

# Financial Accounting

(As Per the Revised Syllabus of BBI, 2016-17, First Year: Semester I, University of Mumbai)

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## PREFACE

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It is a matter of great pleasure to present this revised new edition of the book on **Financial Accounting** to the students and teachers of Bachelor of Commerce (Banking and Insurance) started by the University of Mumbai. This book is written on lines of the syllabus instituted by the University. The book presents the subject matter in a simple and convincing language.

We owe a great many thanks to a great many people who helped and supported us during the writing of this book which includes Principal, Co-coordinator, and Students of BBI Section.

The syllabus contains a list of the topics covered in each chapter which will avoid the controversies regarding the exact scope of the syllabus. The text follows the term-wise, chapter-topic pattern as prescribed in the syllabus. We have preferred to give 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, some mistake of interpretation might have crept in.

This book is an 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 the student community will find this book of great use.

We welcome constructive suggestions for improvement.

We are extremely grateful to Mr. Pandey of Himalaya Publishing House Pvt. Ltd., and for their devoted and untiring personal attention accorded by them to this publication.

We 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 Nishikhant Jha**

**Mrs. Darshita Nirav Goda**

**Authors**

# SYLLABUS

## Financial Accounting

### Modules at a Glance

Sr. No.	Modules	No. of Lectures
1	Introduction to accounting	12
2	Classification of Income & Expenses & Accounting Standards	12
3	Stock Valuation & Hire purchase	20
4	Final Accounts	16
	<b>Total</b>	<b>60</b>

Sr. No.	Modules / Units
<b>1</b>	<b>Introduction to accounting</b>
	Meaning, scope, objectives, need, importance and limitations of accounting. Basic accounting terminology. Branches of accounting. Accounting concepts, Conventions and Principles. Double Entry System, Classifications of accounts, Rules of debit and credit. Writing of journal Entries and Ledger, Sub division of journal and Trial Balance
<b>2</b>	<b>Classification of Income &amp; Expenses &amp; Accounting Standards</b>
	Classifications of Income, Expenditure and Receipts on the basis of capital and revenue. Source documents required for practical accounting. Introduction to Bank Reconciliation Statement and Errors and their Rectification. Accounting Standard 1, 2, 6, 8, 9, 10. Understanding Fair value concept, Overview of Indian-AS vis-a-vis International Financial Reporting Standards (IFRSs).
<b>3</b>	<b>Stock Valuation &amp; Hire purchase</b>
	Stock valuation (FIFO and Weighted Average Method only) Hire Purchase Transactions (calculation of interest, accounting as per asset purchase method only, exclude repossession).
<b>4</b>	<b>Final Accounts</b>
	Trading Account, Profit and Loss Account, Balance Sheet, Adjustment Entries.

# QUESTION PAPER PATTERN

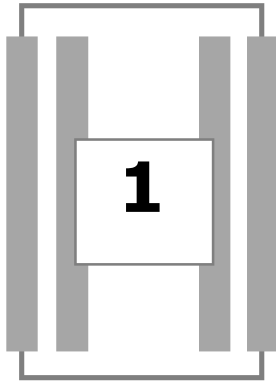
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## Chapter



# Introduction to Accounting

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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 prerequisite 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 for ₹ 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.

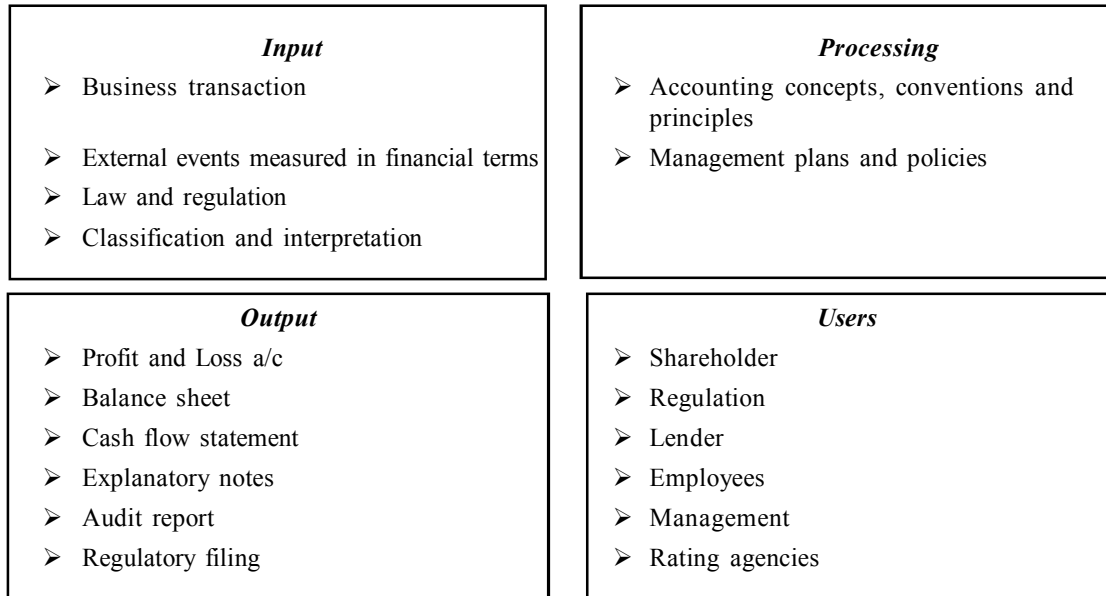
Accountancy refers to a systematic knowledge of accounting. It explains “why to do” and “how to do” of various aspects of accounting. It tells us why and how to prepare the books of accounts and how to summarize the accounting information and communicate it to the interested parties.

## **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, stockbrokers, 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 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.

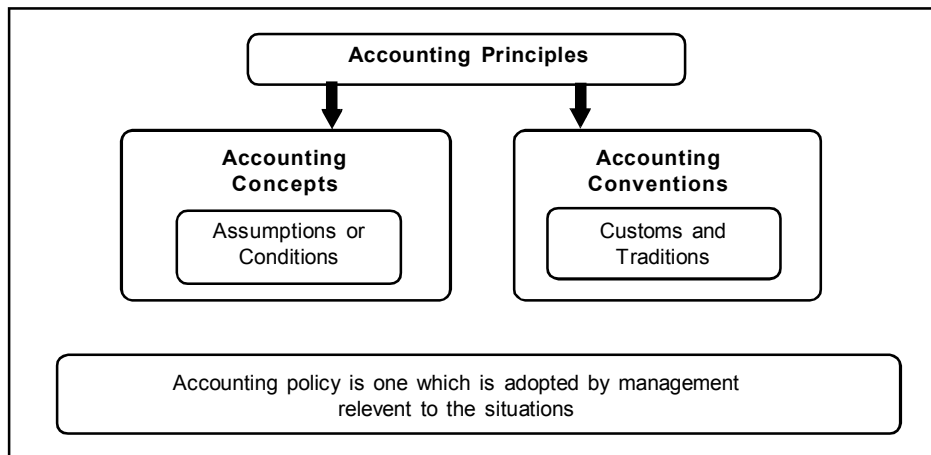


Fig. 1

- **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

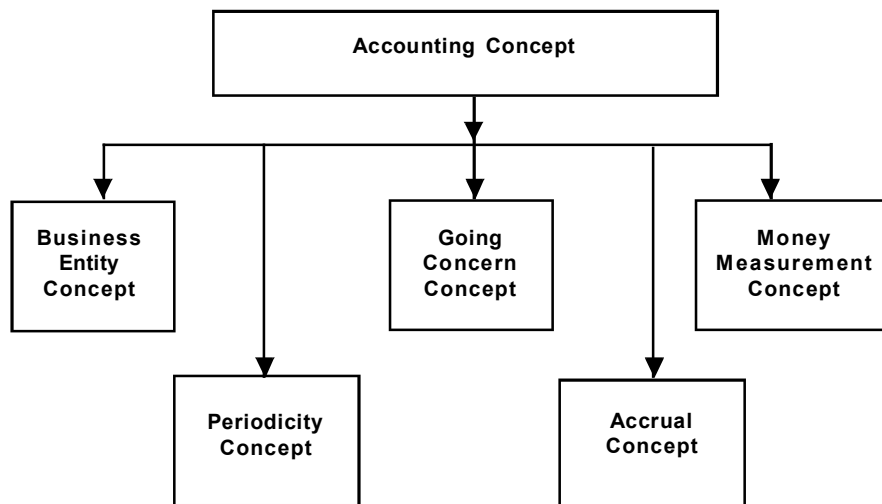
- which economic resources and obligations should be recorded as assets and liabilities by financial accounting,
- which changes in assets and liabilities should be recorded,
- when these changes are to be recorded,
- how the assets and liabilities and changes in them should be measured,
- what information 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 and Fund flow statements are alone mandatory	Statements 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 tenet 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.

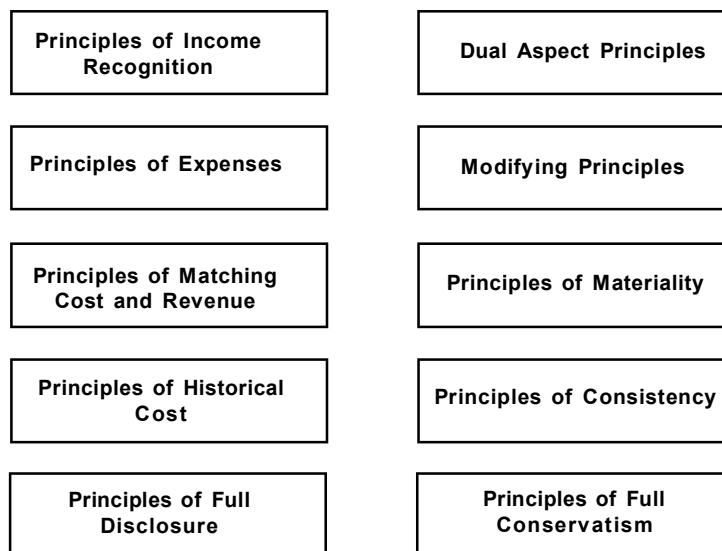
**5. Accrual Concept:** Profit earned or loss suffered for an accounting period is the result of both cash and credit transactions. It is possible that certain incomes are earned but not received and similarly certain expenses incurred but not yet paid during an accounting period. But it is relevant 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.



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 as 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
	<b>20,000</b>		<b>20,000</b>

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.

**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 \_\_\_\_\_.

- Ans.**
- |   |                                     |
|---|-------------------------------------|
| 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?



- |   |                        |                             |
|---|------------------------|-----------------------------|
| 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

- The art or science which teaches the technique of recording and explaining financial transaction is called:
  - Recording transactions
  - Bookkeeping
  - Accounting
  - Bookkeeping and accounting
- The origin of modern accounting was in \_\_\_\_\_
  - England
  - India
  - Italy
  - America
- Who is the father of modern accounting?
  - L.C. Cooper
  - A.W. Johnson
  - Luca Pacioli
  - R.N. Carter
- Which year indicates the period of origin of double-entry system of bookkeeping?
  - 1414
  - 1394
  - 1494
  - 1449
- What was the name of the book written by Luca Pacioli?
  - Accounting in ancient Italia
  - The modern concept on accounting
  - Summa de Arithmetica Geometria Proportionate Proportionalita*
  - Accounting in the past
- The history of accounting is:
  - A new discipline
  - Invention of science
  - As old as the human civilization
  - A new achievement of social science
- The principal object of bookkeeping is
  - Keeping written records of transaction
  - Keeping written records of expenditure
  - Ascertainment of financial results
  - 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

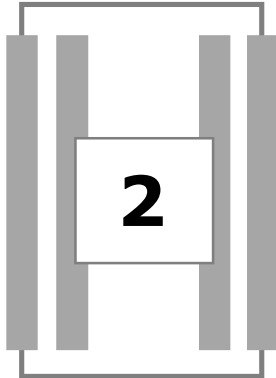
Ans. 1. (b), 2. (c), 3. (c), 4. (c), 5. (c), 6. (c), 7. (a), 8. (d).

### 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 bookkeeping 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?

...✍...✍...✍

## Chapter



# Classification of Accounts and Procedure

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## 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

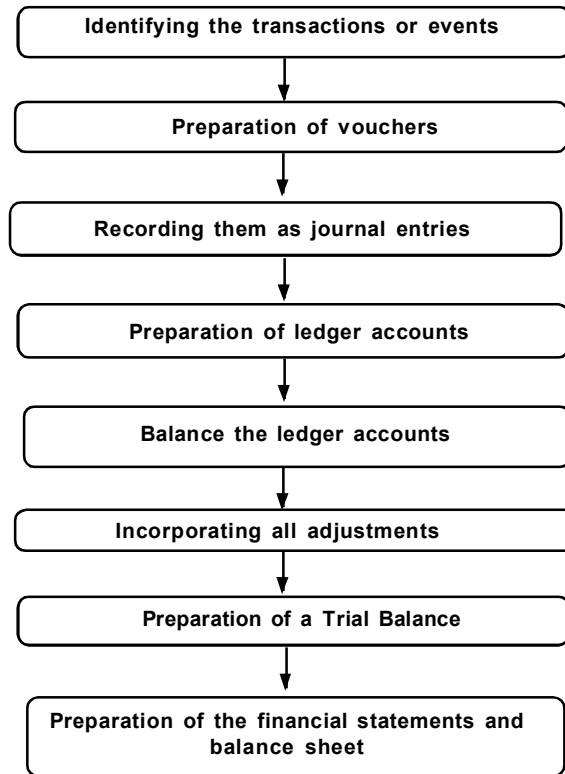
**Revenue a/c:** 5, 11, 13, 19, 25, 26, 34

**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:

- Subramanya started his business with cash
- Borrowed from Mahesh
- Purchased furniture
- Purchased furniture from Mohan on credit
- Purchased goods for cash
- 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

#### **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>Assets 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>Assets 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>Assets 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
<b>Less:</b> Trade discount @ 12%	<u>9,000</u>
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
<b>Less:</b> Cash discount @ 2%	<u>1,320</u>
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:

Date	Invoice No.	Particulars
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**

Date	Purchase Invoice No.	Name of the supplier	L.F.	Details	Amount
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**

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

**Adikari Mills a/c**

Date	Particulars	L.F.	Amount	Date	Particulars	L.F.	Amount
				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.**

No. of the Bill	Date of Receipt	From Whom Received	Acceptor	Where payable	Term of the Bill	Due Date	L.F.	Amount ₹	Remarks
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.**

No. of the Bill	Date of Receipt	To Whom Given	Drawer	Payee	When Payable	Due Date	L.F.	Amount ₹	Date of Payment	Remarks
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**

Date	Receipts	Cash	Date	Payments	Cash
2014			2014		
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
	<b>Total</b>	<b>33,550</b>		<b>Total</b>	<b>33,550</b>

*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>
2014				2014			
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
	<b>Total</b>	<b>2,800</b>	<b>17,350</b>		<b>Total</b>	<b>2,800</b>	<b>17,350</b>

*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>
2014					2014				
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
	<b>Total</b>	<b>100</b>	<b>9,100</b>	<b>13,500</b>	31	By Bal c/d		5,600	7,000
							<b>50</b>	<b>9,100</b>	<b>13,500</b>

*Note the following points from the above illustration:*

- 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.
- There are two contra entries each on 15th and 30th. On 15<sup>th</sup>, 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.
- To indicate contra entry, "C" is mentioned against the entry.
- Drawings represent the amount withdrawn from bank for business purposes.
- Dividend from X Co. is received by cheque and the company should have remitted the dividend directly to the bank account of the businessman.
- 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, 2014		₹
1 <sup>st</sup>	Commenced business with cash	20000
2 <sup>nd</sup>	Bought goods for cash	5000
3 <sup>rd</sup>	Sold goods for cash	4000
4 <sup>th</sup>	Goods purchased from Ravi Kumar	10000
10 <sup>th</sup>	Paid to Ravi Kumar	7000
14 <sup>th</sup>	Cash sales	8000
18 <sup>th</sup>	Purchased furniture for office	4000
22 <sup>nd</sup>	Paid wages	500
25 <sup>th</sup>	Paid rent	600
30 <sup>th</sup>	Received commission	4000
30 <sup>th</sup>	Withdrew for personal purpose	1000
31 <sup>st</sup>	Paid salary	900

**Solution:**

**Cash Book of Gopichand**

Date	Particulars	Amount	Date	Particulars	Amount
2014			2014		
March 1 <sup>st</sup>	To Capital	20,000	March 2 <sup>nd</sup>	By Goods	5000
3 <sup>rd</sup>	To Sales	4,000	10 <sup>th</sup>	By Ravi Kumar	7000
14 <sup>th</sup>	To Sales	8,000	18 <sup>th</sup>	By Office furniture	4000
	To Commission	4,000	22 <sup>nd</sup>	By Wages	500
			25 <sup>th</sup>	By Rent	600
			30 <sup>th</sup>	By Drawings	1000
			31 <sup>st</sup>	By Salary	900
			31 <sup>st</sup>	By Balance c/d	17,000
		<b>36,000</b>			<b>36,000</b>

**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 2014.

July, 2014		₹
01 <sup>st</sup>	Opening balance b/d (Cash)	14,500
	Opening balance b/d (Bank)	7,000
04 <sup>th</sup>	Cash purchases	6,700
05 <sup>th</sup>	Rent for June month paid by cheque	2,500
09 <sup>th</sup>	Cash sales	15,200

12 <sup>th</sup>	Dividend paid by cheque	4,350
15 <sup>th</sup>	Cash deposited into bank	5,000
18 <sup>th</sup>	Cash paid to Rahim & Bros to settle his account	10,000
20 <sup>th</sup>	Repairs paid	1,000
22 <sup>nd</sup>	Commission paid by cheque	2,000
23 <sup>rd</sup>	Customer, Deepak remitted to our bank account	20,000
25 <sup>th</sup>	Cash withdrawn from bank for office use	5,000
27 <sup>th</sup>	Drawings made from business cash for personal purpose	2,000
28 <sup>th</sup>	Purchased stationery by cash	3,000
30 <sup>th</sup>	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 14				July 14			
1 <sup>st</sup>	To Op bal b/d	14,500	7,000	4 <sup>th</sup>	By Purchases	6,700	
9 <sup>th</sup>	To Sales	15,200		5 <sup>th</sup>	By Rent		2,500
15 <sup>th</sup>	To Cash (C)		5,000	12 <sup>th</sup>	By Dividend paid		4,350
23 <sup>rd</sup>	To Deepak		20,000	15 <sup>th</sup>	By Bank (C)	5,000	
25 <sup>th</sup>	To Bank (C)	5,000		18 <sup>th</sup>	By Rahim & Bros	10,000	
				20 <sup>th</sup>	By Repairs	1,000	
				22 <sup>nd</sup>	By Comm. paid		2,000
				25 <sup>th</sup>	By Cash (C)		5,000
				27 <sup>th</sup>	By Drawings	2,000	
				28 <sup>th</sup>	By Stationery	3,000	
				30 <sup>th</sup>	By Drawings		1,400
				30 <sup>th</sup>	By Balance c/d	7,000	16,750
		<b>34,700</b>	<b>32,000</b>			<b>34,700</b>	<b>32,000</b>
	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 <sup>st</sup>	Balance of cash in hand ₹ 14,000; bank overdraft at bank ₹ 5,000
4 <sup>th</sup>	Invested further capital ₹ 10,000 out of which ₹ 6,000 was deposited in the bank
6 <sup>th</sup>	Sold goods for cash ₹ 30,000
6 <sup>th</sup>	Collected from debtors of last year ₹ 80,000; Discount allowed to them ₹ 2,000
10 <sup>th</sup>	Purchased goods for cash ₹ 55,000
11 <sup>th</sup>	Paid Ram Vilas, our creditor ₹ 25,000; discount allowed by him ₹ 650
13 <sup>th</sup>	Commission paid to our agent ₹ 5,300

14 <sup>th</sup>	Office furniture purchased for cash ₹ 2,000
14 <sup>th</sup>	Rent paid ₹ 400; electricity charges paid ₹ 1,000
14 <sup>th</sup>	Drew cheque for personal use ₹ 7,000
17 <sup>th</sup>	Cash sales ₹ 25,000
18 <sup>th</sup>	Collection from Atal Bihari ₹ 40,000, deposited in the bank on 19 <sup>th</sup> April
19 <sup>th</sup>	Drew from the bank for office use ₹ 5,000
22 <sup>nd</sup>	Drew cheque for petty expenses ₹ 1,500
24 <sup>th</sup>	Dividend received by cheque ₹ 500, deposited in the bank on the same day
25 <sup>th</sup>	Commission received by cheque ₹ 2,300, deposited in the bank on 28 <sup>th</sup> April
29 <sup>th</sup>	Drew from the bank for salary of the office staff ₹ 15,000
30 <sup>th</sup>	Deposited cash in the bank ₹ 10,000.

**Solution:**

**Three Column Cash Book**

Particulars	Disc ₹	Cash ₹	Bank ₹	Particulars	Disc ₹	Cash ₹	Bank ₹
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
<b>Total</b>	<b>2,000</b>	<b>2,00,300</b>	<b>58,800</b>	<b>Total</b>	<b>650</b>	<b>2,00,300</b>	<b>58,800</b>

**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.



## Cash Book

<i>Date</i>	<i>Receipts</i>	<i>Amount ₹</i>	<i>Date</i>	<i>Payments</i>	<i>Amount ₹</i>
			1 <sup>st</sup> Nov	By Petty cash	1,000

## Ledger

## Travelling Expenses Account

<i>Date</i>	<i>Receipts</i>	<i>Amount ₹</i>	<i>Date</i>	<i>Payments</i>	<i>Amount ₹</i>
1 <sup>st</sup> Nov	To Petty cash	120			

## Postage Expenses Account

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

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

- |       |                      |                                 |         |
|-------|----------------------|---------------------------------|---------|
| (i)   | Jan 1 <sup>st</sup>  | Received for petty cash payment | ₹ 500/- |
| (ii)  | Jan 2 <sup>nd</sup>  | Paid for postage                | ₹ 40/-  |
| (iii) | Jan 5 <sup>th</sup>  | Paid for stationery             | ₹ 25/-  |
| (iv)  | Jan 8 <sup>th</sup>  | Paid for advertisement          | ₹ 150/- |
| (v)   | Jan 12 <sup>th</sup> | Paid for wages                  | ₹ 50/-  |

(vi)	Jan 16 <sup>th</sup>	Paid for carriage	₹ 25/-
(vii)	Jan 20 <sup>th</sup>	Paid for conveyance	₹ 22/-
(viii)	Jan 25 <sup>th</sup>	Paid for travelling expenses	₹ 80/-
(ix)	Jan 27 <sup>th</sup>	Paid for postage	₹ 50/-
(x)	Jan 28 <sup>th</sup>	Paid wages to cleaner	₹ 10/-
(xi)	Jan 30 <sup>th</sup>	Paid for telegram	₹ 20/-
(xii)	Jan 30 <sup>th</sup>	Sent registered notice	₹ 10/-

**Solution:****Petty Cash Book**

Cash recd ₹	Date	Particulars	L.F.	Total Pay-ment	Postage & tele-gram	Carriage	Printing & statio-ner-y	Advt	Travel exp.	Wages	Sundry
500	2014 Jan										
	1 <sup>st</sup>	To Cash									
	2 <sup>nd</sup>	By Postage		40	40						
	5 <sup>th</sup>	By Stationery		25			25				
	8 <sup>th</sup>	By Advt		150				150			
	12 <sup>th</sup>	By Wages		50						50	
	16 <sup>th</sup>	By Carriage		25		25					
	20 <sup>th</sup>	By Conveyance		22					22		
	25 <sup>th</sup>	By Travelling		80					80		
	27 <sup>th</sup>	By Postage		50	50						
	28 <sup>th</sup>	By Wages		10						10	
	30 <sup>th</sup>	By Telegram		20	20						
	30 <sup>th</sup>	By Register		10	10						
				482	120	25	25	150	102	60	
	30 <sup>th</sup>	By Balance b/d		18							
500				500							
18	July 1 <sup>st</sup>	By Balance b/d									
482	July 1 <sup>st</sup>	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 2014, Narayan transacted the following business:

<i>Dates</i>	<i>₹</i>
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) ( <b>Logic:</b> 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 To Shyam's Account (Being the goods purchased on credit) <b>(Logic:</b> Purchases is expenses. Debit all expenses. Shyam is a personal account. Credit the giver.)	Dr.	30,000	30,000
Jan 3	Purchases Account To Cash Account (Being the goods purchased for cash) <b>(Logic:</b> Purchases is expenses. Debit all expenses. Cash is a real account. Credit what goes out.)	Dr.	1,000	1,000
Jan 4	Gopalan's Account To Cash Account (Being the amount paid to Gopalan) <b>(Logic:</b> 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) <b>(Logic:</b> 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) <b>(Logic:</b> 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) <b>(Logic:</b> 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) <b>(Logic:</b> 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) <b>(Logic:</b> 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) <b>(Logic:</b> 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	Dr.	200	200

	(Being the amount paid for postage & telegrams) ( <b>Logic:</b> Postage and telegrams is a nominal account. Debit all expenses. Cash is a real account. Credit the giver.)			
Jan 13	Sales Return Account To Kamal's Account (Being the goods returned by Kamal) ( <b>Logic:</b> 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	Dr.	200	
200	(Being the amount paid for stationery) ( <b>Logic:</b> Stationery is a nominal account. Debit all the expenses. Cash is a real account. Credit what goes out.)			
Jan 18	Bank Account To Cash Account (Being the amount deposited into the bank) ( <b>Logic:</b> 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) ( <b>Logic:</b> 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) ( <b>Logic:</b> 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) ( <b>Logic:</b> 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) ( <b>Logic:</b> 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) ( <b>Logic:</b> 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 ₹
2014					2014				
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
			<b>44,350</b>	<b>500</b>				<b>44,350</b>	<b>500</b>

**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 ₹
2014				
Jan. 2	Shyam			30,000
			<b>Total</b>	<b>30,000</b>

#### Purchase Returns Book

Date	Name of Supplier	Ledger Folio	Inward Invoice No.	Amount ₹
2014				
Jan. 9	Shyam			200
			<b>Total</b>	<b>200</b>

#### Sales Book

Date	Name of Customer	Ledger Folio	Outward Invoice No.	Amount ₹
2014				
Jan. 10	Kamal			10,000
			<b>Total</b>	<b>10,000</b>

## Sales Return Book

Date	Name of Customer	Ledger Folio	Credit Notes No.	Amount ₹
2014 Jan. 13	Kamal			500
			<b>Total</b>	<b>500</b>

## General Ledger

## Capital Account

Dr.

