	2,500
Finished goods	15,500	Commission	450
Sundry Debtors	24,000	Provision for doubtful debts	1,650
Carriage	1,500	Capital	1,00,000
Bills Receivable	15,000	Sales	1,67,200
Wages	13,000		
Salaries	10,000		
Postage & telegrams	1,000		
Repairs & Renewals	1,100		
Purchases	85,000		
Cash at Bank	17,000		
Plant & Machinery	70,000		
Furniture	10,000		
Rent	6,000		
Lighting	1,350		
General expenses	1,850		

Adjustments:

- (i) Stock on 31st March 2004:
 Raw materials – ₹ 16,200
 Work-in-progress – ₹ 7,800
 Finished goods – ₹ 18,100
- (ii) Salaries and wages outstanding were ₹ 900 and ₹ 2,000.
- (iii) Machinery is to be depreciated by 10% and furniture by 7.5%.
- (iv) Office premises occupy 1/4 of total area. Lighting is to be charged as to 2/3 to factory and 1/3 to office.

(Ans: Gross Profit = ₹ 56,400; Net Profit = ₹ 36,450; Balance Sheet total = ₹ 1,70,350)

23. Prepare Trading and Profit and Loss Account and Balance Sheet for the year ended 31-3-09.

<i>Particulars</i>	()
Capital	80,000
Drawings	6,000
Opening Stock (1-4-98)	45,000
Purchases	3,10,000
Sales	2,50,000
Furniture	10,000
Debtors	40,000
Freight and Octroi	4,800
Trade Expenses	500
Salary	5,500
Rent	2,400
Advertisement	5,000
Insurance Premium	400
Commission earned	1,300
Discount allowed	200
Bad debts	1,800
Provision for Bad Debts	900
Cash	5,200
Bank	5,800
Goodwill (at cost)	20,000

Adjustments:

- (i) Closing stock ` 53,000.
 - (ii) Salaries have been paid for 11 months only.
 - (iii) Prepaid Insurance Premium ` 100.
 - (iv) Commission earned but not received ` 122.
 - (v) Create 3% provision for bad debts in debtors.
 - (vi) Depreciation on furniture at 10% is to be charged.
 - (vii) 1/4th of advertisements is to be written off.
- (Ans: G.P. = ` 63,200; N.P. = 50,872; B/S Total = ` 1,45,372)

Hint: Difference in trial balance = ` 9,600 (Dr).

24. The following is trial balance from the books of Mr. Rahul on 31st December, 2004.

<i>Particulars</i>	() <i>Dr.</i>	() <i>Cr.</i>
Furniture & Fittings	640	–
Motor Vehicles	6,250	–
Buildings	7,500	–
Capital a/c		12,500
Bad debts	125	–
Provision for bad debts		200
Sundry debtors and creditors	3,800	2,500
Stock on 1 st January, 1994	3,460	–
Purchases and sales	5,475	15,450
Bank Overdraft		2,850
Sales and Purchases returns	200	125
Advertising	450	–
Interest Account	118	–
Commission	–	375
Cash	650	–
Taxes and insurance	1,250	–
General Expenses	782	–
Salaries	3,300	–

Adjustments:

- (i) Stock in hand on 31-12-2004 was ` 3,250.
- (ii) Depreciate building at 5%, Furniture & fittings at 10% and Motor vehicles at 20%.
- (iii) ` 85 is due for interest on Bank overdraft.
- (iv) Salaries ` 300 and taxes ` 120 are outstanding.
- (v) Insurance amounting to ` 100 is prepaid.
- (vi) One-third of the commission received is in respect of work to be done next year.
- (vii) Write off further ` 100 as bad debts and provision for bad debts is to be made equal to 5% on sundry debtors.

Prepare Trading and Profit & Loss a/c for the year ending 31-12-2004 and a Balance Sheet as on that date.

(**Ans:** Gross Profit = ` 9,690; Net Profit = ` 1,736; Balance Sheet total = ` 20,216)

25. The following is the Trial Balance of Anbumani as on 31-12-2009.

<i>Debit balance</i>	()	<i>Credit balance</i>	()
Cash in hand	540	Sales	98,780
Cash at bank	2,630	Return outwards	500
Purchases	40,675	Anbumani's capital	71,000
Return inwards	680	Creditors	6,300
Wages	10,480		
Fuel and power	4,730		
Carriage inwards	2,040		
Carriage outwards	3,200		
Opening stock	5,760		
Premises	30,000		
Lands	10,000		
Machinery	20,000		
Patents	7,500		
Salaries	15,000		
Sundry Expenses	3,000		
Insurance	600		
Drawings	5,245		
Debtors	14,500		
	1,76,580		1,76,580

Taking into consideration the following adjustments, prepare Trading and Profit and Loss account and a Balance Sheet as on 31-12-2009.