Cr.

Date	Particulars	JF No.	Amount ₹	Date	Particulars	JF No.	Amount ₹
2014 Jan. 31	To Balance c/d		40,000	2014 Jan. 1	By Cash a/c		40,000
			<b>40,000</b>				<b>40,000</b>
				Feb. 1	By Balance b/d		40,000

## Shyam's Account

Dr.

Cr.

Date	Particulars	JF No.	₹	Date	Particulars	JF No.	₹
2014 Jan. 9	To Purchase Returns		200	2014 Jan. 1	By Purchases a/c		30,000
Jan. 31	To Balance c/d		29,800				<b>30,000</b>
			<b>30,000</b>	Feb. 1	By Balance b/d		29,800

## Purchase Account

Dr.

Cr.

Date	Particulars	JF No.	Amount ₹	Date	Particulars	JF No.	Amount ₹
2014 Jan. 2	To Shyam a/c		30,000	2014 Jan. 31	By Balance c/d		32,000
Jan. 3	To Cash		1,000				
Jan. 22	To Cash		1,000				<b>32,000</b>
			<b>32,000</b>				
Feb. 1	To Balance b/d		32,000				

## Sales 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>
2014 Jan. 31	To Balance c/d		10,750	2014 Jan. 13	By Kamal's a/c		10,000
				Jan. 20	By Cash		750
			<b>10,750</b>				<b>10,750</b>
				Feb.1	By Balance b/d		10,750

## Purchase Returns 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>
2014 Jan. 31	To Balance c/d		200	2014 Jan. 9	By Shyam's a/c		200
			<b>200</b>				<b>200</b>
				Feb.1	By Balance b/d		200

## Sales Returns 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>
2014 Jan. 13	To Kamal's a/c		500	2014 Jan. 31	By Balance c/d		500
			<b>500</b>				<b>500</b>
Feb.1	To Balance b/d		500				

## Gopalan 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>
2014 Jan. 6	To Cash a/c		2,000	2014 Jan. 31	By Balance c/d		2,000
			<b>2,000</b>				<b>2,000</b>
Feb.1	To Balance b/d		2,000				

## 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>
2014 Jan 7	To Cash a/c		500	2014 Jan. 31	By Balance c/d		500
			<b>500</b>				<b>500</b>
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>
2014 Jan. 1	To Balance c/d		600	2014 Jan. 31	By Cash a/c		600
			<b>600</b>				<b>600</b>
				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>
2014 Jan. 10	To Sales a/c		10,000	2014 Jan. 31	By Sales returns a/c		500
				Jan. 31	By Balance c/d		9,500
			<b>10,000</b>				<b>10,000</b>
Feb.1	To Balance b/d		9,500				

**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>
2014 Jan. 10	To Cash a/c		200	2014 Jan. 31	By Balance c/d		200
			<b>200</b>				<b>200</b>
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>
2014 Jan. 15	To Cash a/c		200	2014 Jan. 31	By Balance c/d		200
			<b>200</b>				<b>200</b>
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>
2014 Jan. 25	To Cash a/c		700	2014 Jan. 31	By Balance c/d		700
			<b>700</b>				<b>700</b>
Feb.1	To Balance b/d		700				

## Rent Account

Dr.				Cr.			
Date	Particulars	JF No.	Amount ₹	Date	Particulars	JF No.	Amount ₹
2014 Jan. 28	To Cash a/c		500	2014 Jan. 31	By Balance c/d		500
			<b>500</b>				<b>500</b>
Feb.1	To Balance b/d		500				

## Drawings Account

Dr.				Cr.			
Date	Particulars	JF No.	Amount ₹	Date	Particulars	JF No.	Amount ₹
2014 Jan. 31	To Cash a/c		1,000	2014 Jan. 31	By Balance c/d		1,000
			<b>1,000</b>				<b>1,000</b>
Feb.1	To Balance b/d		1,000				

## Murthy's Account

Dr.				Cr.			
Date	Particulars	JF No.	Amount ₹	Date	Particulars	JF No.	Amount ₹
2014 Jan. 31	To Balance c/d		3,000	2014 Jan. 5	By Cash a/c		3,000
			<b>3,000</b>				<b>3,000</b>
				Feb.1	By Balance b/d		3,000

## Furniture Account

Dr.				Cr.			
Date	Particulars	JF No.	Amount ₹	Date	Particulars	JF No.	Amount ₹
2014 Jan. 6	To Cash a/c		2,000	2014 Jan. 31	By Balance c/d		2,000
			<b>2,000</b>				<b>2,000</b>
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 .....

Sr. No	Particulars	L.F.	Debit bl.	Credit bl.
	Capital		**	
	Assets			**
	Total		**	**

**Ledger Form of Trial Balance**

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

Sr.	Particulars	Debit	Sr.	Particulars	Credit
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	**
	<b>Total</b>	<b>**</b>		<b>Total</b>	<b>**</b>

**Illustration 13:** From the above ledger accounts of Mr. Narayan for January 2014, prepare a trial balance.

Trial Balance of Mr. Narayan as on January 2014

Particulars	Debit	Particulars	Credit
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		
<b>Total</b>	<b>84,350</b>	<b>Total</b>	<b>84,350</b>

**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., 2013, 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 1<sup>st</sup> January, 2013, the assets and liabilities have to be brought in. The following entry is recorded in Journal Proper.

Date	Particulars	L.F.	Debit ₹	Credit ₹
1-1-13	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)			32,300
	(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.

**Ans.**

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)

**Ans.**

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.**

2014

- 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 2014.**

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:**

2014

- 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.

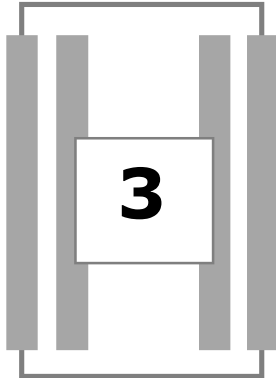
**8. Journalise the following transactions in a Journal and post them to the Ledger accounts and prepare Trial Balance:**

2014

- 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.

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## Chapter



# Classification of Income and Expenditure

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### INTRODUCTION

Accounting is the recording and reporting of business transactions. Business transactions involve activities of actual business (selling goods or services), investment (purchasing assets) and financing (raising money for investment). In accounting, business activities give rise to revenue income and revenue expenditure; investment activities give rise to capital expenditure; financing activities give rise to capital receipts, P & L a/c is a summary of revenue income and revenue expenses, Balance Sheet is summary of capital receipts and capital expenditure.

Expenditure is usually of two types:

1. Capital Expenditure
2. Revenue Expenditure

**Capital Expenditure:** Capital expenditure consists of expenditure, the benefit of which is not fully enjoyed in one accounting period but spread over several accounting periods. It includes assets acquired for the purpose of earning income or increasing the earning capacity of the business or effecting economy in the operation of an asset. These are not meant for sale. Expenditure incurred for improving assets and extending an existing asset is also capital expenditure.

**Definition:** Eric Kohler has defined capital expenditure as “an expenditure intended to benefit future periods; an addition to fixed assets. The term is generally restricted to expenditures that add fixed asset units or that has the effect of increasing the capacity, efficiency, life span or economy of operation of an existing asset.”

**Examples:**

- (a) Interest on capital paid during the period of construction of company.
- (b) Expenditure in connection with or incidental to the purchase or installation of an asset.
- (c) Acquisition of new assets.
- (d) Expenditure incurred for putting the old asset purchased into working condition.

- (e) Additions and extensions to existing assets.
- (f) Betterment of fixed assets or improvement of an asset to produce more to improve its earning capacity or to reduce its operating expenses or to increase the life of asset.

**Revenue Expenditure:** Revenue expenditure consists of expenditure incurred in one period of the accounting, the full benefit of which is enjoyed in that period only. This does not increase the earning capacity of the business but it is incurred in order to maintain the existing earning capacity of the business. It includes all expenses which arise in normal course of business. The benefit of such expenditure is for a short period, say, one year only and it is not to be carried forward to the next year. The expenditure is of a recurring nature, i.e., arises again and again.

**Definition:** Eric Kohler has defined revenue expenditure as “an expenditure charged against operation: a term used to contrast with capital expenditure.”

**Examples:**

- (a) Purchase of raw materials for conversion into finished goods.
- (b) Selling and distribution expenses incurred for sale of finished goods, e.g., sales office expenses, delivery expenses, advertisement charges, etc.
- (c) Establishment expenses like salaries, wages, rent, rates, taxes, insurance and depreciation on office equipment.
- (d) Depreciation of plant, machinery and equipment.
- (e) Expenses incurred in order to maintain the existing fixed assets in an efficient and workable state such as repairs to building, repairs to plant, whitewashing and painting of building.

### Difference between Capital and Revenue Expenditures

<i>Capital Expenditures</i>	<i>Revenue Expenditures</i>
1. Its effect is long-term, i.e., it is not exhausted within the current account year. Its benefit is enjoyed in future year or years also. In a word, its effect reduces gradually.	1. Its effect is temporary, i.e., it is exhausted within the current accounting year.
2. An asset is acquired or the value of an asset is increased as a result of this expenditure.	2. Neither an asset is acquired nor is the value of an asset increased.
3. It does not occur again and again – it is non-recurring and irregular.	3. It occurs repeatedly. It is recurring and regular.
4. Generally, it has physical existence, i.e., it can be seen with eyes.	4. It has no physical existence, i.e., it cannot be seen with eyes.
5. This expenditure improves the position of the concern.	5. This expenditure helps to maintain the position of the concern.
6. A portion of this expenditure is shown in the trading and profit and loss account or income and expenditure account as depreciation.	6. The whole amount of this expenditure is shown in trading and profit and loss account or income and expense account. But deferred revenue expenditures and prepaid expenses are not shown.
7. It pertains to investing activity.	7. It pertains to business activity.
8. It does not reduce the revenue of the concern. Purchase of fixed assets does not affect revenue.	8. It reduces revenue. Payment of salaries to employees decreases revenue.

**Deferred Revenue Expenditure:** Deferred revenue expenditure is a revenue expenditure which has been incurred during one accounting year which is applicable either wholly or in part to further accounting years.

**Definition:** According to Prof. AW. Johnson, “Deferred revenue expenditure includes those non-recurring expenses, which are expected to be of financial nature, distributed to several accounting periods of indeterminate total length. These are of revenue nature but are deferred or postponed. It is of quasi-capital nature.”

In simple words, we can say that Deferred Revenue Expenses are those expenses, the benefit of which may be extended to a number of years, say, 3 to 5 years. It is basically expenditure while forming company. The benefit of this will be derived in the future years also. Any expenditures relating to capital (shares, debentures, securities) is called deferred revenue expenditure.

**Examples:**

- (a) Every expenditure for launching of new project (Advertisement Expenditure).
- (b) Expenditure for the issue or raising loan or capital or debentures.
- (c) Expenditure for the formation or registration of company.
- (d) Preliminary expenditure.

## RECEIPTS

Receipts refer to the actual amounts of cash received. They can be either of capital nature or revenue nature.

**Capital Receipts:** Capital receipts mean an amount received by a concern in the course of its financing activity (obtaining money as capital or loan or sale of assets). Concerns need money to carry on its business activities and investment activities (purchase of assets or investments). The money is obtained either from the proprietor (capital) or loans (liabilities) or sale of assets or sale of investments. Capital receipts are non-recurring in nature. Thus, loan is obtained from the bank only once in a while and not everyday.

Capital receipts include the following:

1. Capital brought in by the proprietor at the commencement and any additions made subsequently.
2. Money borrowed from partners, bankers, private individuals, etc.
3. Money received by the sale of fixed assets.
4. Money received on account of capital profit.

**Revenue Receipts:** Revenue receipts means the receipts from customers for sale of goods, for services given, or for use of funds (loans, capital) or use of assets (patents). Total revenue receipts are computed by adding up the sale price of goods sold, fees for services, interest on loans given, dividend on shares and royalty for use of patents etc. Just like trees planted earlier yield fruits, revenue receipts arise from past capital expenditure, i.e., from exploiting assets and investments acquired earlier. Revenue receipts are recurring in nature, e.g., income from sale of goods is received regularly so long as the business continues.

Revenue receipts include the following:

1. Money received by the sale of floating assets — by sale of goods.
2. Money received on account of some revenue profit.

### Distinction between Capital Receipts and Revenue Receipts

<i>Capital Receipts</i>	<i>Revenue Receipts</i>
1. Capital receipt pertains to financing activity.	1. Revenue receipts pertains to business activity.
2. Examples are capital from owner, loans from bank, etc.	2. Examples are revenue receipts from sale of goods, fees, interest, dividend, royalty.
3. Capital receipts are shown as liability in balance sheet.	3. Revenue receipt pertaining to current year is shown as income in P & L a/c. Revenue receipt pertaining to future period is shown as liability (advance income) in balance sheet.
4. Capital receipts may be returned back.	4. Revenue receipt cannot be returned/refunded.
5. Capital receipts is non-recurring in nature.	5. Revenue receipt is recurring in nature
6. Capital receipts increases funds available for investment, but may reduce profits as interest is to be paid on loans obtained.	6. Revenue receipts increases profits and funds.

### CAPITAL AND REVENUE PROFITS

#### Definition and Explanation

*Capital profit* means a profit made on the sale of a fixed asset or profit earned on raising monies for the business. For example, a building purchased for ₹ 20,000 is sold for ₹ 25,000. The profit ₹ 5,000, thus, made is a capital profit.

*Revenue profit*, on the other hand, is a profit made by the business, e.g., profit on the sale of goods, interest from investments, commission earned etc.

Whenever capital profit is made, it should either be transferred to the capital account of the proprietor or credited to capital reserve account which would appear as a liability on the balance sheet. But capital profits, should in no case be transferred to profit and loss account because it is non-trading profit. Revenue profits, on the other hand, should be transferred to profit and loss account because they arise out of regular trading operation.

### CAPITAL AND REVENUE LOSSES

#### Definition and Explanation

*Capital loss* means a loss made on the sale of a fixed asset or a loss incurred in connection with the raising of money for business. Capital loss may be shown as an asset in the balance sheet. But as this asset is of fictitious nature, it would advisable to write off it.

*Revenue loss*, on the other hand, is the loss incurred in trading operations such as loss on the sale of goods. Revenue losses are charged to profit and loss account of the year in which they occur.

### CAPITALIZED OR DEFERRED REVENUE EXPENDITURES

Where a certain revenue expenditure incurred is of such a nature that its benefit is likely to be spread over a certain number of years, or where it is of non-recurring and special nature and large in amount, in such circumstances, instead of debiting the entire amount to the profit and loss account of

the year in which it has been incurred, it may be spread over a number of years, a proportionate amount as Revenue Expenditure being charged to each year's Profit and Loss account. The remaining portion of the expenditure is carried forward and is known as Capital Expenditure or Deferred Revenue Expenditure and is shown as an asset in the Balance Sheet. Items such as preliminary expenses, cost of issue of debentures are examples that may be classified under this head.

### Exceptions to General Rules

There are certain expenses which are usually of revenue in nature but under certain circumstances they become capital expenditures. The following are the examples of expenses which are usually revenue but under certain circumstances become capital.

**Legal Charges:** These are, as a rule, revenue charges, but legal charges incurred in connection with the purchase of a fixed asset are capital expenditures as they form an additional cost of the asset acquired.

**Wages:** Wages are ordinary revenue expenditure. But in a manufacturing business where the firm's own men are employed in making of fixed asset, the wages paid for such purpose would be capitalized. For example, if the firm's own men are employed in making extension to the factory building or in erection of plant or manufacturing tools for own requirements, the wages and salaries paid to the persons are not revenue but capital expenditures.

**Brokerage and Stamp Duty:** Normally, these are revenue expenditures, but brokerage paid on acquisition of a property and stamp duty involved thereon can be capitalized.

**Freight and Carriage:** This is revenue charge, but freight and carriage paid on newly acquired plant or fixed assets are capital expenditures.

**Advertising:** Ordinarily, amount expended on advertising is revenue charge but the cost of special advertising undertaken for the purpose of introducing a new line of goods may be capitalized.

**Development Expenses:** In concern like collieries, mines, tea, rubber etc., all expenses incurred during the period of development are treated as capital.

**Preliminary Expenses:** These are the expenses incurred in connection with the formation of a public company. These expenses although are revenue in nature but are allowed to be capitalized and can be shown as an asset in the balance sheet.

**Illustration 1:** If a building is purchased for ₹ 20,000 from X and ₹ 10,000 is paid in cash and the remaining sum to be paid after six months; ₹ 20,000 is capital expenditure, but ₹ 10,000 is only capital payment. Similarly, if goods are purchased from X for 30,000 and ₹ 15,000 is paid in cash, ₹ 30,000 is revenue expenditure but only ₹ 15,000 is revenue payment.

**Illustration 2:** Examples of capital acquisitions include the purchase of an office building and the purchase of a vehicle for business use. However, in acquiring a capital asset, certain costs are incurred, such as carriage inwards, installation costs, import duties and valuator fees. Those costs are included as part of the acquisition cost and form part of capital expenditure as well.

**Illustration 3:** Depreciation of non-current assets: Revenue Expenditure

Insurance, salaries and regular maintenance: Revenue Expenditure

Major repairs of a fixed asset that increases its productivity: Capital Expenditure

Transport costs for tradeable assets: Revenue Expenditure

Transport and installation costs for non-current assets: Capital Expenditure

**Illustration 4:** The following table illustrates examples of capital and revenue expenditure:

<i>Capital Expenditure</i>	<i>Revenue Expenditure</i>
Installation of heating system	Annual costs of heating system
Upgrades to computer system	Power cost of computing system
New premises	Repairs to premises
Painting new premises	Repainting existing premises
Carriage inwards on new equipment	Carriage inwards on stocks for resale
Installation costs of machinery	Running costs of machinery
One-off license fee	Annual road tax

## EXERCISE

### Self Assessment Questions

1. State with reasons whether the following are capital, revenue or deferred revenue expenses:

- (i) Payment for purchase of goods.
- (ii) Payment for purchase of stationery.
- (iii) Payment for purchase of a car.
- (iv) Payment for heavy inaugural expenses.
- (v) Partial refund of capital to a partner.
- (vi) Payment of a loan taken earlier.
- (vii) Payment of salaries.
- (viii) Wages for erection of machinery.

[Ans. Capital — 3, 6, 8; Revenue — 1, 2, 5, 7; Deferred — 4.]

### Terminal Questions

1. State whether the following expenditure is a capital, revenue or deferred revenue expenditure. Give reasons:
  - (i) Legal expenses incurred in connection with issue of capital.
  - (ii) Cost of replacement of a defective part of the machinery.
  - (iii) Expenditure incurred in preparing a project report.
  - (iv) Expenditure for training employees for better running of machinery.
  - (v) Expenditure incurred for repairing cinema screen.
2. State whether the following expenditure is a capital, revenue or deferred revenue expenditure. Give reasons:
  - (i) Legal expenses incurred in connection with issue of equity shares of the company.
  - (ii) Cost of replacement of a defective part of the machinery.
  - (iii) Expenditure incurred in preparing a project report.
  - (iv) Expenditure for training employees for better running of machinery.
  - (v) Purchase of machinery for sale.
  - (vi) Daily wages paid to office peon.
3. S. Jaggi sells and services typewriters. State which of the following are capital expenditure and which are revenue expenditure, giving reasons for your answer:
  - (i) Purchase of a typewriter for office use.
  - (ii) Purchase of typewriters for resale.
  - (iii) Travelling expenses to service typewriters.

- (iv) Purchase of spare parts to service typewriters.
  - (v) Wages of mechanic.
  - (vi) Wages of office staff.
  - (vii) Telephone charges.
  - (viii) Purchase of tools for servicing work.
4. State which of the following are capital expenditure and which are revenue expenditure, giving reasons in each case:
- (i) Payment by cheque for carriage on purchase.
  - (ii) Purchase of packing material for distribution of goods from the Calcutta Paper Mill Ltd.
  - (iii) Purchase of duplicator for use in own office from Gulab & Co.
  - (iv) The firm acquired a private car from B. Raha, one of the partners of the firm.
5. State with reasons whether the following are Capital or Revenue expenditure:
- (i) Expenses incurred in connection with obtaining a license for starting the factory were ₹ 8,000.
  - (ii) ₹ 1,500 paid for removal of stock to a new site.
  - (iii) Rings and Pistons of an engine were changed at a cost of ₹ 4,000 to get fuel efficiency.
  - (iv) ₹ 2,500 spent as lawyer's fee to defend a suit claiming that the firm's factory site belonged to the plaintiff. The suit was not successful.
  - (v) ₹ 8,000 were spent on advertising the introduction of a new product in the market, the benefit of which will be effective during four years.
  - (vi) A factory shed was constructed at a cost of ₹ 1,20,000. A sum of ₹ 7,000 had been incurred in the construction of temporary huts for storing building material.
6. The Building Account of Calcutta High School stands in the books at ₹ 75,000. The undermentioned expenses were incurred on the Building during the year. You are asked to state how these items will be treated in the books?
- (i) Addition of a new wing to the Library – ₹ 40,000.
  - (ii) Repairs to the Student's Common Room – ₹ 500.
  - (iii) Whitewashing the entire Building – ₹ 2,000.
  - (iv) Pulling out an old structure ₹ 750 and rebuilding it ₹ 10,500.
7. Classify the following between capital expenditure and revenue expenditure giving brief reasons in each case.
- (i) Cost of ₹ 30,000 for dismantling, removing and reinstalling plant by a sugar mill incurred in connection with the removal of works to a more suitable locality.
  - (ii) A sum of ₹ 10,000 spent for alternation of existing plant incorporating thereby new devices, which could effect substantial reduction in power consumption.
  - (iii) Imported goods worth ₹ 25,000 confiscated by custom authority for non-disclosure of material facts.
  - (iv) A petrol driven engine of a passenger bus was replaced by a diesel engine.
  - (v) Cost of repainting the factory shed.
  - (vi) Cost of transportation ₹ 500 in connection with a newly acquired machine.
  - (vii) Cost of improving seating capacity of a Cinema Hall.
  - (viii) Heavy amount spent in a legal suit.
  - (ix) ₹ 1,000 spent on replacement of defective parts of an old plant.
8. Under what category can we place amounts paid for acquisition of brands?
9. If a capital equipment is purchased with an expected life of seven years, but after two years it is realized that the useful life overall will be only five years. How do we take this into account for purposes of depreciation?

## Chapter

# 4

# Reconciliation and Rectification of Errors

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### **BANK RECONCILIATION STATEMENT**

The Bank Reconciliation Statement is an aid used to ensure the accuracy of transactions appearing in the bank columns of the cash book. Such transactions can be verified through an external record, namely, the bank statement received periodically from the banker. While the business keeps a record of its transactions through the bank columns in the cash book, the banker in turn maintains the bank's transactions with the business in his ledger. An extract from this ledger showing details of the transactions during a specified period is sent at frequent intervals by the bank to the business and this extract is referred to as a bank statement.

### **Reasons for Difference between Bank Balances as per Cash Book and Pass-book**

The relationship between the customer and the banker is that of a creditor and a debtor. So, if the bank columns of the cash book show a debit balance as on a specified date, the bank statement should show an equal amount of credit balance as on that date and *vice versa*. However, the balances shown by the two independent records may not always agree due to the following:

- (a) Cheques issued by the business to its suppliers or other parties may not have been presented for payment.
- (b) Cheques received from customers and deposited may not have been collected by the banker.
- (c) Deposits may have been directly made by the customers into the bank account of the enterprise.
- (d) Collection charges, service charges and interest on overdraft charged by the banker. The business can ascertain the exact amount of charges and record them in the cash book only after the receipt of the bank statement.
- (e) Interest credited by bank for the balance maintained with it and any other income such as interest on securities, dividend, etc., collected by the bank on behalf of the business can be ascertained only from the bank statement.

- (f) Wrong entries made by the business in the cash book or errors committed by the bank in its ledger.
- (g) Omission of entries in the two sets of books.
- (h) Dishonour of customers checks deposited in the bank account.

The effect of each of these entries is explained below:

**Cheques Issued but not Presented for Payment:** When a cheque is issued to a third party, it is entered in the cash book by crediting the Bank a/c resulting in reducing the bank balance in the depositor's books. But bank debits the customer's account only when the cheque is presented by that third party. So, till it is presented and paid for, the bank's passbook shows more balance than shown by the depositor's cash book.

**Cash Book (Bank Column only)**

Date	Particulars	₹	Date	Particulars	₹
04.03.×1	To Balance b/d	15,000.00	05.03.×1	By Rajan Traders a/c	2,000.00
			05.03.×1	By Balance c/d	13,000.00
		<b>15,000.00</b>			<b>15,000.00</b>

**Pass Book**

Date	Particulars	Dr. (withdrawn)	Cr. (deposited)	Balance ₹
04.03.×1	To Balance b/d			15,000.00 (cr)

**Cheques Deposited and Remaining Uncollected:** Whenever a check is received by a person from a third party and he deposits it in a bank, he will debit Bank a/c and credit the a/c of third party in his own books. His bank balance (in cash book) is therefore increased. But bank will credit that cheque not when it is deposited but only when that amount has been realized. Until the cheque has been collected, the balance appearing in the passbook would be less than the balance in the Bank a/c of cash book.

**Cash Book (Bank Column only)**

Date	Particulars	₹	Date	Particulars	₹
05.05.×1	To balance b/d	10,000	05.03.×1	By Balance c/d	15,000
07.05.×1	To Mr. Balaram a/c	5,000	05.03.×1		
		<b>15,000</b>			<b>15,000</b>

**Bank Statement**

Date	Particulars	Dr. (withdrawn)	Cr. (deposited)	Balance ₹
04.03.×1	To Balance b/d			10,000

So, balance as per bank statement is ₹ 5,000 less than the balance in the cash book.

**Deposits Directly Made into Bank a/c of the Enterprise:** If suppose a debtor credits the amount directly into the bank account of a company, the balance in the pass book increases without a corresponding increase in the cash book (bank column) until it receives the information from the bank.

**Cash Book (Bank Column only)**

Dr.			Cr.		
<i>Date</i>	<i>Particulars</i>	₹	<i>Date</i>	<i>Particulars</i>	₹
	To Balance b/d	5,000		By Balance c/d	5,000

**Pass Book**

<i>Date</i>	<i>Particulars</i>	<i>Dr.</i>	<i>Cr.</i>	<i>Balance</i>
	By Balance b/d			5,000
	By Cash		10,000	15,000

**Bank Charges:** Bank charges some amount from customer by way of incidental charges, collection charges, etc. These adjustments are shown in the passbook as and when they occur and hence the balance in the passbook decreases. Only when the customer collects his passbook and verifies it, he will not know about it and hence the balance in the bank column of cash book shown is more.

**Cash Book (Bank Column only)**

Dr.			Cr.		
<i>Date</i>	<i>Particulars</i>	₹	<i>Date</i>	<i>Particulars</i>	₹
	To Balance b/d	3,000		By Balance c/d	3,000

**Pass Book**

<i>Date</i>	<i>Particulars</i>	<i>Dr.</i>	<i>Cr.</i>	<i>Balance</i>
	By Balance b/d			3,000 (cr)
	By Cash	15	10,000	2,985 (cr)

Similarly, interest on deposits credited by the bank leads to an increase in balance in bank's pass-book without corresponding increase in the cash book.

- In addition to the above-mentioned transactions, the balances may not agree because of omission of entries in two sets of books.
- Wrong entries made by the business in cash book or errors committed by the bank in its ledger.
- Dishonour of customers cheques deposited in the bank account.

**THE RECONCILIATION STATEMENT**

On receipt of the bank statement, a comparison of the entries in the Cash Book with those appearing in the bank statement will help in identifying the items causing the difference in the two balances. While the difference due to (i) and (ii) above will be eliminated in the near future (that is, creditors will soon present their cheques for payment and customer checks will be collected by the bank in due course), the difference due to items (iii) to (v) can be eliminated only if such items are recorded in the cash book. In addition, the business must rectify any errors in the cash book, include any transactions omitted and record the dishonour, if any, of customers' cheques. After these adjustments have been recorded, a statement will be prepared to reconcile the balance as shown by the cash book with that shown by the passbook. This statement is referred to as Bank Reconciliation Statement. It must be understood that this reconciliation statement will generally contain details of:

- (a) Cheques issued and not presented,
- (b) Cheques deposited and remaining uncollected,
- (c) Errors in the bank statement, and
- (d) Omission of entries in the bank statement.

The bank reconciliation statement is, thus, an additional tool available to check the accuracy of the bank columns of the cash book.

### Advantages of Bank Reconciliation Statement

- (i) **Error Detection:** It helps in detection of errors of omission of transactions or wrong recording of transactions either by the bank or the business enterprises. Errors identified in the books by preparing BRS can be rectified.
- (ii) **Delay in Collection Revealed:** The delay in the collection of cheques, bills, etc., if any, are revealed, when BRS is prepared. The matter can be pursued to avoid unnecessary delays in collection. It also helps the management to keep track of the cheques and bills sent for collection.
- (iii) **Completion of Cash Book:** Business enterprises get information about bank charges, cheques dishonoured, direct payments, direct deposits, etc., from the bank statement only. Entries of the same are made in the cash book on the basis of bank statement. Thus, to complete the cash book, comparison and reconciliation of cash book and bank book is essential.
- (iv) **Chances of Embezzlements are Reduced:** Periodical comparison of cash book and pass book keeps a check on the office staff. For example, entry for cash deposit is appearing in the cash book, but not in the passbook, indicates fraud being committed by the staff. This type of frauds come to light when Bank Reconciliation Statement is prepared.

### STEPS IN PREPARATION OF BRS

1. Take the cash book or passbook balance as starting point. The following points have to be noted while taking the starting balance.
  - (i) Debit balance as per cash book indicates favourable balance.
  - (ii) Credit balance as per cash book means overdraft or unfavourable balance.
  - (iii) Debit balance as per passbook means overdraft or unfavourable balance.
  - (iv) Credit balance as per passbook means favourable balance.

If the starting point denotes a favourable balance as per cash book or pass book, take it as a positive figure. However, if the starting point denotes negative unfavourable balance, take it as a negative figure.

2. Adjust the starting point amount as per the information given and analyze its impact on the other balances.
3. After adjusting all the differences or errors, the balance as per the other book is obtained. If the final balance is positive, it denotes favourable balance (Debit balance as per cash book or credit balance as per the passbook). However, if the final balance is negative, it denotes the unfavorable balance or overdraft (Credit balance as per cash book or debit balance as per passbook).

The following table summarizes the impact of various differences and errors on the starting balance.

**Bank Reconciliation Statement**

<i>Item</i>	₹	₹
Bank Balance as per Cash Book		*****
Or		
Overdraft balance as per Passbook		
<b>Add:</b>		
1. Cheques issued but not cleared	*****	
2. Direct payments made by customers	*****	
3. Amount collected by bank (rent, dividends, interest, on investment, etc.)	*****	
4. Cheques deposited but omitted to be recorded in cash book	*****	
5. Wrong credit on the credit side of passbook	*****	
		*****
<b>Less:</b>		
1. Cheques deposited but not collected	*****	
2. Cheques paid into the bank but dishonoured	*****	
3. Bank charges and interest charges	*****	
4. Payments made by the banker on behalf of the trader	*****	
5. Cheques issued but not recorded in the cash book	*****	
6. Wrong entry on the debit side of the Passbook		*****
Bank balance as per the Passbook		*****

**Illustration 1:** On March 31, 2014, the cash book of Prithvi Limited showed a bank balance (debit) of ₹ 48,500. However, the bank statement showed a credit balance of ₹ 53,900 as on the same date. A detailed comparison of entries revealed the following:

- (a) Customers' cheques amounting to ₹ 8,450 had not been collected by the bank as on 31.3.2014.
- (b) Certain cheques amounting to ₹ 8,850 had not been presented for payment as on 31.3.2014.
- (c) Bank charges of ₹ 1,000 and interest on investments of ₹ 2,500 collected by the banker appear only in the bank statement.
- (d) A wrong credit of ₹ 2,500 in the bank statement.
- (e) Swaroop Limited, a customer, had paid into the bank directly a sum of ₹ 3,000 on March 29, 2014. This has not been recorded in the Cash Book.
- (f) A cheque for ₹ 2,000 received from Excel Limited, a customer, and deposited had been returned unpaid. The dishonour of this cheque has not been entered in the Cash Book.

Prithvi Limited will first pass the necessary rectification entries in the cash book and then prepare a reconciliation statement.

## Cash Book of Prithvi Limited (Bank Columns only)

Date	Receipts	Bank ₹	Date	Payments	Bank ₹
2014			2014		
March 31	To Balance b/d	48,500	March 31	By Bank charges	1,000
March 31	To Interest received	2,500	March 31	By Excel Limited	2,000
March 31	To Swaroop Limited	3,000	March 31	By Balance c/d	51,000
		<b>54,000</b>			<b>54,000</b>

**Solution:**

## Bank Reconciliation Statement as on March 31, 2014

Particulars	₹	₹
Bank balance as per Cash Book		51,000
<i>Add:</i> Chequeks issued and not presented	8,850	
Wrong credit in the bank statement	2,500	11,350
		62,350
<i>Less:</i> Chequeks deposited and remaining uncollected		8,450
Bank balance as per bank statement		<b>53,900</b>

**Illustration 2:** Mr. Q maintains two accounts known as account No. 1 and account No. 2 in Bank of Maharashtra. On 31st December 2014, the overdraft as per pass book for account No. 1 is ₹ 86,552. But the overdraft as per cash book is not the same and on comparing the pass book and the cash book, he finds the following:

- Out of the total cheques of ₹ 7,400 deposited on 27th December, 2014, one cheque amounting to ₹ 2,650 was collected on 4th January, 2015.
- Out of the total cheques of ₹ 12,560 issued on 22nd December 2014, two cheques of ₹ 1,500 each were not presented until 31st December, 2015.
- A cheque amounting to ₹ 2,260 was sent to the supplier, through post on 29th December, 2014 and it is expected to reach him only after 3rd January, 2015.
- Bank charges amounting to ₹ 63 and interest charges amounting to ₹ 262 have not yet been recorded in the cash book.
- Mr. Q has deposited a cheque in his account No.2, for ₹ 1,000 on 2nd December, 2014 was wrongly credited to account No. 1 by the bank.
- A cheque deposited on 15th December, 2014 for ₹ 500 was returned dishonoured by bankers on 2nd January, 2015.
- A cheque of ₹ 200 issued for account No. 1 by mistake was recorded in bank column of the cash book for account No. 2, and this cheque was presented for payment on 4th January, 2015.

From the above particulars, prepare a bank reconciliation statement to find out the Bank Overdraft as per cash book.

**Solution:****Bank Reconciliation Statement as on 31st December, 2014**

<i>Particulars</i>	₹	₹
Bank Overdraft as per Passbook:		86,552
<i>Add:</i> Cheques issued but not presented for payment	3,000	
<i>Add:</i> Cheque sent to the supplier through post, but has not reached him, hence, not presented for payment	2,260	
<i>Add:</i> Cheque wrongly credited to account No.1 by bank instead of account No. 2	1,000	6,260
		92,812
<i>Less:</i> Cheques deposited but not yet collected by the bank	2,650	
<i>Less:</i> Bank charges and interest not recorded in cash book	325	
<i>Less:</i> Cheque deposited on 15 <sup>th</sup> December, 2014, but not cleared by the until 31 <sup>st</sup> December, 2014	500	3,475
Bank Overdraft as per Cash Book		<b>89,33</b>

**Note:** Item No. (vii), will not make impact as on 31st December, 2014, as it was presented for payment only on 4th January, 19x2 and the cash book (Bank column) of account No. 2 is affected and not account No. 1.

**Illustration 3:** On 31, March, 2014, the Cash Book of a firm showed a balance at bank for ₹ 40,000. From the information given below, prepare a Bank Reconciliation Statement.

- Cheques issued for ₹ 7,000 have not yet been presented at the bank for payment.
- Cheques amounting to ₹ 8,000 were paid on 29th March but have not been credited by the bank.
- One cheque for ₹ 2,500 was entered in the Cash Book on 31st March, but was banked on 2nd April.
- A cheque from Suresh for ₹ 3,000 paid in on 27th March was dishonoured but the advice of the dishonour was received only on the 2nd April, 2014.
- Passbook included a bank charge, ₹ 100 on its debit side.
- Passbook showed ₹ 2,500 collected by the bank as interest on securities.

**Solution:****Bank Reconciliation Statement as on March 31, 2014**

<i>Particulars</i>	₹	₹
Balance as per Cash Book		40,000
<i>Add:</i>		
Cheques issued but not yet presented	7,000	
Interest collected by the bank but not yet entered in the Cash Book	2,500	9,500
		49,500
<i>Less:</i>		
Cheques paid in but not yet collected	8,000	
Cheques entered in Cash Book but not yet paid in	2,500	
Cheques dishonoured but not yet entered in Cash Book	3,000	
Bank charges not yet entered in Cash Book	100	13,600
Balance as per Passbook		<b>35,900</b>

**Illustration 4:** On March 31, 2014, the cash book of Sai Apna Ltd. showed an overdraft balance of ₹ 12,500 and this balance did not agree with the balance as per bank statement. On verification, the following facts were discovered.

- (a) A cheque for ₹ 3,400 deposited on March 24, 2014 was dishonoured by bankers on April 3, 2014.
- (b) Bank charges amounting to ₹ 180 and interest charges amounting to ₹ 615 have not been recorded in the cash book.
- (c) Certain cheques amounting to ₹ 7,250 have not been presented for payment as on March 31, 2014.
- (d) Interest on investment of ₹ 2,000 collected by the banker appears only in the bank statement.
- (e) The debit side of the cash book had been overcasted by ₹ 900.

You are required to find out the balance as per bank book.

**Solution:**

**Bank Reconciliation Statement of Sai Apna Ltd.**

<i>Particulars</i>	₹	₹
Overdraft balance as per Cash Book		12,500
<b>Add:</b>		
(a) A cheque deposited on March 24, 2001 dishonoured	3,400	
(b) Bank charges (entered only in passbook)	180	
(c) Interest on overdraft (entered only in passbook)	615	
(d) Adjustment of cash book	900	5,095
		<b>17,595</b>
<b>Less:</b>		
(a) Cheques issued but not presented for payment	7,250	
(b) Interest on investment directly credited to bank account	2,000	9,250
Overdraft balance as per Passbook		<b>8,345</b>

**Illustration 5:** Prepare a Bank Reconciliation Statement as on 30th September, 2014 from the following entries in the Bank Column of the Cash Book and the corresponding Passbook.

**Cash Book (Bank Column only)**

<i>Date</i>	<i>Particulars</i>	₹	<i>Date</i>	<i>Particulars</i>	₹
Sept. 1	To Balance b/d	8,000	Sept. 4	By Drawings	700
3	To Kamlesh	2,200	8	By Suresh	3,300
9	To Prabhu	1,500	12	By Salary	2,800
16	To Pawan	3,400	16	By Manish	1,700
23	To Satish	2,600	18	By Shyam	4,200
27	To Mohan	100	21	By Kapil	2,000
30	To Kapoor	350	26	By Seeta	1,100
			30	By Commission	100
			30	By Balance c/d	2,250
		<b>18,150</b>			<b>18,150</b>



**Errors and their Rectifications:** 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:

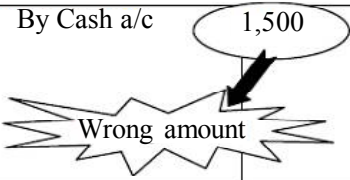
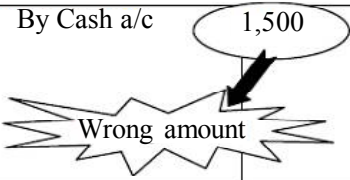
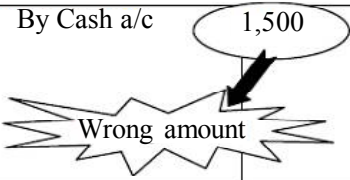
- Journalizing,
- Posting,
- Casting (totaling),
- Balancing,
- Transferring to trial balance and so on.

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.

<p><b>Example:</b> Cash received from Rama ₹ 1,150 is posted to Rama's ledger account as ₹ 1,500 while it is correctly recorded in cash account.</p>											
		<table style="width: 100%; border-collapse: collapse;"> <tr> <td style="width: 60%; border: none;">By Cash a/c</td> <td style="width: 40%; border: none; text-align: right;">1,500</td> </tr> <tr> <td colspan="2" style="text-align: center; padding-top: 10px;">  </td> </tr> </table>	By Cash a/c	1,500							
By Cash a/c	1,500										
											
<p><b>Rectification entry</b></p> <table style="width: 100%; border-collapse: collapse;"> <tr> <td style="width: 40%;">Rama's account</td> <td style="width: 20%; text-align: right;">Dr. ₹ 350</td> <td style="width: 40%;"></td> </tr> <tr> <td style="padding-left: 20px;">To Suspense account</td> <td></td> <td style="text-align: right;">₹ 350</td> </tr> <tr> <td colspan="3" style="padding-left: 20px;">(Being excess credit given to Rama's account rectified)</td> </tr> </table>			Rama's account	Dr. ₹ 350		To Suspense account		₹ 350	(Being excess credit given to Rama's account rectified)		
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		TRIAL BALANCE		
ABC Ltd.	xxxx	Cash	Debit	Credit
MNC Ltd.	xxxx	Sales	xxx	xxx
PQR Ltd.	xxxx	Purchase	5,700	
Total	<u>5,800</u>			

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- (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 omission to post rent paid in rent account rectified.)

- (e) **Omission of an Account Altogether from Being Shown in Trial Balance:**

**Example:** Advertisement account which shows a debit balance is completely omitted from trial balance.

**ADVERTISEMENT ACCOUNT**

To Cash a/c	xxxx	By balance c/d	xxxx
Total	xxxx	Total	xxxx

To Balance b/d      xxxx

**TRIAL BALANCE**

Particulars	Debit	Credit
Advertisement		

**Rectification entry**


Advertisement expense a/c	Dr. ₹ 10,000	
To Suspense a/c		₹ 10,000

(Being debit balance in advertisement account accounted)

- (f) **Posting an Amount to a Correct Account more than Once:** This result in imbalance in the trial balance.

**Example:** Receipt from Sundry debtors of ₹ 5,000 was accounted twice in Sundry Debtors account.

SUNDRY DEBTORS A/C			
		By cash a/c	50,000
		By cash a/c	50,000

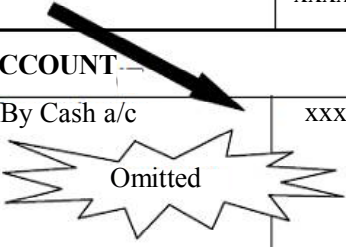


Rectification entry			
Suspense a/c		Dr. ₹ 5,000	
	To Sundry Debtors a/c		₹ 5,000
(Being excess debit in sundry debtors account rectified)			

- (g) **Posting an Item to the Same Side of Two Different Ledger Accounts:** If two accounts are debited/credited for the same transaction, this type of error occurs.

**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	Suppliers' Name	L.F.	Inv No.	₹
	Jairam			



PURCHASE ACCOUNT				
To	xxx			
Jairam				



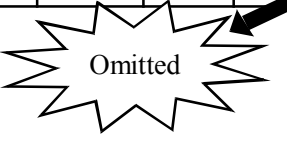
Since both aspects — debit and credit — of the transaction are missing, the trial balance is not affected at all. To rectify such errors, the transaction should be recorded when it is traced.

- (b) **Error of Commission:** If the error of wrong posting, wrong casting, wrong calculation etc., committed in the books of original entry or ledger, it is said to be error commission.

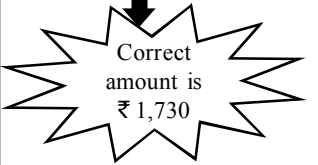
**Example:** Purchase invoice of ₹ 1,730 may have been entered as ₹ 1,370 in the purchases book itself, then, in the subsequent ledger accounts the same mistake continues and thereby cannot be disclosed by trial balance.

The difference of ₹ 360 (1,730 – 1,370) should be added to purchases account and to the respective supplier's account.

PURCHASE BOOK				
Date	Suppliers' Name	L.F.	Inv	₹
	xxx			1,370



PURCHASE ACCOUNT				
To	1,370			
xxx				



The error can be detected only when the original invoice is referred to after getting the complaint from the supplier.

**Rectification entry**

Purchases a/c	Dr. ₹ 360	
To Supplier's a/c		₹ 360

(Being deficit amount added to rectify the account)

- (c) **Error of Principle:** While drawing journal entries, often error of principle is committed and this goes unnoticed because it does not affect the total of trial balance.

**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.

Mr. X account				Mrs. X account			
Dr.				Dr.			
To Cash	100			To Cash	1000		
↓				↓			
Instead of ₹ 1,000				Instead of ₹ 100			

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)	



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

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

**Illustration 6:** 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:**

Date	Particulars	L.F.	Debit (₹)	Credit (₹)
1	Anand's account <span style="float: right;">Dr.</span> To Suspense account (Being wrong amount, wrongly credited to Anand's a/c rectified)		78.74	78.74
2	Suspense account <span style="float: right;">Dr.</span> To Purchases account (Being over debit of purchase a/c rectified)		9.00	9.00
3	Repairs account <span style="float: right;">Dr.</span> To Buildings account (Being wrong debit given to buildings account rectified)		158.00	158.00
4	B's account <span style="float: right;">Dr.</span> To Discount received account (Being discount received from B, omitted earlier, brought to account)		80	80
5	Sales account <span style="float: right;">Dr.</span> 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 7:** The trial balance of Evergreen Co. Ltd. taken out as on 31st December, 2014 did not tally and the difference was carried to suspense account. The following errors were detected subsequently.

- Sales book total for November was undercast by ₹ 1,200.
- Purchase of new equipment costing ₹ 9,475 has been posted to Purchases a/c.
- Discount received ₹ 1,250 and discount allowed ₹ 850 in September 2002 have been posted to wrong side of discount account.
- 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.
- Stocks worth ₹ 255 taken for use of Mr. Dayananda, the Managing Director, has been entered in sales day book.
- While carrying forward, the total in return inwards book has been taken as ₹ 674 instead of ₹ 647.
- 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>
31-12-2014	Suspense account To Sales account (Being undercasting of sales book rectified)	Dr.	1,200	1,200
31-12-2014	New Equipment account To Purchases account (Being wrong debit given to purchase account rectified)	Dr.	9,475	9,475
31-12-2014	Discount allowed account Suspense account To Discount received account (Being discount received and discount allowed posted to wrong side of discount account rectified)	Dr. Dr.	1,700 800	2,500
31-12-2014	Suspense account To Longford's account (Being short credit given to Longford's account)	Dr.	450	450
31-12-2014	Sales account To Suspense account (Being stock used for personal purpose wrongly credited to sales account rectified)	Dr.	255	255
31-12-2014	Suspense account To Return Inwards account (Being excess debit given to return inwards account to the extent of ₹ 27 now rectified)	Dr.	27	27

31-12-2014	Salary account	Dr.	775	
	To Ramachandra's account			757
	To Suspense account			18
	(Being the wrong debit of salary to the personal account of Ramachandra now rectified)			

**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 (₹ 1,250 + ₹ 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 8:** The trial balance of M/s J Ltd. on 31st March, 2014 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:

- (a) Total of sales figure was taken as ₹ 58,726 instead of ₹ 58,762.
- (b) A discount of ₹ 52 allowed to Mr. X was not recorded in the discount allowed account.
- (c) The total of purchases returns book was undercast by ₹ 43.
- (d) Sale of old furniture for ₹ 130 was wrongly entered in Machinery a/c.
- (e) A credit purchase for ₹ 49 made from Mr. Y was recorded in purchases book, but was omitted to record in Y's account.
- (f) ₹ 320 received from P was posted to the credit of R.
- (g) A credit sale made to Mr. S for ₹ 250 was recorded twice in his account.
- (h) Depreciation on plant and machinery was wrongly recorded as ₹ 750, instead of ₹ 950.
- (i) ₹ 50 wages paid on 30th March, 2014, are not debited to wages account.

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

**Solution:**

**Rectification of Errors**

Particulars		Debit (₹)	Credit (₹)
(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 9:** 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.
- Office furniture purchased for ₹ 2,100 has been passed through the purchase account.
- Repairs to office car amounting to ₹ 850 were debited to the office car account.

You are required to:

- Pass the journal entries for rectification of the above errors.
- Prepare suspense account.