- (a) Closing stock ` 6,800 in 31-12-2009.
- (b) ` 2,000 spent on erection of a shed were included in wages account.
- (c) The insurance policy expires on 30-6-2010.
- (d) Provide 5% for doubtful debts.
- (e) ` 2,000 is to be transferred to Reserve Fund out of profits if any.

(Ans: G.P. = ` 43,715; N.P. = ` 21,490; Balance profit transferred to B/S = ` 19,490; B/S Total = ` 93,545)

26. From the following particulars, prepare a trading and profit & loss a/c for the year ended 31-12-2007 and the Balance Sheet as on that date:

Trail Balance

<i>Particulars</i>	<i>Debit (`)</i>	<i>Credit (`)</i>
Cash at Bank	20,500	
Capital a/c		80,000
Drawings a/c	6,000	
Machinery	25,000	
Stock on 1-1-1987	15,000	
Purchases	82,000	
Sales returns	2,000	
Sundry Debtors	20,600	
Furniture	5,000	
Taxes	2,000	
Carriage Outwards	500	
Rent	4,600	
Printing & Stationery	800	
Trade expenses	400	
Sundry Creditors		10,000
Sales		1,20,000
Purchase returns		1,000
Postage & Telegram	800	
Reserve for bad & doubtful debts		400
Discount		800
Rent received		1,200
Insurance premium	700	
Salary & wages	21,300	
Cash in hand	6,200	
	2,13,400	2,13,400

Adjustments:

- (i) Stock on 31-12-2007 ` 14,600.
- (ii) Write off Bad debts ` 600.
- (iii) Reserve for bad doubtful debts at 5% on sundry debtors is required.
- (iv) Provide reserve for discount on debtors at 2% and reserve for discount on creditors also at 2%.
- (v) Depreciate machinery and furniture at 5% and 20% respectively.
- (vi) Prepaid Insurance ` 100.
- (vii) A fire occurred on 25-12-2007 destroying stock to the extent of ` 5,000. The stock were insured and the insurance company reimbursed the loss.

(Ans: Gross Profit = ` 41,600; Net Profit = ` 8,970; Balance Sheet total = ` 92,770)

27. From the following Trial Balance of Mr. Satish, prepare Trading and Profit & Loss a/c for the year ended 30th June, 2005 and a Balance Sheet as on that date.

<i>Particulars</i>	<i>Debit (`)</i>	<i>Credit (`)</i>
Satish's Capital		71,000
Cash in hand and at Bank	3,900	98,800
Purchases and sales	41,000	500
Returns	600	
Productive wages	10,500	
Power & fuel	4,000	
Carriage outward	15,000	
Carriage inward	3,200	
Stock (1-7-74)	2,000	
Buildings	5,800	
Plant & Machinery	40,000	
Furniture	20,000	
Debtors and Creditors	7,500	6,300
General expenses	14,500	
Insurance	3,000	
Drawings	600	
Salary	5,000	
	1,76,600	1,76,600

Adjustment:

- (i) Charge 5% interest on Drawings.
- (ii) Goods purchased worth ` 5,000 were received and included in closing stock but were not entered in purchases book.
- (iii) Prepaid insurance amounted to ` 170.
- (iv) Salaries and advertisement bill are outstanding to the extent of ` 500 and ` 1,000 respectively.
- (v) Building, machinery and furniture are to be depreciated by ` 2,000, ` 3,000 and ` 1,500 respectively.
- (vi) Stock on 30th June 2005 was valued at ` 7,000.

(Ans: Gross Profit = ` 37,400; Net Profit = ` 8,020; Balance Sheet total = ` 86,570)

28. Following are the balances extracted from the books of M/s R.K. Enterprises as on 31st March, 2002. You are required to prepare the Manufacturing Account and the Trading Account for the year ended and a Balance Sheet as on that date.

<i>Particulars</i>	()
<i>Opening Stock:</i>	
Raw Materials	50,000
Work-in-progress	37,500
Finished Goods	45,000
Raw Material Purchases	1,25,000
Finished goods Purchases	50,000
Productive Wages	75,000
Coal and Fuel	12,500
Sales	3,95,000
Carriage Inward on raw material purchases	2,500
Railway Freight on raw material purchases	1,250
Repairs to Machinery	3,750
Royalty on Production	2,500
Purchase returns	1,250
Sales returns	2,500
Factory Insurance	3,750
Factory Rent	46,250
<i>Closing Stock:</i>	
Raw Materials	37,500
Work-in-progress	45,000
Finished Goods	25,000

29. From the following details, prepare Manufacturing, Trading and Profit and Loss Account for the year ended on 31st March, 2003.