**Solution:**

**Jay Ltd.  
Journal Entries**

Particulars		Dr. (₹)	Cr. (₹)
(a)	Mr. Roshan's account (₹ 2,100 × 2) To Suspense account (Being sales to Mr. Roshan wrongly credited to his account, now rectified)	Dr. 4,200	4,200

(b)	Suspense account To Mr. Kanithkar's account (Being purchase from Mr. Kanithkar omitted to be posted to his account in the ledger, now rectified)	Dr.	1,200	1,200
(c)	Office Furniture account To Profit and Loss Adjustment account (Being purchase of office furniture wrongly passed through the purchase day book, now rectified)	Dr.	2,100	2,100
(d)	Profit and Loss Adjustment account To Office Car account (Being repairs to office car wrongly debited to office car account, now rectified)	Dr.	850	850

**Illustration 10:** In the month of April 2014, the accountant of Mapani & Co. found the following errors in the books of accounts for the year 2013-2014 in spite of the agreed balance sheet:

- 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.
- A purchase of ₹ 16,000 from Mr. Philip on 30th March 2014 was taken in stock, but the invoice was not passed through the purchase day book.
- Goods to the value of ₹ 2,750 returned by Mr. Rajkumar had been debited to his account and also to sales return account.
- The purchase day book for the month of March 2014 was undercast by ₹ 10,000.
- Bank interest on overdraft for the month of March 2014, amounting to ₹ 3,750 has not been recorded in the books of accounts.
- A credit sale of ₹ 20,000 on 29th March 2014, 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**

Particulars		Dr. (₹)	Cr. (₹)
(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 Passbook represents \_\_\_\_\_.
- Cheques deposited by a trader and cleared by the bank appear on the \_\_\_\_\_ side of his Passbook.
- Cheques issued by a trader and encashed by his creditors are \_\_\_\_\_ in his Pass Book.
- Interest on overdraft is \_\_\_\_\_ by the bank in the Passbook.
- Balance as per Cash Book and Passbook are always equal.
- A bank reconciliation statement is not prepared when the trader has no bank account.
- Errors in the Cash Book or Passbook cannot be found by preparing a Reconciliation Statement.
- While reconciling the Cash Book and Passbook Balance of the debit side, Cash Book is compared with the credit side of Passbook and *vice versa*.
- If the bank gives a bank statement instead of the Passbook, no reconciling statement is necessary.
- 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)
- Errors of omission, error of principle and compensating errors are not disclosed by trial balance, (True/False)
- Errors of casting, posting to wrong side of an account or posting a wrong amount, etc., can be detected by trial balance, (True/False)
- Suspense account is the difference between debit total and credit total of a trial balance, (True/False)
- Suspense account is created temporarily and later, it is removed as and when errors are detected and suitable rectified. (True/False)
- If amount paid to Rama ₹ 500 is credited to Ramanan's account, what type of error has occurred and give the rectification entry.
- 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?

**Ans.** 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,

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,



- (c) Dividend collected by bank on our behalf ₹ 500. The intimation of the same was received on 3rd July 2003.
  - (d) Bank had paid insurance premium of ₹ 800 on behalf of the company for which there was no entry in the cash book.
  - (e) Interest on bank balance credited in the passbook ₹ 300 but it was not recorded in the cash book.
  - (f) Bank charges of ₹ 100 charged by bank, but not recorded in the cash book.
3. From the following details, prepare Vipin's Bank Reconciliation Statement as on 31st March 2003.
- (a) Balance as per cash book ₹ 3,000.
  - (b) Cheques issued in March ₹ 8,000 out of which cheques for ₹ 3,000 were encashed in March.
  - (c) Cheques issued but not presented ₹ 500.
  - (d) Cheques issued but dishonoured ₹ 700.
  - (e) Cheques deposited in March ₹ 3,000 out of which cheques for ₹ 2,000 were cleared in April and thereafter.
  - (f) Cheques deposited but dishonoured ₹ 500 but dishonour entry not made in cash book.
  - (g) Dividends collected by the bank ₹ 800 not entered in cash book.
  - (h) Bank charges ₹ 10 not entered in cash book.
  - (i) Direct deposit by a customer ₹ 250 not entered in cash book.
  - (j) Interest credited by the bank ₹ 150 not entered in cash book.
  - (k) Direct payment for LIP ₹ 250 not entered in cash book.
4. From the following particulars, prepare a bank reconciliation statement for Shri Kirti Shah as at 31st March, 2003.
- (a) Bank Balance as per Cash Book ₹ 15,000.
  - (b) Cheques deposited during the month but credited in April 2003 ₹ 5,000.
  - (c) Cheques issued but presented after 31st March 2003 ₹ 2,000.
  - (d) Cheques deposited and credited by the bank but did not entered in cash book ₹ 4,000.
  - (e) Cheques received and entered in cash book but not sent to the bank ₹ 3,000.
  - (f) Bank interest credited in passbook but not debited in cash book ₹ 200.
  - (g) Bank charges debited in passbook but not credited in cash book ₹ 20.
  - (h) Bank paid insurance premium and debited in passbook but not credited in cash book ₹ 200.
  - (i) Bank collected rent of premises and credited in passbook but not debited in cash book ₹ 5,000.
  - (j) A cheque received from G. Mishra was dishonoured and returned by bank but no action was taken in cash book ₹ 1,500.
5. The following are the necessary extracts from the Cash Book and the Passbook. You are required to prepare a Bank Reconciliation Statement as on 31st December 2012.

**Cash Book (Bank Column)**

<b>Dr.</b>			<b>Cr.</b>		
<i>Date</i>	<i>Particulars</i>	<i>₹</i>	<i>Date</i>	<i>Particulars</i>	<i>₹</i>
2012			2012		
Dec. 1	To Balance b/d	400	Dec. 20	By Sharmila's a/c	65
5	To Sharda' a/c	100	24	By Urmila's a/c	150
10	To Smita's a/c	50	26	By Pramila's a/c	75
16	To Shila's a/c	125	31	By Balance c/d	460
20	To Sunita's a/c	75			
		<b>750</b>			<b>750</b>

## Bank Passbook

Dr.			Cr.		
Date	Particulars	₹	Date	Particulars	₹
2012			2012		
Dec. 25	To Sharmila's a/c	65	Dec. 1	By Balance b/d	400
27	To Urmila's a/c	125	9	By Sharda's a/c	100
29	To Pramila's a/c	100	16	By Smita's a/c	50
31	To Balance c/d	270	25	By Interest	10
		<b>560</b>			<b>560</b>

6. Set out below are extracted from cash book (Bank columns only) and bank pass book of Babulnath. Prepare a bank reconciliation statement as on 15th January 2012.

## Cash Book (Bank Column)

Dr.			Cr.		
Date	Particulars	₹	Date	Particulars	₹
2012			2012		
Jan. 1	To Balance b/d	1,132	Jan. 2	By Wages a/c	850
5	To K. Kamdar's a/c	900	6	By Investment a/c	1,000
8	To Sales a/c	609	8	By Purchase a/c	306
10	To Rent a/c	56	9	By Furniture a/c	160
12	To Ganpat's a/c	1,252	10	By Bapat's a/c	210
13	To Raman's a/c	888	10	By Drawings a/c	80
15	To Balance c/d	401	14	By Fakir's a/c	1,822
		<b>5,238</b>	15	By Mustafa's a/c	810
					<b>5,238</b>

## Pass Book

Dr.			Cr.		
Date	Particulars	₹	Date	Particulars	₹
2012			2012		
Jan. 2	To Wages a/c	850	Jan. 1	By Balance b/d	1,132
6	To Investment a/c	1,000	6	By K. Kamdar's a/c	900
7	To Purchase a/c	306	8	By Sales a/c	609
9	To Furniture a/c	160	10	By Rent a/c	56
10	To Self (Drawings) a/c	80	14	By J. Jamdar's a/c	200
13	To Bills Payable a/c	100			
15	To Balance c/d	401			
		<b>2,897</b>			<b>2,897</b>

7. The extract from the Cash book (Bank account) and Pass Book of M/s Desai & Sons are given below. Prepare a Bank Reconciliation Statement as on 31st Jan. 2003.

**Cash Book (Bank Column)**

Dr.			Cr.		
Date	Particulars	₹	Date	Particulars	₹
2012			2012		
Jan. 1	To Balance b/d	8,000	Jan. 2	By Charan's a/c	1,600
4	To Mohan's a/c	6,400	5	By Saran's a/c	2,000
8	To Dinesh's a/c	1,000	11	By Kishan's a/c	4,400
18	To Nandesh's a/c	7,400	28	By Vadan's a/c	3,600
21	To Pratap's a/c	2,800	29	By Manoj's a/c	3,800
28	To Ajay's	200	29	By Dara & Co.	3,400
29	To Vijay's a/c	900	30	By Bank Charges	40
			31	By Balance c/d	5,260
		<b>26,700</b>			<b>26,700</b>

**Pass Book**

Date	Particulars	Dr. (₹)	Cr. (₹)	Balance (₹)
2012				
Jan. 1	By Balance b/d		8,000	
2	To Charan's a/c	1,600		6,400
5	To Saran's a/c	2,000		4,400
6	By Mohan's a/c		6,400	10,800
11	By Dinesh		1,000	11,800
14	To Kishan's a/c	4,400		7,400
20	To Sunder's a/c	2,600		4,800
20	By Nandesh's a/c		7,400	12,200
23	To Vadan's a/c	3,600		8,600
28	By Ajay's a/c	200		8,800
29	By Vijay's a/c	900		9,700
30	To Dara & Co.	3,400		6,300
30	To Bank Charges	40		6,260
30	To Bank Commission	8		6,252
30	To Electricity Charges	160		6,092
31	By Balance c/d			6,092

8. From the following extracts, prepare a Bank Reconciliation statement as on 31st December 2012

**Cash Book (Bank Column)**

Dr.			Cr.		
Date	Particulars	₹	Date	Particulars	₹
2012			2012		
Dec. 1	To Balance b/d	1,200	Dec. 11	By Shankar Bros. a/c	1,000
7	To Babul's a/c	225	14	By Salaries a/c	200
19	To Sales a/c	420	17	By Jintendra's a/c	110
23	To Ramnarayan's a/c	150	19	By Wages a/c	275
25	To Nilesh's a/c	250	24	By Prabha's a/c	150
28	To Interest a/c	50	26	By Naresh's a/c	200
			31	By Balance c/d	360
		<b>2,295</b>			<b>2,295</b>

**Bank Passbook**

Dr.			Cr.		
Date	Particulars	₹	Date	Particulars	₹
2013			2013		
Jan. 1	To Jitendra's a/c	110	Jan. 1	By Balance b/d	345
3	To Wages a/c	275	4	By Ramnarayan's a/c	150
4	To Commission a/c	20	5	By Nilesh's a/c	250
6	To Sitaram's a/c	240	6	By Mittal's a/c	350
			10	By Talreja's a/c	250

9. From the entries of the Cash Book (Bank Column) and the corresponding Bank passbook of Mr. Reddy, you are asked to prepare a Bank Reconciliation Statement as on 31st January 2013.

**Cash Book (Bank Column)**

Dr.			Cr.		
Date	Particulars	₹	Date	Particulars	₹
2013			2013		
Jan. 1	To Balance b/d	2,150	Jan. 10	By Shakti & Co.'s a/c	1,400
6	To Bills Receivable a/c	325	12	By Salaries a/c	300
16	To Sales a/c	610	18	By Drawings a/c	125
22	To R. Ramchandra's a/c	135	29	By Joshi Bros. a/c	210
30	To Naresh Bros. a/c	250	29	By Wages a/c	500
31	To Interest a/c	58	31	By N. Narayan's a/c	320
31	To G. Ganesh's a/c	156	31	By P. Piyush's a/c	175
			31	By Balance c/d	654
		<b>3,684</b>			<b>3,684</b>

## Bank Passbook

Dr.			Cr.		
Date	Particulars	₹	Date	Particulars	₹
2013			2013		
Feb. 2	To Joshi Bros a/c	210	Feb. 1	By Balance b/d	1,400
2	To Commission a/c	1	2	By Naresh Bros. a/c	300
3	To N. Narayan's a/c	320	3	By G. Ganesh's a/c	125
3	To P. Piyush's a/c	175	3	By Ramchandra's a/c	210
3	To Commission a/c	1	8	By Cash a/c	500
8	To S.Sirish's a/c	300	10	By M. Manoj's a/c	320
10	To Wages a/c	300	12	By T. Tarawala's a/c	175

10. The following errors were traced while preparing the Final accounts of a firm for the year ending 31st December 2012. The entries are to be rectified before the books are closed.

- ₹ 3000 purchase of machinery has been entered in the purchase book.
- Goods worth ₹ 838 sold to Mr. K on credit is recorded as purchase of ₹ 983 in Purchase book
- The monthly total of Purchase book for December 1983 has been overcast by ₹ 250.
- Repairing charges of ₹ 180 paid for repairing a machine have been debited to the Machinery Account.
- ₹ 400/- paid to the owner of the shop, Shri B, for rent has been debited to his personal account.
- The balance of ₹ 300 of the salaries account has been shown as debit balance.
- Goods worth ₹ 550 at cost price were distributed as free samples but no entry is made in the books.
- ₹ 220 received from Mr. A which were written off last year as bad debts were received in cash which have been credited to his personal account.
- ₹ 20 received in cash from Mr. P is entered in the discount column of cash book through an error.

11. 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.

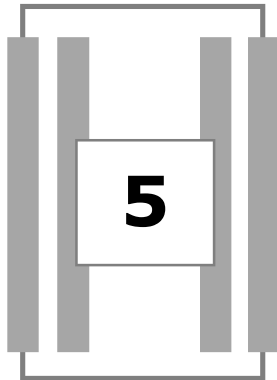
- An amount of ₹ 100 was received from Dhiraj on 31st December, 2012 but had been entered in the cash book on 3rd Jan 2013.
- The total of return inward book for December had been cast ₹ 100 short.
- The purchase of an office table costing ₹ 300/- had been passed through the purchase book.
- ₹ 375 paid for the wages to workmen for making showcases had been charged to wages account.
- A purchase of ₹ 67 had been posted to the creditors account as ₹ 60/-.
- A cheque for ₹ 200/- received from P.C. Joshi had been dishonoured and was passed to the debit of allowances account.
- ₹ 1000 paid for the purchase of a motor cycle for Mr. Dutt's personally use had been charged to miscellaneous expenses account.
- 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.
- 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 mean 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.



## Chapter



# Accounting Standards

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## ACCOUNTING STANDARDS

Accounting is the art of recording transactions in the best possible manner, so as to enable the reader to arrive at judgments/come to conclusions, and in this regard it is utmost necessary that there are set guidelines. These guidelines are generally called accounting policies. The intricacies of accounting policies permitted companies to alter their accounting principles for their benefit. This made it impossible to make comparisons. In order to avoid the above and to have a harmonised accounting principle, standards needed to be set by recognised accounting bodies. This paved the way for Accounting Standards to come into existence.

Accounting Standards in India are issued by the Institute of Chartered Accountants of India (ICAI). At present there are 30 Accounting Standards issued by ICAI.

## OBJECTIVE OF ACCOUNTING STANDARDS

Objective of Accounting Standards is to standardize the diverse accounting policies and practices with a view to eliminate to the extent possible the non-comparability of financial statements and the reliability of the financial statements.

The Institute of Chartered Accountants of India, recognizing the need to harmonize the diverse accounting policies and practices, constituted an Accounting Standard Board (ASB) on 21st April, 1977.

## COMPLIANCE WITH ACCOUNTING STANDARDS ISSUED BY ICAI

Subsection(3A) to section 211 of the Companies Act, 1956 requires that every Profit/Loss Account and Balance Sheet shall comply with the Accounting Standards. 'Accounting Standards' means the standard of accounting recommended by the ICAI and prescribed by the Central Government in consultation with the National Advisory Committee on Accounting Standards (NACAs) constituted under section 210(1) of the Companies Act, 1956.

Accounting Standards Apply only to material items.

The Accounting Standard Board (ASB) of the Institute of Chartered Accountants of India has issued the following Accounting Standards that are to be followed by its members.

Accounting Standards are collection of generally followed accounting principles, policies and practices. These help to ensure a common basis for financial statements different originations. This means that people can understand these more easily and make useful comparisons

Financial Statements are at the centre of business reporting. Financial statements usually provide users with essential information that heavily influence their decisions. The US is the leader in financial reporting, and US Securities and Exchange Commission is respected for its role in formulating and implementing US GAAP despite the general vote of confidence. In India, the Statements on Accounting Standards are issued by the Institute of Chartered Accountants of India (ICAI) to establish standards that have to be complied with to ensure that financial statements are prepared with generally accepted accounting standards in India (India GAAP)

The Council of ICAI constituted the Accounting Standards Board (ASB) in April 1977 to formulate Accounting Standards. While formulating the Accounting Standards, ASB takes into consideration the applicable laws, usages and business environment. However, users were strongly critical about certain aspects of financial statements and they offered or supported many substantive ideas for improvement. Standard setters, regulators, and many others devote considerable resources in maintaining and improving the standards.

The new accounting norms are aimed at protecting shareholders interest and recommending ways of improving corporate governance

Format of each Standard contains:

1. A statement of concepts and fundamental accounting principles relating to the standards.
2. Definition of the terms used in standard.
3. The manner in which the accounting principles have been applied for formulating the standard
4. Presentation and disclosure requirements.
5. Class of enterprise to which it applies
6. Effective date.

## **ACCOUNTING STANDARDS BENEFITS**

Running a business is not just about earning profits, depositing money in the bank, paying employees, and luring more clients and customers. It is about knowing if the business is thriving or if the owner is just investing in something that is not going to earn at all.

Businesses have to have accounting standards to ensure that everything goes smoothly and that cash flow is running perfectly. These accounting measures for businesses also have to adhere to the accounting standards set by regulating bodies like the ASB and the ICAI. This is because there are policies and other documents that are imperative to every accounting act. In many cases, businesses hire the services of auditors and bookkeepers in order to make sure that all record-keeping practices are done correctly. Doing so will provide access to investor capital, facilitate reasonable assessment of performance, and prevent costs brought about by legal action.

Here are other reasons why accounting standards are important to every business:

**PROTECTING INVESTORS:** By employing accounting standards, investors' interests are ensured as the documents they review are definitely accurate and genuine. As investors, they are interested to know that their money will eventually earn and go back to them. Accounting standards increase the investors' confidence in the business.

**REGULATORY COMPLIANCE:** Government regulators set accounting standards that have to be adhered to by all companies. This is both beneficial to the investor or business owner as well as to the customers or clients because it protects all of them from fraud in businesses. It also promotes transparency among the business' transactions, which will eventually lead to the improved efficiency of the markets. Following accounting standards set by the ASB and the ICAI will help prevent a company or business from spending on legal actions initiated by the government against it.

**ASSESSING BUSINESS PERFORMANCE:** The use of accounting standards will enable a business to see or assess its performance. By doing so, it can also compare and contrast its performance with other companies or competitors. These standards also help a business see its strengths and weaknesses. By also comparing past and current performances, a business can assess the success of its strategies.

Businesses will either prosper or fall. Depending on the trends and the economy of the country, an investment may grow or go down the drain. But in the end, accounting standards will make a difference. That is why all businesses have to follow and strictly adhere to these accounting standards.

## **PROCEDURE FOR ISSUING AN ACCOUNTING STANDARDS**

Broadly, the following procedure is adopted for formulating Accounting Standard:

1. The ASB determines the broad areas in which Accounting Standards need to be formulated and the priority in regard to the selection thereof.
2. In the preparation of Accounting Standards, the ASB will be assisted by Study Groups constituted to consider specific subjects. In the formation of Study Groups, provision will be made for wide participation by the members of the Institute and others.
3. The draft of the proposed standard will normally include the following:
  - (a) Objective of the Standards,
  - (b) Scope of the Standard,
  - (c) Definitions of the terms used in the Standard,
  - (d) Recognition and measurement principles, wherever applicable,
  - (e) Presentation and disclosure requirements.
4. The ASB will condier the preliminary draft prepared by the Study Group and if any revision of the draft is required on the basis of deliberations, the ASB will make the same or refer the same to the Study Group.
5. The ASB will circulate the draft of the Accounting Standard to the Council memebrrs of the ICAI and the following specified bodies for their comments:
  - (i) Department of Company Affairs (DCA)
  - (ii) Comptroller and Auditor General of India (C&AG)
  - (iii) Central Board of Direct Taxes (CBDT)

- (iv) The Institute of Cost and Works Accountants of India (ICWAI)
  - (v) The Institute of Company Secretaries of India (ICSI)
  - (vi) Associated Chambers of Commerce and Industry (ASSOCHAM), Confederation of Indian Industry (CII) and Federation of Indian Chambers of Commerce and Industry (FICCI)
  - (vii) Reserve Bank of India (RBI)
  - (viii) Securities and Exchange Board of India (SEBI)
  - (ix) Standing Conference of Public Enterprises (SCOPE)
  - (x) Indian Banks' Association (IBA)
  - (xi) Any other body considered relevant by the ASB keeping in view the nature of the Accounting Standard.
6. The ASB will hold a meeting with the representatives of specified bodies to ascertain their views on the draft of the proposed Accounting Standards. On the basis of comments received and discussion with the representatives of specified bodies, the ASB will finalise the Exposure Draft of the proposed Accounting Standard.
  7. The Exposure Draft of the proposed Standard will be issued for comments by the members of the Institute and the public. The Exposure Draft will specifically be sent to specified bodies (as listed above), stock exchanges, and other interest groups, as appropriate.
  8. After taking into consideration the comments received, the draft of the proposed Standard will be finalised by the ASB and submitted to the Council of the ICAI.
  9. The Council of the ICAI will consider the final draft of the proposed Standard, and if found necessary, modify the same in consultation with the ASB. The Accounting Standard on the relevant subject will then be issued by the ICAI.
  10. For a substantive revision of an Accounting Standard, the procedure followed for formulation of a new Accounting Standard, as detailed above, will be followed.
  11. Subsequent to issuance of an Accounting Standard, some aspect(s) may require revision which are not substantive in nature. For this purpose, the ICAI may make limited revision to an Accounting Standard. The procedure followed for the limited revision will substantially be the same as that to be followed for formulation of an Accounting Standard, ensuring that sufficient opportunity is given to various interest groups, and general public to react to the proposal for limited revision.

**Accounting Standards Issued by the Institute of Chartered Accountants of India are as below:**

<i>Number of the Accounting Standard (AS)</i>	<i>Title of the Accounting Standard</i>	<i>Date from which is 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 policies	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 benefits	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	For listed co.
		1-4-2002	Co. other than listed
		1-4-2006	See note 2
		1-4-2002	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 asset	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.

**Disclosure of Accounting Policies:** Accounting Policies refer to specific accounting principles and the method of applying those principles adopted by the enterprises in preparation and presentation of the financial statements.

**Valuation of Inventories:** The objective of this standard is to formulate the method of computation of cost of inventories/stock, determine the value of closing stock/inventory at which the inventory is to be shown in balance sheet till it is not sold and recognized as revenue.

**Cash Flow Statements:** Cash flow statement is additional information to user of financial statement. This statement exhibits the flow of incoming and outgoing cash. This statement assesses the ability of the enterprise to generate cash and to utilize the cash. This statement is one of the tools for assessing the liquidity and solvency of the enterprise.

**Contingencies and Events Occurring after the Balance Sheet Date:** In preparing financial statement of a particular enterprise, accounting is done by following accrual basis of accounting and prudent accounting policies to calculate the profit or loss for the year and to recognize assets and liabilities in balance sheet. While following the prudent accounting policies, the provision is made for all known liabilities and losses even for those liabilities/events, which are probable. Professional judgement is required to classify the likelihood of the future events occurring and, therefore, the question of contingencies and their accounting arises. Objective of this standard is to prescribe the accounting of contingencies and the events, which take place after the balance sheet date but before approval of balance sheet by Board of Directors. The Accounting Standard deals with Contingencies and Events occurring after the balance sheet date.

**Net Profit or Loss for the Period, Prior Period Items and Change in Accounting Policies:** The objective of this accounting standard is to prescribe the criteria for certain items in the profit and loss account so that comparability of the financial statement can be enhanced. Profit and loss account being a period statement covers the items of the income and expenditure of the particular period. This accounting standard also deals with change in accounting policy, accounting estimates and extraordinary items.

**Depreciation Accounting:** It is a measure of wearing out, consumption or other loss of value of a depreciable asset arising from use, passage of time. Depreciation is nothing but distribution of total cost of asset over its useful life.

**Construction Contracts:** Accounting for long-term construction contracts involves question as to when revenue should be recognized and how to measure the revenue in the books of contractor. As the period of construction contract is long, work of construction starts in one year and is completed in another year or after 4-5 years or so. Therefore question arises how the profit or loss of construction contract by contractor should be determined. There may be following two ways to determine profit or loss: On year-to-year basis based on percentage of completion or on completion of the contract.

**Revenue Recognition:** The standard explains as to when the revenue should be recognized in profit and loss account and also states the circumstances in which revenue recognition can be postponed. Revenue means gross inflow of cash, receivable or other consideration arising in the course of ordinary activities of an enterprise such as:- The sale of goods, rendering of services, and use of enterprises'

resources by other yielding interest, dividends and royalties. In other words, revenue is a charge made to customers/clients for goods supplied and services rendered.

**Accounting for Fixed Assets:** It is an asset, which is held with intention of being used for the purpose of producing or providing goods and services. Not held for sale in the normal course of business. Expected to be used for more than one accounting period.

**The Effects of Changes in Foreign Exchange Rates:** Effect of Changes in Foreign Exchange Rate shall be applicable in Respect of Accounting Period commencing on or after 01-04-2004 and is mandatory in nature. This Accounting Standard applicable to accounting for transaction in Foreign currencies in translating the Financial Statement of foreign operation integral as well as non-integral and also accounting for forward exchange. Effect of Changes in Foreign Exchange Rate, an enterprises should disclose following aspects:

- Amount exchange difference included in net profit or loss;
- Amount accumulated in foreign exchange translation reserve;
- Reconciliation of opening and closing balance of foreign exchange translation reserve;

**Accounting for Government Grants:** Government Grants are assistance by the Govt. in the form of cash or kind to an enterprise in return for past or future compliance with certain conditions. Government assistance, which cannot be valued reasonably, is excluded from Govt. grants. Those transactions with Government, which cannot be distinguished from the normal trading transactions of the enterprise, are not considered as Government grants.

**Accounting for Investments:** It is the assets held for earning income by way of dividend, interest and rentals, for capital appreciation or for other benefits.

**Accounting for Amalgamation:** This accounting standard deals with accounting to be made in books of Transferee company in case of amalgamation. This accounting standard is not applicable to cases of acquisition of shares when one company acquires/purchases the share of another company and the acquired company is not dissolved and its separate entity continues to exist. The standard is applicable when acquired company is dissolved and separate entity ceases to exist and purchasing company continues with the business of acquired company

**Employee Benefits:** Accounting Standard has been revised by ICAI and is applicable in respect of accounting periods commencing on or after 1st April 2006. The scope of the accounting standard has been enlarged, to include accounting for short-term employee benefits and termination benefits.

**Borrowing Costs:** Enterprises are borrowing the funds to acquire, build and install the fixed assets and other assets, these assets take time to make them usable or saleable, therefore the enterprises incur the interest (cost on borrowing) to acquire and build these assets. The objective of the Accounting Standard is to prescribe the treatment of borrowing cost (interest + other cost) in accounting, whether the cost of borrowing should be included in the cost of assets or not.

**Segment Reporting:** An enterprise needs in multiple products/services and operates in different geographical areas. Multiple products/services and their operations in different geographical areas are exposed to different risks and returns. Information about multiple products/services and their operation in different geographical areas are called segment information. Such information is used to assess the risk and return of multiple products/services and their operation in different geographical areas. Disclosure of such information is called segment reporting.

**Related Party Disclosure:** Sometimes business transactions between related parties lose the feature and character of the arms length transactions. Related party relationship affects the volume and decision of business of one enterprise for the benefit of the other enterprise. Hence, disclosure of related party transaction is essential for proper understanding of financial performance and financial position of the enterprise.

**Accounting for Leases:** Lease is an arrangement by which the lessor gives the right to use an asset for a given period of time to the lessee on rent. It involves two parties, a lessor and a lessee and an asset which is to be leased. The lessor who owns the asset agrees to allow the lessee to use it for a specified period of time in return for periodic rent payments.

**Earning Per Share:** Earning per share (EPS) is a financial ratio that gives the information regarding earning available to each equity share. It is very important financial ratio for assessing the state of market price of share. This accounting standard gives computational methodology for the determination and presentation of earning per share, which will improve the comparison of EPS. The statement is applicable to the enterprise whose equity shares or potential equity shares are listed in stock exchange.

**Consolidated Financial Statements:** The objective of this statement is to present financial statements of a parent and its subsidiary(ies) as a single economic entity. In other words the holding company and its subsidiary(ies) are treated as one entity for the preparation of these consolidated financial statements. Consolidated profit/loss account and consolidated balance sheet are prepared for disclosing the total profit/loss of the group and total assets and liabilities of the group. As per this accounting standard, the consolidated balance sheet if prepared should be prepared in the manner prescribed by this statement.

**Accounting for Taxes on Income:** This accounting standard prescribes the accounting treatment for taxes on income. Traditionally, amount of tax payable is determined on the profit/loss computed as per income tax laws. According to this accounting standard, tax on income is determined on the principle of accrual concept. According to this concept, tax should be accounted in the period in which corresponding revenue and expenses are accounted. In simple words, tax shall be accounted on accrual basis; not on liability to pay basis.

**Accounting for Investments in Associates in Consolidated Financial Statements:** The accounting standard was formulated with the objective to set out the principles and procedures for recognizing the investment in associates in the consolidated financial statements of the investor, so that the effect of investment in associates on the financial position of the group is indicated.

**Discontinuing Operations:** The objective of this standard is to establish principles for reporting information about discontinuing operations. This standard covers “discontinuing operations” rather than “discontinued operation”. The focus of the disclosure of the Information is about the operations which the enterprise plans to discontinue rather than disclosing on the operations which are already discontinued. However, the disclosure about discontinued operation is also covered by this standard.

**Interim Financial Reporting (IFR):** Interim financial reporting is the reporting for periods of less than a year generally for a period of 3 months. As per Clause 41 of listing agreement the companies are required to publish the financial results on a quarterly basis.

**Intangible Assets:** An Intangible Asset is an identifiable non-monetary asset without physical substance held for use in the production or supplying of goods or services for rentals to others or for administrative purpose

**Financial Reporting of Interest in Joint Ventures:** Joint Venture is defined as a contractual arrangement whereby two or more parties carry on an economic activity under ‘**joint control**’. Control is the power to govern the financial and operating policies of an economic activity so as to obtain benefit from it. ‘Joint control’ is the contractually agreed sharing of control over economic activity.

**Impairment of Assets:** The dictionary meaning of ‘impairment of asset’ is weakening in value of asset. In other words when the value of asset decreases, it may be called impairment of an asset. As per AS-28, asset is said to be impaired when carrying amount of asset is more than its recoverable amount.

**Provisions, Contingent Liabilities and Contingent Assets:** Objective of this standard is to prescribe the accounting for Provisions, Contingent Liabilities, Contingent Assets, Provision for Restructuring Cost. Provision: It is a liability, which can be measured only by using a substantial degree of estimation. Liability: A liability is present obligation of the enterprise arising from past events, the settlement of which is expected to result in an outflow from the enterprise of resources embodying economic benefits.

**Financial Instrument: Recognition and Measurement,** issued by The Council of the Institute of Chartered Accountants of India, comes into effect in respect of Accounting periods commencing on or after 1-4-2009 and will be recommendatory in nature for an initial period of two years. This Accounting Standard will become mandatory in respect of Accounting periods commencing on or after 1-4-2011 for all commercial, industrial and business entities except to a Small and Medium-sized Entity. The objective of this Standard is to establish principles for recognizing and measuring financial assets, financial liabilities and some contracts to buy or sell non-financial items. Requirements for presenting information about financial instruments are in Accounting Standard.

**Financial Instrument Presentation:** The objective of this Standard is to establish principles for presenting financial instruments as liabilities or equity and for offsetting financial assets and financial liabilities. It applies to the classification of financial instruments, from the perspective of the issuer, into financial assets, financial liabilities and equity instruments; the classification of related interest, dividends, losses and gains; and the circumstances in which financial assets and financial liabilities should be offset. The principles in this Standard complement the principles for recognising and measuring financial assets and financial liabilities in Accounting Standard Financial Instruments:

**Financial Instruments, Disclosures and Limited Revision to Accounting Standards:** The objective of this Standard is to require entities to provide disclosures in their financial statements that enable users to evaluate:

- the significance of financial instruments for the entity’s financial position and performance; and
- the nature and extent of risks arising from financial instruments to which the entity is exposed during the period and at the reporting date, and how the entity manages those risks.

## SELF ASSESSMENT QUESTIONS

### Multiple Choice Questions: Accounting Standards

1. Significant accounting policies are disclosed
 

(a) Along with financial statement	(b) In the books of accounts
(c) Along with balance sheet	(d) In the accounting software

2. Accounting Standard 1 is
  - (a) Mandatory
  - (b) Optional
  - (c) Recommendatory
  - (d) No longer valid
3. The purpose of AS 1 is to establish a Standard as to
  - (a) The preparation of final statements
  - (b) Fundamental accounting assumptions
  - (c) Desirable accounting policies
  - (d) Disclosure of accounting policies
4. Following is an example of an accounting policy
  - (a) Consistency
  - (b) Depreciation
  - (c) Accrual
  - (d) Going concern
5. Following is an example of an accounting policy
  - (a) Going concern
  - (b) Entity
  - (c) Conservatism
  - (d) Conversion of foreign currency items
6. Following is an example of accounting policy
  - (a) Realisation
  - (b) Accrual
  - (c) Entity
  - (d) Valuation of fixed assets
7. Factors to be considered while selecting accounting policies
  - (a) Consistency
  - (b) Prudence
  - (c) Dual aspect
  - (d) Cost
8. Disclosure should form part of
  - (a) Directors report
  - (b) Auditor's report
  - (c) Final accounts
  - (d) Books of accounts
9. As per AS 1 the effect of any change in accounting policy on the value of any item in the final accounts should
  - (a) Be reported to directors
  - (b) Be reported to CEO
  - (c) Be disclosed
  - (d) Be ignored
10. Accounting policies are
  - (a) Prescribed by AS-1
  - (b) Same for all the organisations
  - (c) Change from concern to concern
  - (d) Laid down by law
11. Following is the example of accounting policy
  - (a) Consistency
  - (b) Goodwill treatment
  - (c) Cost
  - (d) Conservatism
12. Following is the example of accounting policy
  - (a) Going Concern
  - (b) Accrual
  - (c) Treatment of retirement benefits
  - (d) Disclosure
13. Following is the example of accounting policy
  - (a) Realisation
  - (b) Accrual
  - (c) Accounting period
  - (d) Recognition of profit on contract
14. Following factors should be considered in selection of accounting policies
  - (a) Consistency
  - (b) Prudence
  - (c) Dual aspect
  - (d) Cost

15. Following factors should be considered in selection of accounting policies
  - (a) Going concern
  - (b) Growth of business
  - (c) Substance over form
  - (d) Solvency
16. Following factors should be considered in selection of accounting policies
  - (a) Liquidity
  - (b) Cost
  - (c) Materiality
  - (d) Morale of employees
17. As per AS-1, disclosure should be made of
  - (a) Significant accounting policies
  - (b) Assumptions in accounting
  - (c) Accounting principles
  - (d) Accounting policies
18. As per AS-1, disclosure of accounting policies should form part of
  - (a) Financial statements
  - (b) Director's Report
  - (c) Auditor's Report
  - (d) Books of account
19. As per AS-1, disclosure of accounting policies should be made
  - (a) At all relevant places
  - (b) At one place
  - (c) In Profit & Loss Account
  - (d) In Balance Sheet
20. As per AS-1, any change in accounting policy
  - (a) Should be disclosed
  - (b) Should not be disclosed
  - (c) Requires permission from ICAI
  - (d) Requires permission from the Government
21. The Rule followed in disclosure of accounting policies
  - (a) All significant policies should be disclosed
  - (b) Only a few policies should be disclosed
  - (c) Accounting policies should not be disclosed
  - (d) None of the above

[Ans. (1 – a), (2 – a), (3 – d), (4 – b), (5 – d), (6 – d), (7 – b), (8 – c), (9 – c), (10 – c), (11 – b), (12 – c), (13 – d), (14 – b), (15 – c), (16 – c), (17 – a), (18 – a), (19 – b), (20 – a), (21 – a)]

### Accounting Standard – 9: Revenue Recognition

1. The AS deals with revenue recognition is
  - (a) AS-1
  - (b) AS-9
  - (c) AS-3
  - (d) AS-10
2. AS-9 does not deal with revenue arising from
  - (a) Sale of goods
  - (b) Interest
  - (c) Service contracts
  - (d) Construction contracts
3. Revenue from interest is recognised when
  - (a) Interest is received
  - (b) Loan is repaid
  - (c) Interest accrues on time basis
  - (d) When loan is taken
4. Revenue from dividend is recognised when
  - (a) Dividend is received
  - (b) Right to receive dividend is established
  - (c) Amount is credited to Bank Account
  - (d) Dividend warrant is despatched by the company

5. In consignment revenue is recognised when
- (a) Goods are sent on consignment                      (b) Goods are received by the consignee
- (c) Goods are sold out by the consignee

[Ans. (1 – b), (2 – d), (3 – c), (4 – b), (5 – c)]

### MATCH THE FOLLOWING COLUMNS.

#### Accounting Standard – 1: Disclosure of Accounting Policies

##### Column A

- (a) Accounting Standards issued by  
(b) Accounting policy  
(c) Accounting assumption  
(d) Disclosure of accounting policies  
(e) Treatment of goodwill

##### Column B

- (i) Conservatism  
(ii) AS-1  
(iii) Area of accounting policies  
(iv) Disclosure of policy  
(v) Method of Stock Valuation  
(vi) ICAI

[Ans. (a – vi), (b – v), (c – i), (d – ii), (e – iii) ]

#### Accounting Standard – 9: Revenue Recognition

##### Column A

- (a) Revenue recognition  
(b) AS-9 does not deal  
(c) Revenue  
(d) Revenue from interest  
(e) Dividend recognised

##### Column B

- (i) With revenue from construction contract  
(ii) Amount earned by sale of goods  
(iii) Booked on time basis  
(iv) When right to receive dividend is established  
(v) Royalties  
(vi) AS-9

[Ans. (a – vi), (b – i), (c – ii), (d – iii), (e – iv) ]

### FILL IN THE BLANKS WITH SUITABLE WORDS.

#### Accounting Standard – 1: Disclosure of Accounting Policies

- If standards are not followed, the \_\_\_\_\_ has to make a disclosure in the accounting report in case of failure.
- The \_\_\_\_\_ statements are prepared from the books of accounts and other records maintained by the enterprise.
- There is \_\_\_\_\_ to establish accounting standards.
- There is need of \_\_\_\_\_ to accounts.
- There is need of \_\_\_\_\_ change in accounting policies.
- Depreciation can be calculated either by \_\_\_\_\_ line method or \_\_\_\_\_ value methods.
- Inventories may be valued by the \_\_\_\_\_ methods.
- It is difficult to follow a \_\_\_\_\_ accounting policy in all the circumstances.

[Ans. 1. auditor, 2. financial, 3. need, 4. notes, 5. disclose, 6. straight, written down, 7. different, 8. uniform]

**Accounting Standard – 9: Revenue Recognition**

1. AS-9 is applicable to \_\_\_\_\_ enterprises.
2. AS-9 explains when the \_\_\_\_\_ should be recognised in the Profit & Loss Account.
3. As per AS-9 revenue from sale of goods is recognised when the seller \_\_\_\_\_ the goods to the buyer for a \_\_\_\_\_ .
4. Installation fees are recognised as revenue when the installation is \_\_\_\_\_ and its is \_\_\_\_\_ by the client.
5. The buyer requests delayed delivery although he purchases the \_\_\_\_\_, takes the \_\_\_\_\_, and accepts billing, in this case the sale is complete.
6. Revenue should be recognised when goods are installed at the buyer's place to his \_\_\_\_\_ and goods are inspected and \_\_\_\_\_ by the buyer.

[Ans. 1. all, 2. revenue, 3. transfers, consideration, 4. completed, accepted, 5. goods, title, 6. satisfaction, accepted]

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## Chapter

# 6

# Stock Valuation

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### Valuation of Inventories – AS-2:

#### (A) Introduction

1. Accounting Standard 2(AS-2) issued by the Institute of Chartered Accountants of India (ICAI) deals with method of accounting for valuation of inventories. This standard was originally introduced by the ICAI in 1981; however, it became mandatory only from 1.4.1999.
2. Basically, the main objective of having an accounting standard is to achieve 'Comparability,' i.e., enabling comparison of operating results of two years of the same entity or comparing the operating results of different entities of the same industry.
3. The wealth and future of the business is based on the inventory and its valuation. It is one of the most important items stated on Assets side of the Balance Sheet and plays an important role in determining the operational and financial results.
4. Generally, it is the second largest item after fixed assets in the financial statements of a manufacturing organisation. The value attached to inventories can materially affect the operating result and financial position. However, different bases of valuing inventories are used by different businesses and even by different undertakings within the same industry.
5. The statement applies to financial statements prepared on Historical Cost basis. Different considerations would be involved for statement prepared on other basis.
6. The inventory is the main item which can convert profit making unit into loss making and *vice versa*. As per AS-1, i.e., Disclosure of Accounting Policies and Disclosure of True and Fair View, Inventory Valuation plays very important role.
7. As provided in the Companies Act 1956 Part I and II of Schedule VI and MAOCARO and now Companies (Auditor's Report) Order 2003 issued by Central Government of India *w.e.f.* 1.4.2004, Inventory Valuation shown as per AS-2 gives better disclosure, reliability and comparability.

#### (B) Objective of AS-2

1. The determination of the value at which inventories are carried in the financial statements until the related revenues are recognised, including the ascertainment of cost of inventories.

2. However, there will be no impact on 'Profit' or taxable income and Current Assets for disclosure of true and fair view of financial position and working results under Companies Act 1956.
3. The mandatory AS-2 is also applicable in respect of financial statements audited under section 44AB of the Income Tax Act, 1961.

### (C) Coverage

1. The standard lays down the coverage and valuation of inventories
2. Inventories encompass goods purchased and held for resale. It can be raw material, finished goods or work-in-progress and stores and spares, packing material, etc.

**Definitions:** The standard defines and stipulates the following factors to be considered for inventories are assets:

Held for sale in the ordinary course of business; In the process of production for such sale; or In the form of materials or supplies to be consumed in the production process or In the rendering of services.

Net realisable value is the estimated selling price in the ordinary course of business less the estimated costs of completion and the estimated costs necessary to make the sale.

3. The cost of inventories should comprise all cost of purchase, cost of conversion and other cost incurred in bringing the inventories to that present location and condition.
4. It must be noted and clarified that AS-2 does not apply to:

Work-in-progress in Construction Contracts – AS-7

Work-in-progress in case of service provides.

Inventory of livestock agricultural and forest products, mineral oils, ores and gases as specified in paras 1(d) of AS-2.

Excludes machinery spare dedicated to a particular machinery or equipment and use of the spare is irregular.

Shares, debentures and financial instruments held as stock-in trade.

Question arises as to how the inventory of shares, debentures and financial assets held as stock-in-trade should be valued as AS-2 which mandates lower of cost or net realisable value method of valuation is not applicable and the method of valuation prescribed by AS-13 dealing with investments to be lower of cost and fair value is also not applicable. Prudence requires the basis of valuation to be lower of cost of purchase. Cost of purchase in this case would be cost of the security plus brokerage and transfer charges.

AS-13 also deals with "current" or short-term investments this would be applicable to inventory of shares and securities.

5. Paras 12 and 13 of AS-2 prescribe as to what is excluded whilst computing COST. These are: Abnormal wastage of labour and materials. Storage costs, unless those costs are necessary in the production process prior to further production. Administrative overheads that do not contribute to bringing inventories to their present location and condition. Selling and distribution costs. Interest and other borrowing costs. Trade discounts and rebates, duty drawbacks.
6. Inclusion of Excise duty in inventory valuation.

The cost of purchase consists of the purchase price including duties and taxes (other than those subsequently recoverable by the enterprise from the taxing authorities).

As per the Guidance Note issued by the Institute of Chartered Accountants of India, the excise duty is a cost incurred to bring the inventories to their present location and condition and accordingly it is required to be considered as an element of cost for inventory valuation.

7. In this connection, MODVAT (now CENVAT) will not form part of cost of purchase.
8. Increase or decrease of exchange rate variation will be part of cost of inventories.
9. It must be noted that the Expert Committee of the Institute of has consistently opined that interest cannot form of cost of inventories even if production or conversion of an item of inventory takes a long time.

However, interest can be part of cost of inventories which take long period of time to get completed before the inventory is ready for sale, e.g., wine, timber, etc.

**Inventory Accounting Systems:** The two most widely used inventory accounting systems are the periodic and the perpetual.

- **Perpetual:** The perpetual inventory system requires accounting records to show the amount of inventory on hand at all times. It maintains a separate account in the subsidiary ledger for each good in stock, and the account is updated each time a quantity is added or taken out.
- **Periodic:** In the periodic inventory system, sales are recorded as they occur but the inventory is not updated. A physical inventory must be taken at the end of the year to determine the cost of goods sold. Regardless of what inventory accounting system is used, it is good practice to perform a physical inventory at least once a year.

**Periodic versus Perpetual Systems:** There are fundamental differences for accounting and reporting merchandise inventory transactions under the periodic and perpetual inventory systems.

To record purchases, the periodic system debits the Purchases account while the perpetual system debits the Merchandise Inventory account.

To record sales, the perpetual system requires an extra entry to debit the Cost of goods sold and credit Merchandise Inventory.

By recording the cost of goods sold for each sale, the perpetual inventory system alleviated the need for adjusting entries and calculation of the goods sold at the end of a financial period, both of which the periodic inventory system requires.

In Perpetual Inventory System, there must be actual figures and facts.

**Using Non-cost Methods to Value Inventory:** Under certain circumstances, valuation of inventory based on cost is impractical. If the market price of a good drops below the purchase price, the lower of cost or market method of valuation is recommended. This method allows declines in inventory value to be offset against income of the period. When goods are damaged or obsolete, and can only be sold for below purchase prices, they should be recorded at net realisable value. The net realisable value is the estimated selling price less any expense incurred to dispose of the good.

**Methods Used to Estimate Inventory Cost:** In certain business operations, taking a physical inventory is impossible or impractical. In such a situation, it is necessary to estimate the inventory cost.

Two very popular methods are: (1) retail inventory method, and (2) gross profit (or gross margin) method. The retail inventory method uses a cost to retail price ratio. The physical inventory is valued at retail, and it is multiplied by the cost ratio (or percentage) to determine the estimated cost of the ending inventory.

The gross profit method uses the previous year's average gross profit margin (i.e., sales minus cost of goods sold divided by sales). Current year gross profit is estimated by multiplying current year sales by that gross profit margin, the current year cost of goods sold is estimated by subtracting the gross profit from sales, and the ending inventory is estimated by adding cost of goods sold to goods available for sale.

**Inventory Costing Methods:** Recall that a perpetual inventory system means the inventory accounts are adjusted after each sale or purchase transaction. Under FIFO, the cost of the goods that were acquired by the company first, is transferred from Inventory to Cost of Goods sold upon a sale. In other words, when a sale takes place, the cost of units from the earliest inventory layer is expensed first. If there are not enough units in the first layer, the unit cost from the next layer is expensed and so on like that.

**First In First Out (FIFO) – Definition and Explanation:** The **First In First Out (FIFO) Method** of costing is used to introduce the subject of **Materials Costing**. The FIFO method of costing issued materials follows the principle that materials used should carry the actual experienced cost of the specific units used. The method assumes that materials are issued from the **Oldest Supply** in stock and that the cost of those units when placed in stock is the cost of those same units when issued. However, FIFO costing may be used even though physical withdrawal is in a different order.

**Advantages of First In First Out (FIFO) Costing Method:**

**Advantages Claimed for First In First Out (FIFO) Costing method are:**

1. Materials used are drawn from the cost record in a logical and systematic manner.
2. Movement of materials in a continuous, orderly, single file manner represents a condition necessary to and consistent with efficient materials control, particularly for materials subject to deterioration, decay and quality are style changes.

**FIFO Method is Recommended Whenever:**

1. The size and cost of units are large.
2. Materials are easily identified as belonging to a particular purchased lot.
3. Not more than two or three different receipts of the materials are on a materials card at one time.

**Illustration 1:** Brid's Drills Co. has following transactions in the month of February 2014:

February 2014	
(1)	Beginning balance: 800 units @ ₹ 6 per unit.
(4)	Received 200 units @ ₹ 7 per unit.
(10)	Received 200 units @ ₹ 8 per unit.
(11)	Issued 800 units.
(12)	Received 400 units @ ₹ 8 per unit.
(20)	Issued 500 units.
(25)	Returned 100 excess units from the factory to the storeroom to be recorded at the latest issued price.
(28)	Received 600 units @ ₹ 9 per unit.

Calculate the value of closing stock.

(Modified CPT)

Calculation for the above transactions would be as follows:

**FIFO Method**

February 2014			
01. Beginning balance	800 units @ ₹ 6	₹ 4,800	
04. Received	200 units @ ₹ 7	₹ 1,400	
10. Received	200 units @ ₹ 8	₹ 1,600	₹ 7,800
11. Issued	800 units @ ₹ 6		₹ 4,800
<b>Balance</b>	<b>200 units @ ₹ 7</b>	<b>₹ 1,400</b>	
	<b>200 units @ ₹ 8</b>	<b>₹ 1,600</b>	<b>₹ 3,000</b>
12. Received	400 units @ ₹ 8	₹ 3,200	₹ 6,200
20. Issued	200 units @ ₹ 7	₹ 1,400	
300 units @ ₹ 8	₹ 2,400	₹ 3,800	
<b>Balance</b>	<b>300 units @ ₹ 8</b>	<b>₹ 2,400</b>	
25. Returned to storeroom	100 units @ ₹ 8	₹ 800	
28. Received	600 units @ ₹ 9	₹ 5,400	8,600
<b>Balance</b>	<b>400 units @ ₹ 8</b>	<b>₹ 3,200</b>	
	<b>600 units @ ₹ 9</b>	<b>₹ 5,400</b>	<b>₹ 8,600</b>

**Disadvantages or Limitations of FIFO Method:**

**FIFO Method** is definitely awkward if frequent purchases are made at different prices and if units from several purchases are on hand at the same time. Added costing difficulties arise when returns to vendors or to the storeroom occur.

**Weighted Average Method:** This method assumes that all inventories available are best represented by a weighted average cost. The average cost of goods held in inventory is recalculated every time a fresh purchase is made and goods issued or sold out of inventory are priced at such average price till such time as the next lot is purchased.

**Weighted Average Cost** is a method of calculating Ending Inventory cost. It is also known as AVCO. It takes Cost of Goods Available for Sale and divides it by the total amount of goods from Beginning Inventory and Purchases. This gives a Weighted Average Cost per Unit. A physical count is then performed on the ending inventory to determine the amount of goods left. Finally, this amount is multiplied by Weighted Average Cost per Unit to give an estimate of ending inventory cost.

**Illustration 2:** The following is the record of receipts of certain material during the month of February 2014:

- Feb. 1 Received 400 units for job no. 12 @ ₹ 10 per unit
- Feb. 4 Received 300 units for job no.13 @ ₹ 11 per unit
- Feb. 16 Received 200 units for job no. 14 @ ₹ 12 per unit
- Feb. 25 Received 400 units for job no. 15 @ ₹ 13 per unit.

During February 2014, following issue of material are made.