<i>Particulars</i>	()
<i>Opening Stock:</i>	
Raw Materials	60,000
Work-in-progress	50,000
Finished Goods	75,000
Purchase of Raw Materials	3,20,000
Sales	6,25,000
Purchase Returns	5,000
Sales Returns	4,000
Carriage Inward	1,500
Carriage Outward	1,000
Power	2,500
Bad debts	2,000

Coal and Fuel Charges	3,000
Duty and Clearing Charges	2,000
Factory Rent	4,000
Office Rent	5,000
Electric and Water Charges	6,000
Wages	1,40,000
Salary of Works Manager	2,000
Office salaries	5,000
Advertisement	4,000
Depreciation:	
On Plant	3,000
On Factory Shed	1,000
On Office Furniture	600
Closing Stock:	
Raw Materials	40,500
Work-in-progress	60,000
Finished Goods	55,000

30. The following information is given to you from the books of manufacturer in respect of the year ending 31st March, 2003.

<i>Particulars</i>	(₹)	<i>Particulars</i>	(₹)
Stock of Raw Materials (1.4.02)	25,000	Electricity & Telephone	8,000
Freight inward	8,500	Selling Expenses	6,000
Freight outward	6,000	Miscellaneous Expenses	14,000
Purchase of Raw Materials	2,50,000	Stock of Finished Goods (1.4.2002)	30,000
Direct wages	18,000	Provision for doubtful debts	8,500
Indirect wages	14,000	Dep. on Plant & Machinery	4,650
Sales	4,18,000	Dep. on Office Furniture	3,000
Stationery	1,500	Repairs to Plant & Machinery	4,000
Travelling expenses	5,000	Scrap Sales	3,700
Salaries	26,000	Coal consumed	9,000
Factory Expenses	28,000	Work-in-progress (1.4.2002)	7,000
Interest on Loan paid	1,800		
Returns Inward	5,000		
Returns Outward	3,500		
Power and fuel	8,000		
Bank Interest received	2,000		

Adjustments:

- (i) Finished goods worth ` 5,000 were distributed as free samples.
- (ii) A loan was obtained on 1st October, 2002 for ` 50,000 carrying interest at 10% p.a.
- (iii) Bad debts to be written off ` 750 and provision for doubtful debts to be maintained at ` 7,000.
- (iv) Electricity and Telephone to be apportioned as factory 3/5 and office 2/5.
- (v) A fire occurred destroying finished goods worth ` 15,000. Insurance company admitted a claim of ` 12,000 but not yet received.
- (vi) Stock on 31.3.2003 stationery in hand ` 150, Raw materials ` 22,000, Work-in-progress ` 4,000 and Finished Goods ` 40,000.

You are required to prepare the Manufacturing account and Trading account and Profit and loss account for the year ended on 31st March, 2003.

31. The following balances on 31st March, 2003 are extracted from the books of Mr. Amritlal, a manufacturer-cum-trader.

<i>Particulars</i>	(`)
Stock of Raw Materials, (April 1, 2002)	25,500
Stock of Work-in-progress, (April 1, 2002)	30,700
Stock of Finished Goods, (April 1, 2002)	40,500
Stock of Stores (factory), (April 1, 2002)	2,100
Cash in Hand	1,600
Cash at Bank	32,800
Purchase of Raw Materials	3,12,000
Purchase of Finished Goods	1,27,400
Purchase of Factory Stores	12,300
Factory Wages	2,94,600
Salary of Works Manager	15,000
Office Salaries & Wages	8,600
Carriage Inwards (raw materials)	32,300
Carriage Inwards (finished goods)	10,600
Carriage Outwards	3,700
Rent & Rates: Factory	2,800
General	2,400
Electric Charges: Factory	3,800
General	1,700
Insurance: Factory	2,100
General	700
Travelling expenses	4,800

Brokerage on purchase (raw materials)	3,200
Commission on sales	2,600
Advertisement	12,400
Sales	10,36,600
Returns Outward (finished goods)	12,200
Returns inward (finished goods)	23,700
Repairs & renewals (factory)	8,500
Trade expenses	10,200
Provision for bad debts	2,600
Bad debts	1,800
Plant & Machinery	3,26,400
Furniture & Fixtures	57,300
Sundry trade debtors	65,800
Sundry trade creditors	1,53,400
Loose Tools	8,400
Bills receivable	4,600
Bills payable	54,000
Loan from Bank (October 1, 2002 @ 6% p.a.)	1,20,000
Amritlal's Capital	2,80,000
Amritlal's Drawing	40,000
Investments	1,25,900

In addition, you are given the following information and particulars:

1. Closing stock at the end: Raw materials ` 28,700, Work-in-progress ` 33,000, Finished goods ` 43,800 and Factory stores ` 2,900.
2. Purchase of finished goods for ` 500 utilized for private use of Amritlal has not been duly adjusted.
3. Two Bills Receivable for ` 200 and ` 300 respectively have been dishonoured and await adjustment.
4. A quarter of Advertisement represents payment in advance to advertising agents.
5. Depreciation on Plant & Machinery and Furniture & Fixtures at 10% and on Loose Tools at 20% to be provided.
6. Provision for Bad debts should be maintained at 5% of the debtors.