- Feb. 10 Issued 200 units to job no.12
- Feb. 15 Issued 100 units to job no.13
- Feb. 17 Issued 200 units to job no. 12
- Feb. 20 Issued 200 units to job no. 14
- Feb. 26 Issued 100 units to job no. 13
- Feb. 28 Issued 200 units to job no. 15

Show how these transactions will appear in the stores ledger and state the amount of inventory of Feb. 28, 2014. *(Modified ICWA Foundation)*

**Solution:**

**FIFO Method**

Receipts					Issues					Balance		
Date	Job No.	Qty	Rate	Amt	Date	Job No.	Qty	Due	Rate	Amt	Qty	Amt
2014					2014							
Feb. 1	12	400	10	4,000	Feb.						400	4,000
Feb. 4	13	300	11	3,300	Feb.						700	7,300
					Feb. 10	12	200	200	10	2,000	500	5,300
					Feb. 15	13	100	200	11	1,100	400	4,200
Feb. 16	16	200	12	2,400							600	6,600
					Feb. 17	12	200		10	2,000	400	4,600
					Feb. 20	14	200		12	2,400	200	2,200
Feb. 25	15	400	13	5,200							600	7,400
					Feb. 26	13	100	100	11	1,100	500	6,300
					Feb. 28	15	200	200	13	2,600	300	3,700
<b>Total</b>		<b>1,300</b>		<b>14,900</b>			<b>1000</b>			<b>11,200</b>	<b>300</b>	<b>51,600</b>

**Illustration 3:** From the following details, calculate the value of closing stock on 31-12-2014 according to: (a) FIFO Method and (b) weighted average method.

Date	Transaction	No. of Units	Rate per Unit ₹
1-12-2014	Opening stock	4000	30.00
4-12-2014	Purchased	8000	32.10
8-12-2014	Issued	9000	
12-12-2014	Purchased	7000	32.50
16-12-2014	Issued	6000	

**Stock Valuation**

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20-12-2014	Purchased	9000	32.30
23-12-2014	Issued	8000	
25-12-2014	Purchased	6000	33.25
27-12-2014	Issued	9000	
29-12-2014	Purchased	10000	32.50
31-12-2014	Issued	7000	32.50

*(B.Com., MU Modified)***Solution:****FIFO Method**

Purchases				Issued			Balance		
Date	Units	₹	Total	Units	₹	Total	Units	₹	Total
1.12.14	Opening						4000	30	1,20,000
4.12.14	8000	32.10	2,56,800				4000	30	1,20,000
							8000	32.1	2,56,800
8.12.14				4000	30	1,20,000			
				5000	32.1	1,60,500	3000	32.1	96,300
12.12.14	7000	32.5	2,27,500				3000	32.1	96,300
							7000	32.5	2,27,500
16.12.14				3000	32.1	96,300			
				3000	32.5	97,500	4000	32.5	1,30,000
20.12.14	9000	32.3	2,90,700				4000	32.5	1,30,000
							9000	32.3	2,90,700
23.12.14				4000	32.5	1,30,000			
				4000	32.3	1,29,200	5000	32.3	1,61,500
25.12.14	6000	33.25	1,99,500				5000	32.3	1,61,500
							6000	33.25	1,99,500
27.12.14				5000	32.3	1,61,500			
				4000	33.25	1,33,000	2000	33.25	66,500
29.12.14	10000	32.5	3,25,000				2000	33.25	66,500
						10,000	10,000	32.50	3,25,000
31.12.14				2000	33.25	66,500			
				5000	32.5	1,62,500	5000	32.5	1,62,500

The Closing Stock 5000 Units amount into ₹ 1,62,500.

## Weighted Average Method

Receipts				Issued			Balance	
Date	Units	₹	Total	Units	Avg. Cost ₹	Total	Units	Value
1.12.14	Opening						4000	1,20,000
4.12.14	8000	32.1	2,56,800				12000	3,76,800
8.12.14				9000	31.4	2,82,600	3000	94,200
12.12.14	7000	32.5	2,27,500				10000	3,21,700
16.12.14			6000	32.17	1,93,020	4000	1,28,680	
20.12.14	9000	3.3	2,90,700				13000	4,19,380
23.12.14				8000	32.26	2,58,080	5000	1,61,300
25.12.14	6000	33.25	1,99,500				11000	3,60,800
27.12.14				9000	32.8	2,95,200	2000	65,600
29.12.14	10000	32.5	3,25,000				12000	3,90,600
31.12.14				7000	32.55	2,27,850	5000	1,62,750

The Closing Stock 5000 Units amounts to ₹ 1,62,750.

**Illustration 4:** The following transactions took place in respect of a material:

Date	Receipt Quantity (Units)	Rate ₹	Issue Quantity (Units)
02/03/2014	200	2.00	—
10/03/2014	300	2.40	—
15/03/2014	—	—	250
18/03/2014	250	2.60	—
20/03/2014	—	—	300

Prepare a Stock register as per: Weighted Average Method

(CSF Modified)

**Solution:**

## Stock Register (Weighted Average Method)

Date	Receipts			Issues			Balance		
	Qty	Rate	Amt	Qty	Rate	Amt	Qty	Rate	Amt
02/03/2014	200	2.00	400	—	—	—	200	2.00	400
10/03/2014	300	2.40	720	—	—	—	500	2.24	1,120
15/03/2014	—	—	—	250	2.24	560	250	2.24	560
18/03/2014	250	2.60	650	—	—	—	500	2.42	1,120
20/03/2014	—	—	—	300	2.42	726	200	2.42	484

**Illustration 5:** Following data pertains to Raw Material ‘Timmy’ during the month of September 2014:

- 01/09/2014 Opening Balance 100 kg @ ₹ 15 per kg
- 04/09/2014 GRN 903 900 kg @ ₹ 16 per kg
- 07/09/2014 MR 95 800 kg
- 11/09/2014 GRN 908 2000 kg @ ₹ 17 per kg
- 14/09/2014 MR 959 1500 kg
- 20/09/2014 GRN 923 200 kg @ ₹ 25 per kg
- 24/09/2014 MR 963 1000 kg
- 29/09/2014 GRN 942 500 kg @ ₹ 16 per kg

From the above details, you are required to find out quantity and value of closing stock under:

- (i) Weighted average
- (ii) FIFO

*(DFM, MU, Modified 2001)*

**Solution:**

**Stock Register (Weighted Average Method)**

Date	Doc Ref.	Receipts			Issue			Balance		
		Qty 2014	Rate	Amt	Qty	Rate	Amt	Qty	Rate	Amt
April 1								1000	15.00	15,000
4	GRN 903	900	16	14,400				1900	15.47	29,400
7	MR 951				800	15.47	12,376	1100	15.47	17,024
11	GRN 908	2000	17	34,000				3100	16.46	51,024
14	MR 959				1,500	16.46	24,690	1600	16.46	26,334
20	GRN 923	200	25	5,000				1800	17.41	31,334
24	MR 963				1,000	17.41	17,410	800	17.41	13,924
29	GRN 942	500	16	8,000				1300	16.86	21,924
		3600		61,400	3,300		54,476			

## Stock Register (FIFO Method)

Date	Doc Ref.	Receipts			Issue			Balance		
		Qty 2014	Rate	Amt	Qty	Rate	Amt	Qty	Rate	Amt
April 1								1000	15	15,000
4	GRN 903	900	16	14,400				1000	15	15,000
								900	16	14,400
								1900		1,59,000
7	MR 951				800	15.00	12,000	200	15	3,000
								900	16	14,400
								1100		17,400
11	GRN 908	2000	17	34,000				200	15	3,000
								900	16	14,400
								2000	17	34,000
								3100		51,400
14	MR 959				200	15.00	3,000			
					900	16.00	14,400	1600	17	27,200
					400	17.00	6,800			
					1500		2,420			
20	GRN 923	200	25	5,000				1600	17	27,200
								200	25	5,000
								1800		32,200
24	MR 963				1000	17.00	17,000	600	17	10,200
								200	25	5,000
								800		15,200
29	GRN 942	500	16	8,000				600	17	10,200
								200	25	5,000
								500	16	8,000
								1300		23,200
		3600		61,400	3300		55,620			

**SAQ 1:** Following is the record of transactions regarding purchases and sales:

2013

January	Purchased	100 units	@ ₹ 4
February	Purchased	200 units	@ ₹ 4.5
March	Purchased	300 units	@ ₹ 5
April	Sold	70 units	@ ₹ 6
May	Sold	150	@ ₹ 7.50

**Required:**

- (a) Prepare stock register as per the following methods:
- (i) FIFO (**Ans.:** 80 @ 4.5 = ₹ 360 and 300 @ 5.00 = ₹ 1500)
- (ii) Weighted Average. (**Ans.:** 380 @ 4.66 = ₹ 1,770)
- (b) Find out cost of goods sold.

**SAQ 2:** Keep stock record on FIFO. Weighted Average basis from the following transactions:

**Purchases:**

2014

January	1	500	units	@ ₹ 18
	5	700	units	@ ₹ 20
	9	900	units	@ ₹ 18
	15	300	units	@ ₹ 25
	25	200	units	@ ₹ 20
	31	500	units	@ ₹ 25

2014

January	2	200	units	@ ₹ 22
	7	500	units	@ ₹ 25
	11	400	units	@ ₹ 21
	18	800	units	@ ₹ 28
	27	500	units	@ ₹ 25

Also find out cost of goods sold and the profit.

(**Ans.:** FIFO 200@ 20 ₹ 4,000 and

500@ 25 ₹ 12,000, WAM 700@ 235 ₹ 16,500)

**SAQ 3:** The purchases and issues of materials of Alpha Industries Ltd. are as follows:

	Units	Unit Cost (₹)
Purchased	100	1
Purchased	400	1.50
Issued	200	
Purchased	300	1.25
Issued	300	

What is the value of the ending inventory under the following methods:

- (a) Weighted Average Price Method.  
 (b) First in First out Method.

**SAQ 4:** The following transactions took place in Infosys Ltd. of a material.

Date	Receipt Quantity	Rate	Issue Quantity
2.3.2014	200	2	
10.3.2014	300	2.40	
15.3.2014	–	–	250
18.3.2014	250	2.60	–
20.3.2014	–	–	300

Prepare a stock register as per Weighted Average Method.

**SAQ 5:** Find the value of closing stock, under FIFO, and Weighted Average Price Method, from the following information (under both the systems):

2014

January	1	Opening Stock	700 units @ ₹ 5
	4	Sales	300 units
	8	Purchases	900 units @ ₹ 6
	10	Sales	500 units
	11	Sales	100 units
	16	Purchases	800 units @ ₹ 6.50
	18	Sales	400 units
	23	Purchases	1,100 units @ ₹ 7.00
	29	Sales	600 units

The market value of closing stock on 31st January, 2014 was ₹ 6.50.

**SAQ 6:** The following particulars have been extracted in respect of material X. Prepare a Stores Ledger Account showing the receipts and issues, pricing the materials issued in the basis of Weighted Average (under both the systems).

**Receipts:**

2014

October	1	Opening Stock	200 units at ₹ 3.50 per unit
	3	Purchased	300 units at ₹ 4.00 per unit
	13	Purchased	900 units at ₹ 4.30 per unit
	23	Purchased	600 units at ₹ 3.80 per unit

**Issues:**

2014

October	5	Issued	400 units
	15	Issued	600 units
	25	Issued	600 units

(Ans.: Issue Price Rate 5th, 15th, 25th, Closing Stock Weighted Average 3.80, 4.25, 3.98, 400 units ₹ 1,592)

**Illustration 6:** Following date pertains to Raw Material ‘Timmy’ during the month of September 2014:

- 01/09/2014 Opening Balance 100 kg @ ₹ 15 per kg
- 04/09/2014 GRN 903 90 kg @ ₹ 16 per kg
- 07/09/2014 MR 95 80 kg
- 11/09/2014 GRN 908 200 kg @ ₹ 17 per kg
- 14/09/2014 MR 959 150 kg
- 20/09/2014 GRN 923 20 kg @ ₹ 25 per kg
- 24/09/2014 MR 963 100 kg
- 29/09/2014 GRN 942 50 kg @ ₹ 16 per kg

From the above details, you are required to find out:

- (a) (i) Value of total issues under “weighted average” method
- (ii) Quantity and value of closing stock under:
  1. Weighted average
  2. FIFO
- (iii) Average purchase price per unit during the month.
- (b) If (i) 2 kgs of “Timmy” are required to manufacture 1 unit of “Tommy” and
  - (ii) Other conversion cost per unit of Tommy are ₹ 6 per unit and the company want to earn 30% profit on sales.

What should be the selling price per unit of “Tommy”?

**(DFM, MU, Modified, 2001)**

**Solution:****Stock Register (Weighted Average Method)**

Date	Doc Ref.	Receipts			Issue			Balance		
		Qty	Rate	Amt	Qty	Rate	Amt	Qty	Rate	Amt
September 2014										
1								100	15.00	1,500
4	GRN 903	90	16	1,440				190	15.47	2,940
7	MR 951				80	15.47	1,238	110	15.47	1,702
11	GRN 908	200	17	3,400				310	16.46	5,102
14	MR 959				150	16.46	2,469	160	16.46	2,633
20	GRN 923	20	25	500				180	17.41	3,133
24	MR 963				100	17.41	1,741	80	17.40	1,740
29	GRN 942	50	16	800				130	16.86	2,196
		360		6,140	330		5,448			

$$(a) \text{ Simple Average} = \frac{16 + 17 + 25 + 16}{4} = ₹ 18.50 \text{ per unit}$$

$$\text{Weighted Average Method} = \frac{6140}{360} = ₹ 17.06 \text{ per unit}$$

**Weighted Average:**

$$\text{Raw Material } 2 \text{ kg} \times ₹ 17.06 = 34.11$$

$$\text{Other Conversion Costs} = 6.00$$

$$\text{Total Cost} = 40.11$$

$$(+) \text{ Profit (30 on Sales)} = 17.19$$

$$\text{Selling Price} = 57.30$$

**Stock Register (FIFO Method)**

Date	Doc Ref.	Receipts			Issue			Balance		
		Qty	Rate	Amt	Qty	Rate	Amt	Qty	Rate	Amt
April 2014										
1								100	15	1,500
4	GRN 903	90	16	1,440				100	15	1,500
								90	16	1,440
								190		2,940

**Stock Valuation**

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7	MR 951				80	15,47	1,200	20	15	300
								90	16	1,440
								110		1,740
11	GRN 908	200	17	3,400				20	15	300
								90	16	1,440
								200	17	3,400
								310		5,140
14	MR 959				20	15.00	300			
					90	16.00	1,440	160	17	2,720
					40	17.00	680			
					150		2,420			
20	GRN 923	20	25	500				160	17	2,720
								20	25	500
								180		3,220
24	MR 963				100	17.00	1,741	60	17	1,020
								20	25	500
								80		1,520
29	GRN 942	50	16	800				60	17	1,020
								20	25	500
								50	16	800
								130		2,320
		360		6,140	330		5,448			

(b) Input 2 kg Output 1 Unit

Simple Average ₹ per Unit Calculation

Raw Material 2 kg × ₹ 18.50 = 37.00

Other Conversion Costs = 6.00

Total Cost = 43.00                      70

(+) Profit (30 on Sales) = 18.43                      30

Selling Price = 61.43                      100

**Illustration 7:** Assume a trading company with the following information in the first half of 2014:

Jan 1	Beginning Inventory	50 units × 10	(at cost)
Feb 25	Purchase	100 units × 12	(at cost)
Mar 3	Sale	120 units × 20	(at selling price)
Mar 3	Cost of Sale	120 units × TBD	(at cost)
Apr 6	Purchase	60 units × 14	(at cost)
May 17	Sale	70 units × 25	(at selling price)
May 17	Cost of Sale	70 units × TBD	(at cost)

In our example, on March 3, the company sold 120 units. To calculate the cost of goods sold for the 120 units, we take the 50 units from the first layer (beginning inventory, 10 per unit) and 70 items from the second layer (purchased on February 25, 12 per unit).

Next, on May 17, additional 70 units were sold. The cost of goods sold for the 70 units is computed by adding the cost of 30 (i.e., 100 – 70) units remaining from the second layer (purchased on February 25, 12 per unit) and 40 units from the third layer (purchased on April 6, 14 per unit). The computation of the total cost of goods sold is as follows:

**Solution:**

**Example of FIFO Cost Flow Method under Perpetual System**

Date	Purchase					Cost of Goods Sold					Inventory						
	Units	×	Cost	=	Total	Units	×	Cost	=	Total	Units	×	Cost	=	Total		
Jan 1											50	×	10	=	500		
Feb 25	100	×	12	=	1,200						50	×	10	=	500		
											100	×	12	=	1,200		
Mar 3						50	×	10	=	500							
						70	×	12	=	840	30	×	12	=	360		
Apr 6	60	×	14	=	840						30	×	12	=	360		
											60	×	14	=	840		
May 17						30	×	12	=	360							
						40	×	14	=	560	20	×	14	=	280		
						<b>Total COGS</b>					=	<b>2,260</b>	<b>End. Inventory</b>				
											=		<b>280</b>				

The two preceding examples above show the computations of the cost of goods sold and the ending inventory assuming the perpetual inventory system. Let us move on to the periodic inventory system now.

Example of FIFO cost flow method under periodic system. Under the periodic system, inventory accounts are not affected when purchases and sales take place. Instead, the Inventory Purchases account is used. The amount of ending inventory is determined by a physical count of inventory on hand at period end. The cost of goods sold is computed by subtracting the amount of ending inventory from the goods available for sale.

Let us assume that the physical count at the end of the first half of 2014 showed 20 units remaining on hand. The total amount of units sold is therefore 190 (210 – 20).

FIFO means first in, first out. So, we need to use the cost of inventories acquired first. Also note that the FIFO method does not require calculation of intermediate amounts of cost of goods sold and ending inventory balances. The cost of goods sold calculation for the 190 units is presented below:

**Example of FIFO Cost Flow Method under Periodic System**

From Beginning Inventory on Jan 1	50 units × 10 = 500
From Purchase on Feb 25	100 units × 12 = 1,200
From Purchase on Apr 6	40 units × 14 = 560
<b>Total Cost</b>	<b>2,260</b>

The Trading A/c would reveal no profit when the stock used up internally is valued at cost.

**Illustration 8:** Calculate the cost of goods sold and closing stock under weighted Average cost of inventory using:

- (a) Periodic System.
- (b) Perpetual System.

March 1 Stock in hand 500 units @ ₹ 9

**Purchases:**

March 3 500 units @ ₹ 11

March 10 1,000 units @ ₹ 12

March 18 600 units @ ₹ 10

March 24 500 units @ ₹ 12

March 30 400 units @ ₹ 13

**Issue:**

March 2 400 units

March 9 500 units

March 16 900 units

March 23 500 units

March 31 600 units

*(B.Com. – Modified, MU)*

**Solution:**

- (a) **Periodic System:**

Weighted Average Cost per unit

$$= \frac{\text{Total Cost of Goods Available for Sale}}{\text{Total Number of Units Available for Sale}}$$

$$= \frac{(500 \times 9) + (500 \times 11) + (1,000 \times 12) + (600 \times 10) + (500 \times 12) + (400 \times 13)}{500 + 500 + 1,000 + 600 + 500 + 400}$$

$$= \frac{4,500 + 5,500 + 12,000 + 6,000 + 5,200}{3,500}$$

$$= \frac{39,200}{3,500}$$

$$= ₹ 11.20$$

$$\begin{aligned} \text{No. of units sold} &= 400 + 500 + 900 + 500 + 600 \\ &= 2,900 \text{ units} \end{aligned}$$

$$\begin{aligned} \text{Cost of goods sold} &= \text{Units sold} \times \text{Weighted Price per unit} \\ &= 2900 \times 11.20 \\ &= ₹ 32,480 \end{aligned}$$

$$\begin{aligned} \text{No of units stock} &= 3,500 - 2,900 \\ &= 600 \text{ units} \end{aligned}$$

$$\begin{aligned} \text{Value of stock} &= 600 \times 11.20 \\ &= ₹ 6,720 \end{aligned}$$

**(b) Perpetual System:**

Date	Receipt			Issue			Balance		
	Units	Price	Value	Units	Price	Value	Units	Price	Value
March 1	—	—	—	—	—	—	500	9	4,500
March 2	—	—	—	400	9	3,600	100	9	900
March 3	500	11	5,500	—	—	—	600	10.67	6,402
March 9	—	—	—	500	10.67	5,333	100	10.67	1,067
March 10	1,000	12	12,000	—	—	—	1,100	11.88	13,068
March 16	—	—	—	900	11.88	10,691	200	11.88	2,376
March 18	600	10	6,000	—	—	—	800	10.47	8,376
March 23	—	—	—	500	10.47	5,235	300	10.47	3,141
March 24	500	12	6,000	—	—	—	800	11.43	9,144
March 30	400	13	5,200	—	—	—	1,200	11.95	14,340
March 31	—	—	—	600	11.95	7,170	600	11.95	7,170

**Illustration 9:** Calculate the value of closing stock and cost of sales according to FIFO and Weighted Average Method as on 31st March, 2014 using Periodic Inventory System.

March 1, 2014 Stock 5,000 units @ ₹ 8 per unit

March 7, 2014 Purchased 7,500 units @ ₹ 10 per unit

March 12, 2014 Purchased 8,500 units @ ₹ 12 per unit

March 21, 2014 Purchased 9,000 units @ ₹ 15 per unit

March 28, 2014 Purchased 12,000 units @ ₹ 11 per unit

The physical stock taking completed on 31st March, 2014 revealed a closing stock of 3,500 units.

Assuming that sale price is @ ₹ 15 per unit, calculate the gross profit. *(B.Com., Delhi – Modified)*

**Solution:**

Total cost of goods available for sale  

$$= (5,000 \times 8) + (7,500 \times 10) + (8,500 \times 12) + (9,000 \times 15) + (12,000 \times 11)$$

$$= ₹ 4,84,000$$
 Total No. of units = 5,000 + 7,500 + 8,500 + 9,000 + 12,000  

$$= 42,000 \text{ units}$$
 Stock (in units ) = 3,500 units  
 No. of units sold = 42,000 – 3,500  

$$= 38,500 \text{ units}$$
 Sales = 38,500 × 15  

$$= ₹ 5,77,500$$

**Cost of Goods Sold, Stock and Gross Profit:**

**FIFO:**

Closing Stock = 3,500 × 11  

$$= ₹ 38,500$$
 Cost of Goods sold = Total Cost – Closing Stock  

$$= 4,84,000 - 38,500$$

$$= ₹ 4,45,500$$
 Gross Profit = Sales – Cost of Goods Sold  

$$= 5,77,500 - 4,45,500$$

$$= ₹ 1,32,000$$

**Weighted Average:**

Weighted Average Cost Per unit =  $\frac{\text{Total Cost}}{\text{Total Units}}$   

$$= \frac{4,84,000}{42,000}$$

$$= 11.52$$
 Closing Stock = 3,500 × 11.52  

$$= ₹ 40,320$$
 Cost of goods sold = 4,84,000 – 40,320  

$$= ₹ 4,43,680$$
 Gross Profit = 5,77,500 – 4,43,680  

$$= ₹ 1,33,820$$

**Objectives****Accounting Standard – 2: Valuation of Inventories**

1. Valuation of inventories is governed by \_\_\_\_\_.
  - (a) Companies Act
  - (b) Income Tax Act
  - (c) AS-2
  - (d) AS-6
2. AS-2 defines inventory as \_\_\_\_\_.
  - (a) Current assets
  - (b) Current liabilities
  - (c) Fixed assets
  - (d) Assets held for sale in the ordinary course of business
3. As per AS-2, inventory covers \_\_\_\_\_.
  - (a) Livestock
  - (b) Goods purchased for resale
  - (c) Investment held as stock in trade
  - (d) WIP in construction contracts
4. As per AS-2, inventory should be valued at \_\_\_\_\_.
  - (a) Cost
  - (b) Lower of cost and net realisable value
  - (c) Realisable value
  - (d) Retail price
5. As per AS-2, cost of inventories should include \_\_\_\_\_.
  - (a) All cost of purchases
  - (b) All cost of purchase, cost of conversion and cost incurred to bring the inventory to the present location
  - (c) Cost of purchases and selling
  - (d) Cost of purchases and transport
6. AS-2 states that, inventory should be valued at \_\_\_\_\_.
  - (a) FIFO or Weighted average basis
  - (b) Retail price of standard cost
  - (c) LIFO
  - (d) Current replacement cost
7. Weighted Average Method can be used under \_\_\_\_\_.
  - (a) Only periodic inventory system
  - (b) Periodic and perpetual inventory systems
  - (c) Only perpetual inventory system
  - (d) None of the above
8. As per AS-2, cost of inventories should exclude \_\_\_\_\_.
  - (a) Direct labour
  - (b) Interest on loans
  - (c) Factory overheads
  - (d) Cost of designing the product
9. Under periodic inventory system, closing stock is valued \_\_\_\_\_.
  - (a) By actually counting the stock on a particular date
  - (b) From the stores ledger
  - (c) By deducting value of sales from value of purchases
  - (d) On estimate basis

10. As per AS-2, Inventory covers \_\_\_\_\_.
  - (a) Machinery spares
  - (b) WIP in case of service providers
  - (c) Materials or suppliers used in production
  - (d) Stock of mineral oil
11. As per AS, goods and services produced and kept aside for specific projects should be valued at \_\_\_\_\_.
  - (a) Contract price
  - (b) Net realisable value
  - (c) Identified individual cost
  - (d) Pre-placement cost
12. Market Value is \_\_\_\_\_.
  - (a) Net realisable value
  - (b) Net realisable value less profit
  - (c) Discounted present value
13. The method reflects latest purchase cost in the closing stock is \_\_\_\_\_.
  - (a) FIFO
  - (b) LIFO
  - (c) Weighted Average
14. The system which keeps records continuously is \_\_\_\_\_.
  - (a) Perpetual
  - (b) Periodic
  - (c) Physical
15. Stock is valued at cost or at market value whichever is lower as per \_\_\_\_\_.
  - (a) Realisation concept
  - (b) Cost concept
  - (c) Matching concept
16. The system in which each and every item in the warehouse is physically verified is
  - (a) Perpetual Inventory system
  - (b) Physical Inventory system
  - (c) Retail Inventory system
17. The standard which governs inventory valuation is \_\_\_\_\_.
  - (a) AS-3
  - (b) AS-2
  - (c) AS-10
18. Carriage on purchases is \_\_\_\_\_.
  - (a) Added to the cost of inventory
  - (b) Deducted from the cost of inventory
  - (c) Multiplied by the cost of inventory
19. The system in which fluctuations in prices are averaged out \_\_\_\_\_.
  - (a) Weighted Average Method
  - (b) FIFO Method
  - (c) LIFO Method
20. The concept applicable for stock valuation is \_\_\_\_\_.
  - (a) Consistency
  - (b) Realisation
  - (c) Conservatism

**(Ans.:** (1 – c), (2 – d), (3 – b), (4 – b), (5 – b), (6 – a), (7 – b), (8 – b), (9 – a), (10 – c), (11 – c), (12 – a), (13 – a), (14 – a), (15 – a), (16 – b), (17 – b), (18 – a), (19 – a), (20 – b).)

**Practical Problems**

1. From the following transactions, prepare separately the Stores Ledger Accounts, using the following pricing methods:

**FIFO**

January	1	Opening Balance	100 units @ ₹ 5 each	
January	5	Received	500 units @ ₹ 6 each	
January	20	Issued	300 units	
February	5	Issued	200 units	
February	6	Received	600 units @ ₹ 5 each	
March	10	Issued	300 units	
March	12	Issued	250 units	<i>(CPT Modified)</i>

**(Ans.:** 150 units @ ₹ 5 = ₹ 750)

2. At the beginning of October 2014, the Bangalore Tin Co. had 10,000 lbs. of tin @ ₹ 2 per lb. Further purchases were made during the month as follows:

October	4	2,000 lbs. @ ₹ 2.50 per lb.
	10	6,000 lbs. @ 2.00 per lb.
	20	10,000 lbs @ ₹ 3.50 per lb.

The issues to manufacture were as follows:

October	12	16,000 lbs.
	22	10,000 lbs.

Write the stores ledger cards with the above the transactions based in both the FIFO. What will be the value of the closing stock in each case? *(CSF Modified)*

**(Ans.:** FIFO: 2,000 units – ₹ 7,000)

3. Prepare a Stores Ledger Account from the following transactions assuming that issue of stores have been made on the principle of “First In First Out”:

2014				
January	2	Purchased	2000 units at ₹ 4.00 per unit	
January	20	Purchased	250 units at ₹ 5.00 per unit	
February	5	Issued	1000 units	
February	10	Purchased	3000 units at ₹ 6.00 per unit	
February	12	Issued	2000 units	
March	2	Issued	500 units	
March	15	Purchased	2250 units at 5.50 per unit	
March	20	Issued	1500 units	<i>(ICWAF Modified)</i>

**(Ans.:** FIFO Stock: 1,500 units at ₹ 5.50 = ₹ 8,250)

4. Prepare a Stores Ledger Account from the following information for the month of December 2014 on the basis of FIFO Method:

2013

December 3	Opening Balance	200 kg	at ₹ 20 per kg.
December 4	Issue	100 kg.	
December 10	Issue	50 kg	
December 18	Purchases	300 kg	at ₹ 18 per kg.
December 20	Issue	300 kg	
December 28	Purchased	50 kg	at ₹ 15 per kg
December 30	Issue	1	0 kg.
December 30	Received back from completed job	5 kg.	(Previously issued at ₹ 20 per kg)

(CIMA Modified)

(Ans.: Stock 5 kg returned to stores valued at ₹ 20)

5. The following are the transactions in respect of material X for the month of October 2014.

2014

October 5	Opening Balance	400	units at ₹ 2.90 per unit
" 5	Purchased	500	units at ₹ 3 per unit
" 10	Issued	700	units
" 15	Purchased	700	units at ₹ 3.10 per unit
" 20	Issued	800	units
" 25	Purchases	400	units at ₹ 3.20 per unit
" 30	Issued	500	units

(B.Com., MU Modified)

Indicate at what price each issue must be made if based on Weighted Average Method.

(Ans.: ₹ 2.955; ₹ 3.057; ₹ 3.153)

6. Prepare a Stores Ledger from the following transactions adopting the 'Weighted Average Method' of pricing out issues.

2014

June 1	Opening Balance	100 units at ₹ 3 per unit
June 5	Issued to production	4 units
June 7	Purchased	96 units at ₹ 4 per unit
June 9	Issued 40 units to production	
June 19	Purchased	152 units at ₹ 3 per
June 24	Received back into stores	38 units out of 40 units issued on 9th June, 1982
June 27	Issued to production	20 units

(B.Com., DU Modified)

(Ans.: 322 units, ₹ 1.056, Rates ₹ 3, ₹ 3.5, ₹ 3.277)

7. With the help of the following information, prepare the Stores Ledger Card based on the Weighted Average Method of pricing issues (under both the systems):

September 1	Opening Balance	24,000 kg.	@ 7,500 per tonne
1	Purchased	44,000 kg.	@ ₹ 7,600 per tonne

1	Issued	10,000 kg.
5	Issued	16,000 kg.
12	Issued	24,000 kg.
13	Purchased	10,000 kg. @ ₹ 7,800 per tonne
18	Issued	20,000 kg.
22	Purchased	50,000 kg. @ ₹ 8,000 per tonne
28	Issued	30,000 kg.
30	Issued	22,000 kg.

*(B.Com., PU Modified)***(Ans.:** Closing Stock 2,000 kg. @ ₹ 7,974)

8. The following particulars relate to receipts and issues of material during March 2014.

2014

March	4	Received	500 units @ ₹ 2.000 each
	18	Received	350 units @ ₹ 2.10 each
	19	Issued	600 units
	24	Received	600 units @ ₹ 2.20 each
	25	Issued	450 units
	26	Received	500 units @ ₹ 2.30 each
	28	Issued	510 units
	20	Issued	100 units

*(CA Modified)*

Prepare a Store Ledger Account on the basis of Weighted Average Price Method.

**(Ans.:** 290 units @ ₹ 2.2348)

9. You are presented with the following information by Sphinx Engineering Co. relating to the first week of September 2014.

**Materials:** The transactions in connection with the materials are as follows:

Days	Units	Receipts Rate per unit (₹)	Issued Units
1st	40	15.00	
2nd	20	16.50	
3rd			30
4th	50	14.30	
5th			20
6th			40

Calculate the cost of materials issued under FIFO method and Weighted Average method of issue of materials.

*(ICWA Modified)***(Ans.:** FIFO ₹ 1,359, Weighted Average Method ₹ 1,350)

10. The following particulars relate to receipts and issues of a material during March 2014.

2014			
March	1	Received	500 units @ ₹ 2.00 each
	18	Received	350 units @ ₹ 2.10 each
	19	Issued	600 units
	24	Received	600 units @ ₹ 2.20 each
	25	Issued	450 units
	26	Received	500 units @ ₹ 2.30 each
	28	Issued	510 units
	30	Issued	100 units

Prepare a Stores Ledger Account on the basis of Weighted Average Price Method.

*(CS Modified)*

**(Ans.:** 290 units ₹ 649; Issue Rate: ₹ 2,041; ₹ 2,153; ₹ 2,234)

11. Using the information given, draft Stores Ledger Records showing quantities and values of receipts, issues and balance in hand under the following method of pricing stores issues:

Weighted Average Price.

January	1	Balance in hand	1,000 units	₹ 1 each
January	15	Received	3,000 units costing	₹ 3,300
February	12	Received	2,000 units costing	₹ 2,400
January	20	Issued	2,000 units	
February	27	Issued	3,400 units	

*[B.Com., MU Modified]*

**(Ans.:** 600 units ₹ 683; Issue rates ₹ 1.075 and ₹ 1.1375)

12. Enter the following transactions in the Stores Ledger of Y material using the FIFO Method.

2014			
January	1	Balance	250 units @ ₹ 10 unit
	3	Issued	50 units on M.R. No. 61
	6	Received	800 units vide G.R. No. 13 @ ₹ 11 per unit
	7	Issued	300 units on M.R. No. 63
	8	Returned to stores	20 units on M.R. No. 6
	12	Received	300 units per G.R. No. 15 @ ₹ 12 per unit
	15	Issued	320 units M.R. No. 83
	18	Received	100 unit, vide G.R.Note No. 77 @ ₹ 12 per unit
	20	Issued	120 units M.R. No. 102
	23	Returned to vendors	40 units from G.R. No. 77 received on 18th instant
	26	Received	200 units on G.R. No. 96 @ 10 per unit
	28	Fright paid on purchases	(vide G.R. No. 96) ₹ 50
	30	Issued	250 units on M.R. No. 113

**Note:** M.R. = Material Requisition  
G.R. Note = Goods Received Note

*(PU Modified)*

**(Ans.:** FIFO  $340 \times 12.00 = ₹ 4,080$ ;  $200 \times 12.50 = ₹ 2,500$ )



## Chapter

# 7

# Hire Purchase Transactions

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**Introduction:** Hire purchase has been associated with financing of commercial vehicles for road transport operations. It has emerged, in recent years, as a source of equipment financing and an alternative to lease financing. A hire purchase agreement has two aspects, firstly, an aspect of bailment of goods subject to the hire purchase agreement, and secondly, an element of sale that fructifies when the option to purchase is exercised by the intending purchaser. Though the option to purchase is allowed in the very beginning, it can be exercised only at the end of the agreement. The interest component of each hire purchase instalment is computed on the basis of a flat rate of interest and the effective rate component of interest is applied to the declining balance of the original loan amount to determine the interest of each instalment. The property in the goods which does not pass at the time of the agreement is with the intending seller; it only passes later when the option is exercised by the intending purchaser.

**Meaning:** A hire purchase transaction is one when the seller delivers his goods to a person known as hire purchaser with a condition that he will repay the price of goods inclusive of interest by different instalments and acquires the property immediately but the title of the goods is transferred only when the last instalment is paid. Under hire purchase agreement, a person takes delivery of goods with a promise to pay the price in certain number of instalments. It means the **ownership of goods is transferred to the buyer only when last instalment is paid.** This system is beneficial to both the parties. The buyer gets the possession of goods immediately and use the goods and pay for it out of his income in every instalment. The seller also can increase his sales. **The seller gets rights to take back the possession of goods if any default is made by the buyer in payment of instalments.** The buyer may pay certain amount of money at the time of signing the agreements. It is known as down payment or initial payment. The remaining amount may be paid in every instalments, monthly, quarterly, half-yearly or yearly.

Under instalment system, seller transfers the title of goods to the buyer immediately after the transaction has taken place. The last instalment may not be paid by the buyer. In short, under instalment system, sale is outright but payment is by instalments. As the ownership is transferred to the buyer, the seller does not get right of repossession in case of any default in payment.

**Concepts and Characteristics of Hire Purchase:** A hire purchase can be defined as a contractual arrangement under which the owner lets his goods on hire to the hirer and offers an option to the hirer for purchasing the goods in accordance with the terms of the contract. According to the Hire Purchase Act, 1972, an agreement which fulfills the following conditions is also a Hire Purchase Agreement:

1. The possession of goods is delivered by the owner thereof to a person on condition that such person pays the agreed amount in periodic instalment;
2. The property in such goods is to pass to such person on the payment of such last instalment; and
3. Such person has the right to terminate the agreement at any time before the property so passes.

So, the distinct features of a hire purchase transaction are:

1. The option to purchase the goods at any time during the term of the agreement and;
2. The right available to the hirer to terminate the agreement at any time before the payment of the last instalment.

Therefore, from the hirers angle, a hire purchase contract can be compared to a cancelable lease contract with a call (purchase) option.

The call option and the time of termination available with the hirer form the basis for distinguishing a hire purchase transaction from other asset-financing plans like instalment sale and conditional sale where the buyer is committed to pay the full price.

A hire purchase differs from instalment sale on one more count. In instalment sale, the ownership of the asset is transferred to the buyer on payment of the first instalment whereas in a hire purchase, the ownership is transferred to the hirer only when he exercises the option to purchase or a payment of the last instalment.

The salient features of a hire purchase transaction are therefore as follows:

1. The finance company (the counterpart of the lessor) purchases the equipment from the equipment supplier and lets it on hire to the hirer.
2. The hirer is required to make a down payment of 20 to 25 per cent of the equipment cost and repay the balance with interest in equated monthly instalments spread over 36 to 48 months either in advance or in arrears.

As an alternative to the down payment plan, some finance companies offer a deposit linked plan. Under this plan, the hirer is required to invest 20 to 25 per cent of the equipment cost in the fixed deposits of the company. In return, the hirer is provided with 100 per cent finance which has to be repaid with interest in equated monthly instalment spread over 36 to 48 months. On payment of the last instalment, the deposit with accumulated interest is returned to the hirer.

3. The interest component of each hire purchase instalment is calculated on the basis of a flat rate of interest. The rate of interest charged usually lies in the band of 13-15 per cent p.a.
4. During the currency of the contract (hire period), the hirer can opt for an early repayment and purchase the asset. The hirer, exercising this option, is required to pay the remaining amount of hire purchase instalments (instalments which have not fallen due) less an interest rebate. The interest rebate is calculated in different ways which are discussed in the following part.

5. Theoretically, the hirer can exercise the cancelable option and terminate the contract giving due notice to the finance company. But in practice, such terminations are few and far inbetween because the hirer loses the tax shields on capital allowances (like depreciation) by exercising this option.

#### Features of Hire Purchase

1. Hire purchase transaction originates from an agreement. The agreement is between two parties called the hire seller and hire purchaser.
2. The agreement is made for supply of goods.
3. Possession of goods is transferred to the purchaser on signing of the agreement.
4. The purchase agrees to pay for the goods in agreed instalments.
5. Each instalment is treated as a hire charge and not a price.
6. Right of ownership is not passed on to the purchaser unless last instalment is paid.
7. In case of failure of the purchaser in payment, the seller reserves the right of repossession.
8. The hire purchaser must keep the goods in good condition.
9. On the payment of last instalment, hire purchase becomes absolute purchase.
10. The excess of total payment over the cash price is taken as interest.

#### Distinction between Hire Purchase and Instalment Payment

Hire Purchase	Instalment Payment
1. The Hire Purchase transaction is regulated by Hire Purchase Act 1972.	1. There is no Act to control this transaction.
2. Possession of goods is transferred to the buyer and not the ownership.	2. Possession and ownership both are transferred to the buyer immediately after signing of the agreement.
3. Instalment is treated as a hire charge.	3. Instalment is treated as repayment of the principal together with interest.
4. The HP agreement may be canceled by the purchaser before payment of last instalment.	4. The seller cannot repossess the goods even if there is any default made by the purchaser in payment.
5. The seller can repossess the goods in case of default in payment.	5. The seller cannot repossess the goods even if there is any default made by the purchaser in payment.
6. The Hire Purchaser cannot sell the goods as he is not the owner.	6. The purchases can sell the goods as he is the owner of goods.

#### Some Terms:

**Hirer:** A person who gets the possession of goods from the owner under a Hire Purchase Agreement. He is the buyer of goods on HP basis.

**Hire:** It is the sum payable periodically by the hirer under the agreement. It is the rent paid by the buyer to the Hire Vendor.

**Down Payment:** It is the amount paid at the time of taking the delivery of goods. It is the initial payment made by the buyer to the Hire Vendor at the time of signing the agreement.

**Hire Purchase Price:** It is the total amount payable by the purchaser as per the HP agreement to complete the transaction. It is equal to Cash Price plus Interest. It is always inclusive of interest.

**Instalment:** It is the amount inclusive of principal and interest paid at the end of a certain period. It is divided as per the provisions of the agreement.

**Cash Price:** It is the price at which goods can be purchased today for full payment.

**Hire Purchase Agreement:** It means an agreement under which goods are lent on hire and under which the hirer has an option to purchase them in accordance with the terms of the agreement and includes an agreement under which:

1. Possession of goods is delivered by the owner to a person on condition that such person pays the agreed amount in periodical instalments.
2. The property in goods is to pass to the right person on the payment of last instalment.
3. Such a person has a right to terminate the agreement at any time before the passing of the property.

**Contents of Hire Purchase Agreement:** Every hire purchase agreement must be in writing. It contains about the following:

1. Hire purchase price of goods.
2. Cash price of goods.
3. The date of commencement of agreement.
4. Number of instalments.
5. Amount of each instalment.
6. Date of payment of each instalment.
7. The person to whom and the place where the instalment is payable.
8. Description of the goods covered by the agreement.
9. Terms and conditions and warranties as per the Act.

**Depreciation on Assets Under HP System:** Under this system, the ownership is not transferred to the buyer. Hence, there is a dispute about charging of depreciation on asset. However, from practical point of view, **depreciation on asset should be charged at a certain rate on the cash price of the asset acquired.** The logic behind provision of depreciation on asset is that the asset is used by the buyer. Moreover, the asset is to be shown at its real value. Secondly, the purchaser is going to be the owner of asset after payment of last instalment. Hence, depreciation should be provided as a matter of policy in the books of the buyer. Depreciation should be charged on asset year on its cash price.

**Calculation of Interest:** The price quoted by the seller in hire purchase system or instalment system is higher than the price which he would have quoted for sale on cash basis. The excess of hire purchase price over the cash price is treated as payment for interest.

**Procedure of Calculation of Interest:****Step:**

1. Consider the Cash Price of the Asset	xx
2. Deduct down payment	xx
3. Amount due in the beginning of the 1st year	xx
4. <i>Add:</i> Interest on the above for 1st year	xx
5. Amount due before the payment of instalment (3 + 4)	xx
6. <i>Less:</i> Instalment paid (Principal plus Interest)	xx
7. Amount due in the beginning of 2nd year (5 – 6)	xx
8. <i>Add:</i> Interest on above for 2nd year	xx
	xx

Repeat Steps Nos. 5, 6, 7 for each of the year.

The transaction under Hire purchase system requires calculation of interest as well as instalment comprising of interest. There are two situations which is explained with the help of examples.

**When interest rate is given:** The Sachin Co. purchases a motor vehicle from Sehswag Company on a hire purchase agreement on January 1, 2011 paying cash ₹ 20,000 and agreeing to pay further 3 instalments of ₹ 20,000 each on 31st December each year. The cash price of the car is ₹ 70,000 and Sehswag Company charges interest rate @ 10% p.a. Compute the amount of interest at the end of every year.

**Solution:**

Particulars	Jan. 2011	Dec. 2012	Dec. 2013	Dec. 2014
Opening Cash Price	70,000	50,000	35,000	18,500
Instalment	20,000	20,000	20,000	20,000
Interest @10%	—	5,000	3,500	1,500
Closing Cash Price (1 – 4)	50,000	35,000	18,500	NIL

In the last year, Interest rate = Instalment – Opening cash price

For other years, interest should be calculated at opening cash price.

**When rate of interest is not given:** The Dhoni Company purchases a motor vehicle from Gambhir Co. on a hire purchase agreement on Jan 1, 2011 paying cash ₹ 20,000 and agreeing to pay for the three instalments of ₹ 20,000 each on 31<sup>st</sup> December each year. The cash price of car is ₹ 70,000. Compute the amount of interest at the end of the year.

**Solution:**

$$\begin{aligned}
 \text{Interest} &= \text{Total price paid} - \text{Cash price} \\
 &= 20,000 \times 4 - 70,000 \\
 &= 10,000
 \end{aligned}$$

Particulars	Jan. 2011	Dec. 2012	Dec. 2013	Dec. 2014
Opening hire price	80,000	60,000	40,000	20,000
Instalment	20,000	20,000	20,000	20,000
Interest	—	$10,000 \times 3/6$ = 5,000	$10,000 \times 2/6$ = 3333	$10000 \times 1/6$ = 1,667
Cash price (2 – 3)	20,000	15,000	16,667	18,333
Hire price (1 – 2)	60,000	40,000	20,000	NIL

**Illustration 1:** The Purchase price of a motor car purchased by Car Mart Co. on hire purchase from Autoriders Company is ₹ 37,250. It is available on hire purchase on the following terms: (a) Initial amount payable is ₹ 10,000. (b) Total amount of interest @ 5% p.a. comes to ₹ 2,750. (c) Balance amount is payable in three instalments of ₹ 10,000 each. Analyse the terms of above hire purchase agreement.

**Solution:** The terms of above the purchase agreement can be analysed as follows:

- Hire Purchaser:** The Car Mart Co. is the hire purchaser or hirer.
- Hire Vendor:** Autoriders Company is the hire vendor or vendor.
- Cash Price:** The purchase price of ₹ 37,250 is the cash price.
- Interest:** Interest charged by the vendor @ 5% p.a. on the unpaid amounts comes to ₹ 2,750.
- Hire Purchase Price:** This is equal to ₹ 37,250 + ₹ 2,750 = ₹ 40,000.
- Down Payment:** ₹ 10,000 is the down payment.
- Instalment:** The balance amount is equal to (Hire Purchase Price – Down Payment) = ₹ 40,000 – ₹ 10,000 = ₹ 30,000, payable in three instalments of ₹ 10,000 each.

The entries in the books depend upon the total amount of interest as well as the interest paid in each instalment. If the interest rate is given, interest paid in cash instalment = Interest Rate % × Opening Cash Price O/s. Sometimes, the details regarding rate of interest etc. may not be available. How interest amount paid in each instalment is calculated in such circumstances is explained below.

**Illustration 2: (When rate of interest is given):** The Car Mart Company purchases a motor car from Autoriders company on a hire purchase agreement on January 1, 2011, paying cash ₹ 10,000 and agreeing to pay further three instalments of ₹ 10,000 each on 31st December each year. The cash price of the car is ₹ 37,250 and the Autoriders Company charges interest at 5% p.a. Compute the amount of yearly interest.

**Solution:** The interest included in each instalment can be calculated as follows:

- Total Amount of Interest = Total Hire Purchase Price – Cash Price = ₹ 40,000 – ₹ 37,250 = ₹ 2,750
- Interest in each instalment is equal to Rate of Interest × Amount outstanding in the beginning of each instalment. The interest is worked out either in a statement or a table.
- Calculation of Interest (Statement):

Particulars	Date/Period	₹
Cash Price as on	1-1-2011	37,250
Less: Down Payment on	1-1-2011	<u>10,000</u>
Amount Outstanding as on	1-1-2011	27,250
Add: Interest @ 5% for	Jan. to Dec. 2011	<u>1,363</u>
Amount Outstanding as on	31-12-2011	28,613
Less: Instalment paid on	31-12-2011	<u>10,000</u>
Amount Outstanding as on	1-1-2012	18,613
Add: Interest @ 5% for	Jan. to Dec. 2012	<u>931</u>
Amount Outstanding as on	31-12-2012	19,544
Less: Instalment paid on	31-12-2012	<u>10,000</u>
Amount Outstanding as on	1-1-2013	9,544
Add: Interest (Bal. Fig.)	Jan. to Dec. 2013	<u>456</u>
Amount Outstanding as on	31-12-2013	10,000
Less: Instalment paid on	31-12-2013	<u>10,000</u>
Amount Outstanding as on	31-12-2013	Nil

The above details can be presented in a more convenient manner in the following table:

4. Calculation of Interest (Table):

Particulars/Instrument No.	DP	1	2	3
(1) Opening Cash Price	37,250	27,250	18,613	9,544
(2) DP/Instalment Amount	10,000	10,000	10,000	10,000
(3) Interest @ 5% Amount	Nil	1,363	931	456
				(Bal. Fig.)
(4) Cash Price Paid (2-3)	10,000	8,637	9,069	9,544
(5) Closing Cash Price (1-4)	27,250	18,613	9,544	Nil

**Note:** DP means Down Payment. At the time of last instalment, interest is the balancing figure = Instalments Amount Less Opening Cash Price.

**Illustration 3: (When rate of interest is not given):** The Car Mart Company purchase a motor car from Autoriders Company on a hire purchase agreement on January 1, 2004 paying cash ₹ 10,000 and agreeing to pay further three instalments of ₹ 10,000 each on 31st December each year. The cash price of the car is ₹ 37,250. Compute the amount of yearly interest.

**Solution:** Since the rate of interest is not given, we proceed as follows:

1. **Compute Total Interest:**

$$\begin{aligned} \text{Total Interest} &= \text{Total Hire Purchase Price} - \text{Cash Price} = \text{Total Amount Payable} - \text{Cash Price} \\ &= (10,000 + (10,000 \times 3) - 37,250) = 40,000 - 37,250 = ₹ 2,750 \end{aligned}$$

## 2. Calculation of Interest per Instalment:

Spread Total Interest over Each Instalment in Ratio of Closing Hire Price Outstanding When Each Instalment is Due:

First, we fill up the details available in the following format:

Particulars	DP	1	2	3
(1) Opening Hire Price	40,000	30,000	20,000	10,000
(2) DP/Instalment Paid	10,000	10,000	10,000	10,000
(3) Interest	–	–	–	–
(4) Cash Price Paid (2 – 3)	10,000			
(5) Closing Hire Price (1 – 2)	30,000	20,000	10,000	Nil

From the above, we can ascertain the ratio of Closing Hire Price = 30,000 : 20,000 : 10,000 = 3 : 2 : 1. This ratio will be used to calculate the interest in respect of each instalment as shown below.