You are required to prepare a Manufacturing Account, Trading and Profit & Loss Account for the year ending 31st March, 2003 and the Balance Sheet as at that date.

32. The following are the ledger balances of Miss Pooja for the year ended 31.03.2003:

<i>Particulars</i>	()
Capital Account	8,00,000
Miscellaneous expenses	16,500
Rent and taxes	36,500
Discount paid	7,300
Factory power	46,400
Office furniture	1,44,200
Advertisement	84,200
Bad debts	12,400
Discount received	5,665
Staff salaries	43,200
Bank charges	2,200
Plant & Machinery	2,56,400
Purchases	15,64,300
Packing and forwarding	5,200
Machinery repairs	18,600
Factory wages	72,400
Sales	19,25,200
Sundry debtors	2,26,200
Sundry creditors	1,67,600
Cash in hand	1,21,365
Cash at bank	56,000
Reserve for doubtful debts	13,600
Carriage inwards	16,500
Interest	3,000
Light and Heat	25,600
Insurance	5,000
Stock as on 1.4.2002:	
Raw Materials	16,500
Work-in-progress	28,300
Finished Goods	78,200
Drawings	25,600

After taking into account the following further information, prepare the manufacturing, trading and profit and loss account and the balance sheet as at 31st March, 2003.

- (i) Stock on 31.03.2003: Raw materials ` 21,300, Work-in-progress ` 19,230, and Finished goods ` 2,15,600.

- (ii) The following expenses have to be provided for: Factory wages ` 7,800, Rent and Rates ` 3,500, Light and Heat ` 6,200 and Factory Power ` 2,300.
 - (iii) Further, amounts due in all aggregating to ` 15,700 have to be written off as bad debts. The provision for doubtful debts has to be kept at 5% of the debts.
 - (iv) 3/5 of the expenditure on account of heat and light, insurance, rent and rates and miscellaneous expenses are to be allocated to the factory and the balance to the office.
 - (v) A machine costing ` 24,800 purchased on 1.10.2002 was debited to the purchases account and furniture costing ` 2,000 purchased on 1.10.2002 was charged to the miscellaneous expenses account.
 - (vi) Included in the sundry creditors is an amount of ` 50,000 borrowed from Miss. Nancy on 30.9.2002 on which interest is payable at 9% p.a.
 - (vii) Provide depreciation on Plant and Machinery at 15% p.a. and office furniture at 9% p.a.
 - (viii) Insurance was paid upto 30.6.2003.
33. The following are extracted from the books of M/s Non-reliable for the year ended 31st March, 2003.

<i>Particulars</i>	(`)
Capital Account	2,00,000
Drawings	15,000
Purchase less returns	16,50,260
Rates and taxes	2,500
Salaries	35,240
Lighting	6,210
Office rent	6,000
Electricity power	25,600
General reserve	12,500
Travelling expenses	2,220
Insurance (fire)	1,500
Advertisement expenses	37,750
Sales less return	18,35,200
Bad debts written off	9,050
Discount allowed	4,225
General expenses	11,265
Postage and telegram	3,200
Carriage inwards	5,120
Stock as on 1.4.2002:	
Raw Materials	16,800
Finished Goods	23,400
Wages	32,212

Factory Land & Building	25,650
Plant & Machinery	50,250
Furniture & Fixtures	35,420
Sundry debtors	65,210
Sundry creditors	39,640
Cash in Hand	1,218
Cash at Bank	22,040

Prepare the Manufacturing, Trading and Profit and Loss account and the Balance Sheet as at 31st March, 2003 taking into account the additional information given below:

- (i) Stock on 31.03.2003: Raw materials ` 15,707 and Finished goods ` 8,333.
- (ii) Provide depreciation at 10% on Plant and Machinery; 5% p.a., Furniture and Fixtures and 2.5% p.a. on Land and Buildings.
- (iii) Provide 2.5% for discount on debtors and create provision at 10% for bad debts.
- (iv) Sundry creditors include an amount of ` 2,000 realized from Mr. X whose account have been written off 2 years back.
- (v) Insurance was paid upto 30.6.2003.
- (vi) One machine whose value in books as at 1.4.2002 stood at ` 12,000 was disposed off on 30.9.2002 for ` 8,750. No depreciation need to be provided on machinery disposed off during the year.
- (vii) The following expenditure was outstanding : Audit fees ` 1,200, Salaries ` 3,000, Electric Power ` 6,200 and Advertisement ` 2,300.
- (viii) A deposit of ` 5,000 received from one of the debtors was credited to his personal account.