Particulars	DP	1	2	3
(1) Opening Hire Price				
(2) Instalment Paid	10,000	10,000	10,000	10,000
(3) Interest	–	$2,750 \times 3/6 = 1,375$	$2,750 \times 2/6 = 917$	$2,750 \times 1/6 = 458$
(4) Cash Price Paid (2 – 3)	10,000	8,625	9,083	9,542
(5) Closing Hire Price (1 – 2)				

In practice, both these formats are combined as shown below:

Particulars	DP	1	2	3
(1) Opening Hire Price	40,000	30,000	20,000	10,000
(2) DP/Instalment Paid	10,000	10,000		10,000
(3) Interest	–	$2,750 \times 3/6 = 1,375$	$2,750 \times 2/6 = 917$	$2,750 \times 1/6 = 458$
(4) Cash Price Paid (2 – 3)	10,000	8,625	9,083	9,542
(5) Closing Hire Price (1 – 2)	3,000	20,000	10,000	Nil

### Steps:

1. Fill up Row No. 1, 2, 5.
2. Work out ratio of closing hire price.
3. Apportion interest in this ratio in Row 3.
4. Fill-up Row No. 4 = Row 2 – Row 3.

**Calculation of Depreciation:** Under the hire purchase system, the asset is not owned by the hirer (hire purchaser). Nevertheless, depreciation is provided by the hire purchase on such assets since: (a) it is used for the business and (b) it is likely to be owned in near future on payment of the last instalment. Depreciation may be charged either under the straight line method or the written down method. It should be noted that depreciation is charged with reference to the cost of the asset, i.e., its cash price and not its hire purchase price.

**Illustration 4:** The Car Mart Company purchases a motor car from Autoriders Company on a hire purchase agreement on January 1, 2014, paying cash ₹ 10,000, and agreeing to pay further these instalments of ₹ 10,000 each on 31st December each year. The cash price of the car is ₹ 37,250 and the Authoriders Company charges interest at 5% p.a. The Car Mart Company writes off 10% p.a. as depreciation on the reducing instalment system. Compute the amount of yearly depreciation.

**Solution:**

**Calculation of Depreciation**

Particulars/Year	Year 1 2000	Year 2 2000	Year 3 2000
Opening W.D.V. (1-1)	37,250	33,525	30,172
Less: Depreciation @ 10% on Opening W.D.V.	3,725	3,353	3,017
= Closing W.D.V. (31-12)	33,525	30,172	27,155

**Accounting Methods:** How hire purchase transaction are recorded depends upon the frequency and value of such transaction. If the vendor is basically a hire purchase trader, dealing in many such transactions involving even small values, he will need to prepare a separate Hire Purchase Trading Account to ascertain his gross profits from hire purchase dealings. He will then follow the “Stock method”. However, if the vendor only sometimes enters into a hire purchase transaction by way of a special deal involving a substantial amount, he will follow the “Sale Method” to record his hire purchase transactions. Sales method is further divided into the following: (1) Full Cash Price Method (also known as Credit Purchase Method or Sales Method); (2) Actual Cash Price Method (also known as Assets Accrual Method); and (3) Interest Suspense Method. We will be studying only the Full Cash Price Method (Sale Method) as per syllabus.

**Full Cash Price Method [Credit Purchase Method or Sale Method]: Books of Hire Purchaser:** This method follows a practical approach and treats the hire purchaser as the owner of the asset right from the beginning. This method treats the “substance” of the HP agreement as more important than its “form”.

Under this method, in the books of the hire purchaser, the full cash price is debited to the asset account and credited to the vendor’s account at the time of signing the agreement or getting the possession of the goods itself. Thus, under this method, entries are made as if asset is purchased for full price on credit on the date of agreement itself. Thereafter, the interest on each instalment is debited to the Interest Account and credited to the Vendor’s Account. When the instalment is paid, Vendor’s Account is debited and Cash or Bank Account is credited with the amount paid. This method, if used by the hire purchaser, is also known as credit purchase method.

**Books of Hire Vendor:** Under this method, in the books of the hire vendor, the full cash price is debited to the hire purchaser’s account and credited to the HP Sales Account at the time of signing the agreement or handing over the possession of the goods, itself. Thereafter, the interest receivable at the time of each instalment is debited to the Hire Purchaser’s Account and credited to the Interest Earned Account. When the instalment amount is received, Cash or Bank Account is debited and Hire Purchaser’s Account is credited with the amount received. Since the asset given on hire purchase is treated as sold, there is no question of charging any depreciation. This method, if used by the hire vendor, is also known as sale method.

[This is broadly speaking, the method recommended by the Institute of Chartered Accountants of India (under Accounting Standard 19)]. The accounting entries for both the hire purchaser and the hire vendor are shown in the following worksheet.

**Full Cash Price Method:** This is the most practical method of accounting for Hire Purchase/ Instalment. It is not technically correct. However, it treats the hire purchaser as owner of the asset. Under this method, the asset is recorded at full cash price on the basis of substance over form. This method is most appropriate as the intention is to buy and sell the asset. The entries in the books of the hire purchaser and hire vendor are shown as given below:

## Accounting Entries at a Glance

Transactions	In the Books of the Purchaser	In the Books of the Vendor																				
On the date of agreement																						
1. For purchase	Asset A/c Dr. To Vendor's A/c <b>Note:</b> The entry should be passed by total cash price.	Buyer's A/c Dr. To Sales A/c <b>Note:</b> The entry should be passed by total cash price.																				
2. For down payment	Vendor's A/c Dr. To Cash A/c	Cash A/c Dr. To Buyer's A/c																				
3. For interest due	Interest A/c Dr. To Vendor's A/c	Buyer's A/c Dr. To Interest A/c																				
4. For payment of instalment	Vendor's A/c Dr. To Cash A/c	Cash A/c Dr. To Buyer's A/c																				
5. For depreciation	Depreciation A/c Dr. To Asset A/c	No Entry																				
6. For transfer of depreciation to Profit and Loss Account	Profit and Loss A/c Dr. To Depreciation A/c	No Entry																				
7. For transfer of interest to Profit and Loss Account	Profit and Loss A/c Dr. To Interest A/c	Interest A/c Dr. To Profit and Loss A/c																				
8. Disclosure in Balance Sheet	<b>Balance Sheet as on ....</b>	<b>Balance Sheet as on ....</b>																				
	<table border="0"> <tr> <td>Assets</td> <td>₹</td> </tr> <tr> <td><b>Fixed Assets:</b></td> <td></td> </tr> <tr> <td>Asset (Full Cash Price)</td> <td>xx</td> </tr> <tr> <td>Less: Dep.</td> <td>xx</td> </tr> <tr> <td></td> <td>xx</td> </tr> <tr> <td>Less: Balance in Hire Vendor's A/c</td> <td>xx</td> </tr> <tr> <td></td> <td><u>xx</u></td> </tr> </table>	Assets	₹	<b>Fixed Assets:</b>		Asset (Full Cash Price)	xx	Less: Dep.	xx		xx	Less: Balance in Hire Vendor's A/c	xx		<u>xx</u>	<table border="0"> <tr> <td>Assets</td> <td>₹</td> </tr> <tr> <td><b>Current Assets:</b></td> <td></td> </tr> <tr> <td>Hire Purchase Debtors</td> <td>xx</td> </tr> </table>	Assets	₹	<b>Current Assets:</b>		Hire Purchase Debtors	xx
Assets	₹																					
<b>Fixed Assets:</b>																						
Asset (Full Cash Price)	xx																					
Less: Dep.	xx																					
	xx																					
Less: Balance in Hire Vendor's A/c	xx																					
	<u>xx</u>																					
Assets	₹																					
<b>Current Assets:</b>																						
Hire Purchase Debtors	xx																					

**Note:** Repeat Entry Nos. 3, 4, 5, 6 and 7 in subsequent years.

**Illustration 5:** On 1.4.2011, Z purchased motor car from V. The cash price of the motor car was ₹ 2,50,000. Down payment of ₹ 1,00,000 was made on 1.4.2011 and the balance cash price was paid by instalments of ₹ 50,000 per year (starting from 31.3.2012) together with interest at 18 p.a. Z writes off depreciation on motor car at 20% p.a. under written down value method. He closes his books on 31st March every year. You are required to:

1. Prepare the table showing analysis of payments.
2. Prepare Motor Car A/c and V's A/c in the books of Z for the years 2011-2012, 2012-2013 and 2013-2014.

**Solution:****(i) Analysis of Payments**

1.4.2011	Cost of Motor Car	2,50,000
— “ —	Less: Down Payment	1,00,000
	Balance	1,50,000
31.3.2012	Add: Interest @ 18%	27,000
		1,77,000
— “ —	Less: 1st instalment (50,000 + 27,000)	77,000
— “ —	Balance	1,00,000
31.3.2013	Add: Interest @ 18%	18,000
		1,18,000
31.3.2013	Less: 2nd instalment (50,000 + 18,000)	68,000
— “ —	Balance	50,000
31.3.2014	Add: Interest @ 18%	9,000
		59,000
— “ —	Less: 3rd instalment	59,000
— “ —	Balance	<b>NIL</b>

**In the Books of Z**

Dr.		Motor Car Account		Cr.	
Date	Particulars	₹	Date	Particulars	₹
2011 Apr. 1	To V's A/c	2,50,000	2012 Mar. 31 Mar. 31	By Depreciation A/c By Balance c/d	50,000 2,00,000
		<b>2,50,000</b>			<b>2,50,000</b>
2012 Apr. 1	To Balance b/d	2,00,000	2013 Mar. 31 Mar. 31	By Depreciation A/c By Balance c/d	40,000 1,60,000
		<b>2,00,000</b>			<b>2,00,000</b>
2013 Apr. 1	To Balance b/d	1,60,000	2014 Mar. 31 Mar. 31	By Depreciation A/c By Balance c/d	32,000 1,28,000
		<b>1,60,000</b>			<b>1,60,000</b>

Dr.			V's Account		Cr.
Date	Particulars	₹	Date	Particulars	₹
2011 Apr. 1	To Bank A/c	1,00,000	2011 Apr. 1	By Motor Car A/c	2,50,000
2012 Mar. 31	To Bank A/c	77,000	2012 Mar. 31	By Interest A/c	2,77,000
Mar. 31	To Balance c/d	1,00,000			
		<b>2,77,000</b>			<b>2,77,000</b>
2013 Mar. 31	To Bank A/c	68,000	2013 Apr. 1	By Balance b/d	1,18,000
Mar. 31	To Balance c/d	50,000			
		<b>1,18,000</b>			<b>1,18,000</b>

**Illustration 6:** UFO Ltd. had purchased a machine on Hire Purchase System from HP Ltd. The terms are that UFO Ltd. would pay ₹ 40,000 as down payment on signing of the agreement and 4 annual instalments of ₹ 22,000 each commencing from the beginning of the next year. UFO Ltd. charged depreciation @ 20 p.a on cost under W.D.V. System. HP Ltd. charged interest @ 10% p.a. in their hire purchase contract.

Prepare Machinery Account and HP Ltd. Account for 5 years in the books of UFO Ltd.

(B.Com., MU Modified)

**Solution:**

In the books of UFO Ltd.

Calculation of Cash Price and Interest

Year	Balance at Beginning	Interest @ 10%	Total	Instalment Amount	Balance at the End (3 - 4)
1	6,9737	6,974	76,711	22,000	54,711
2	54,711	5,471	60,182	22,000	38,182
3	38,182	3,818	42,000	22,000	20,000
4	20,000	2,000	22,000	22,000	NIL
				<b>88,000</b>	

$$\begin{aligned}
 \text{Cash Price} &= \text{Down Payment} + \text{Balance at the Beginning} \\
 &= 40,000 + 69,737 \\
 &= 1,09,737
 \end{aligned}$$

Dr.			Machinery Account		Cr.	
Date	Particulars	₹	Date	Particulars	₹	
Year 1 Beginning	To HP Ltd. A/c	1,09,737	Year 1 End	By Depreciation A/c (20%)	21,947	
				By Balance c/d	87,790	
		<b>1,09,737</b>			<b>1,09,737</b>	
Year 2 Beginning	To Balance b/d	87,790	Year 2 End	By Depreciation A/c (20%)	17,558	
				By Balance c/d	70,232	
		<b>87,790</b>			<b>87,790</b>	
Year 3 Beginning	To Balance b/d	70,232	Year 3 End	By Depreciation A/c (20%)	14,046	
				By Balance c/d	56,186	
		<b>70,232</b>			<b>70,232</b>	
Year 4 Beginning	To Balance b/d	56,186	Year 4 End	By Depreciation A/c (20%)	11,237	
				By Balance c/d	44,949	
		<b>56,186</b>			<b>56,186</b>	
Year 5 Beginning	To Balance b/d	44,949	Year 5 End	By Depreciation A/c (20%)	8,990	
				By Balance c/d	35,959	
		<b>44,949</b>			<b>44,949</b>	

Dr.			HP Ltd. Account		Cr.	
Date	Particulars	₹	Date	Particulars	₹	
Year 1 Beginning	To Bank A/c	40,000	Year 1 Beginning	By Machinery A/c	1,09,737	
End	To Balance c/d	76,711	End	By Interest A/c	6,974	
		<b>1,16,711</b>			<b>1,16,711</b>	
Year 2 Beginning	To Bank A/c	22,000	Year 2 Beginning	By Balance b/d	76,711	
End	To Balance c/d	60,182	End	By Interest A/c	5,471	
		<b>82,182</b>			<b>82,182</b>	
Year 3 Beginning	To Bank A/c	22,000	Year 3 Beginning	By Balance b/d	60,182	
End	To Balance c/d	42,000	End	By Interest A/c	3,818	
		<b>64,000</b>			<b>64,000</b>	

Year 4			Year 4		
Beginning	To Bank A/c	22,000	Beginning	By Balance b/d	42,000
End	To Balance c/d	22,000	End	By Interest A/c	2,000
		<b>44,000</b>			<b>44,000</b>
Year 5			Year 5		
Beginning	To Bank A/c	22,000	Beginning	By Balance b/d	22,000
		<b>22,000</b>			<b>22,000</b>

**Illustration 7:** On 1st Jan. 2011, Amar purchased an Audio System on hire purchase system. The terms of contract were as under:

- The cash price of the Audio System was ₹ 1,30,000.
- ₹ 40,000 was to be paid on signing of the contract.
- The balance was to be paid in annual instalments of ₹ 30,000 each plus interest.
- Interest chargeable on the outstanding balance was 6% p.a.
- Depreciation @ 10% p.a. is to be written off on W.D.V. basis.

You are required to prepare for 3 years:

- A statement showing calculation of interest
- Audio System's A/c
- Depreciation A/c
- Vendor Company's A/c

(B.Com., PU Modified)

**Solution:**

**In the Books of Amar  
Calculation of Interest**

Date	Particulars	₹
1.1.11	Cost	1,30,000
1.1.11	Less: Down payment	40,000
1.1.11	Balance	90,000
31.12.11	Add: Interest @ 6%	5,400
		95,400
31.12.11	Less: 1st instalment (30,000 + 5,400)	35,400
31.12.11	Balance	60,000
31.12.12	Add: Interest @ 6%	3,600
		63,600
31.12.12	Less: 2nd instalment (30,000 + 3,600)	33,600
31.12.12	Balance	30,000
31.12.12	Add: Interest @ 6%	1,800
		31,800
31.12.13	Less: Final instalment	31,800
31.12.13	Balance	<b>NIL</b>

Dr.			Audio System's Account		Cr.	
Date	Particulars	₹	Date	Particulars	₹	
2011 Jan. 1	To Vendor Company's A/c	1,30,000	2011 Dec. 31	By Depreciation A/c	13,000	
		<b>1,30,000</b>	Dec. 31	By Balance c/d	1,17,000	
					<b>1,30,000</b>	
2012 Jan. 1	To Balance b/d	1,17,000	2012 Dec. 31	By Depreciation A/c	11,700	
		<b>1,17,000</b>	Dec. 31	By Balance c/d	1,05,300	
					<b>1,17,000</b>	
2013 Jan. 1	To Balanc b/d	1,05,300	2013 Dec. 31	By Depreciation A/c	10,530	
		<b>1,05,300</b>	Dec. 31	By Balance c/d	94,770	
					<b>1,05,300</b>	

Dr.			Depreciation Account		Cr.	
Date	Particulars	₹	Date	Particulars	₹	
2011 Dec. 31	To Audio System's A/c	13,000	2011 Dec. 31	By P & L A/c	13,000	
		<b>13,000</b>			<b>13,000</b>	
2012 Dec. 31	To Audio System's A/c	11,700	2012 Dec. 31	By P & L A/c	11,700	
		<b>11,700</b>			<b>11,700</b>	
2013 Dec. 31	To Audio System's A/c	10,530	2013 Dec. 31	By P & L A/c	10,530	
		<b>10,530</b>			<b>10,530</b>	

Dr.			Vendor Company's Account		Cr.	
Date	Particulars	₹	Date	Particulars	₹	
2011 Jan. 1	To Bank A/c	40,000	2011 Jan. 1	By Audio System's A/c	1,30,000	
Dec. 31	To Bank A/c	35,400	Dec. 31	By Interest A/c	5,400	
Dec. 31	To Balance c/d	60,000				
		<b>1,35,400</b>			<b>1,35,400</b>	
2012 Dec. 31	To Bank A/c	33,600	2012 Jan. 1	By Balance b/d	60,000	
Dec. 31	To Balance c/d	30,000	Dec. 31	By Interest A/c	3,600	
		<b>63,600</b>			<b>63,600</b>	
2013 Dec. 31	To Bank A/c	31,800	2013 Jan. 1	By Balance b/d	30,000	
		<b>31,800</b>	Dec. 31	By Interest A/c	1,800	
					<b>31,800</b>	

**Illustration 8:** On 1st January, 2010, Raja delivered to Kishore a machine on hire purchase basis, ₹ 50,000 was paid on delivery and the balance in five instalments of ₹ 50,000 each payable on 31st December every year. The cash price of the machine was ₹ 3,00,000. Show the Machinery account and Raja's A/c in the books of Kishore assuming that he closes his books on 31st December every year and the rate of depreciation 20% p.a. on W.D.V. and rate of interest is 5% p.a. Instalment is excluding interest. Use Credit Purchase Method. *(CS Modified)*

**Solution:****In the Books of Kishore**

Dr.			Cr.		
Machinery A/c					
Date	Particulars	₹	Date	Particulars	₹
2010 Jan. 1	To Raja's A/c	3,00,000	2010 Dec. 31	By Depreciation A/c	60,000
			Dec. 31	By Balance c/d	2,40,000
		<b>3,00,000</b>			<b>3,00,000</b>
2011 Jan. 1	To Balance b/d	2,40,000	2011 Dec. 31	By Depreciation A/c	48,000
			Dec. 31	By Balance c/d	1,92,000
		<b>2,40,000</b>			<b>2,40,000</b>
2012 Jan. 1	To Balance b/d	1,92,000	2012 Dec. 31	By Depreciation A/c	38,400
			Dec. 31	By Balance c/d	1,53,600
		<b>1,92,000</b>			<b>1,92,000</b>
2013 Jan. 1	To Balance b/d	1,53,600	2013 Dec. 31	By Depreciation A/c	30,720
			Dec. 31	By Balance c/d	1,22,880
		<b>1,53,600</b>			<b>1,53,600</b>
2014 Jan. 1	To Balance b/d	1,22,880	2014 Dec. 31	By Depreciation A/c	24,576
			Dec. 31	By Balance c/d	98,304
		<b>1,22,880</b>			<b>1,22,880</b>

Dr.			Cr.		
Raja's A/c					
Date	Particulars	₹	Date	Particulars	₹
2010 Jan. 1	To Bank A/c	50,000	2010 Jan. 1	By Machinery A/c	3,00,000
Dec. 31	To Bank A/c	62,500	Dec. 31	By Interest A/c	12,500
Dec. 31	To Balance c/d	2,00,000			
		<b>3,12,500</b>			<b>3,12,500</b>
2011 Dec. 31	To Bank A/c	60,000	2011 Jan. 1	By Balance b/d	2,00,00
Dec. 31	To Balance c/d	1,50,000	Dec. 31	By Interest A/c	10,000
		<b>2,10,000</b>			<b>2,10,000</b>

2012 Dec. 31	To Bank A/c	57,500	2012 Jan. 1	By Balance b/d	1,50,000
Dec. 31	To Balance c/d	1,00,000	Dec. 31	By Interest A/c	7,500
		<b>1,57,500</b>			<b>1,57,500</b>
2013 Dec. 31	To Bank A/c	55,000	2013 Jan. 1	By Balance b/d	1,00,000
		50,000	Dec. 31	By Interest A/c	5,000
		<b>1,05,000</b>			<b>1,05,000</b>
2014 Dec. 31	To Bank A/c	52,500	2014 Jan. 1	By Balance b/d	50,000
		<b>52,500</b>	Dec. 31	By Interest A/c	2,500
					<b>52,500</b>

**Illustration 9:** 'B' Ltd. purchased a machinery on instalment system from 'A' Ltd. The cash down price for the machinery was ₹ 80,000. The price was to be paid as ₹ 25,536 down payment and the balance in 3 equal annual instalments of ₹ 20,000 each commencing from the end of the first year at 5% interest per annum. Show the (a) Machinery A/c, (b) 'A' Ltd. A/c and (c) Interest A/c in the books of 'B' Ltd. assuming that the depreciation is charged at 10% p.a. on reducing balance method.

(B.Com., PU Modified)

**Solution:**

**In the Books of B Ltd.**

Dr.			(a) Machinery A/c			Cr.		
Year	Particulars	₹	Year	Particulars	₹			
1st yr.	To A Ltd. A/c	25,536	1st yr.	By Depreciation A/c	8,000			
	To B Ltd. A/c	20,000	End	By Balance c/d	37,536			
		<b>45,536</b>			<b>45,536</b>			
2nd yr.	To Balance b/d	37,536	2nd yr.	By Depreciation A/c	7,200			
	To A Ltd. A/c	20,000		By Balance c/d	50,336			
		<b>57,536</b>			<b>57,536</b>			
3rd yr.	To Balance b/d	50,336	3rd yr.	By Depreciation A/c	6,480			
	To A Ltd. A/c	20,000		By Balance c/d	63,856			
		<b>70,336</b>			<b>70,336</b>			

**(b) A Ltd. A/c**

Year	Particulars	₹	Year	Particulars	₹
1st yr.	To Cash A/c	25,536	1st yr.	By Machinery A/c	25,536
	To Cash A/c	22,723		By Machinery A/c	20,000
		<b>48,259</b>		By Interest A/c	2,723
2nd yr.	To Cash A/c	21,723	2nd yr.	By Machinery A/c	20,000
		<b>21,723</b>		By Interest A/c	1,723
					<b>21,723</b>

3rd yr.	To Cash A/c	20,723	3rd yr.	By Machinery A/c	20,000
				By Interest A/c	723
		<b>20,723</b>			<b>20,723</b>

## (c) Interest A/c

Year	Particulars	₹	Year	Particulars	₹
1st yr.	To A Ltd. A/c	2,723	1st yr.	By P & L A/c	2,723
		2,723			2,723
2nd yr.	To A Ltd. A/c	1,859	2nd yr.	By P & L A/c	1,859
		1,859			1,859
3rd yr.	To A Ltd. A/c	954	3rd yr.	By P & L A/c	954
		954			954

**Working Note:****Calculation of Interest**

Year	Down	I	II	III
Opening Cash Price	80,000	54,464	37,187	19,046
Instalment Down Payment Amount	25,536	20,000	20,000	20,000
Interest	–	2,723	1,859	954
Cash Price Paid (2 – 3)	25,536	17,277	18,141	19,046
Closing Cash Balance (1 – 4)	54,464	37,187	19,046	NIL

**SAQ 1:** M/s NDC purchased two machines of ₹ 10,500 each on hire purchase system. The payment was to be made ₹ 6,000 cash down and the remainder in three equal instalments of ₹ 5,000 each, together with interest at 5% p.a. NDC charge depreciation at 10% p.a. on written down value. Show the necessary accounts in the books of NDC.

(Ans.: Interest: 750, 500; Depreciation: 2100 and 1701)

**SAQ 2:** MTC purchased two taxis on hire purchase terms. The cash price was ₹ 87,092. Payments were to be made as under:

on 1-1-2002 ₹ 20,000 (down payment)

on 31-12-2002 ₹ 30,000

on 31-12-2003 ₹ 30,000

on 31-12-2003 ₹ 20,000

Interest was reckoned at 10% per annum. Depreciation was charged at 20% p.a. Prepare the necessary accounts in the books of MTC.

(Ans.: Interest: 6710, 4380 and 1818)

**SAQ 3:** ABC Co. took delivery of a van on hire purchase on 1st April, 2001, payments to be made by three equal instalments of ₹ 6,000 each, on 31st March, 2002, 2003 and 2004. The cash price was ₹ 16,340. The vendors charge interest @ 5% p.a. You are required to show in the books of ABC Co.: (1) Calculation of interest, (2) Delivery Van Account and (3) Vendor's Account.

(Ans.: Interest: 817, 558 and 285; Depreciation: 4000, 3068 and 2301)

**SAQ 4:** V purchased a car from H Ltd. on 1st January, 2000 on hire purchase system. The payment inclusive of interest is to be made as follows: ₹ 4,000 on delivery, ₹ 7,600 at the end of first year, ₹ 6,000 at the end of second year and ₹ 5,500 at the end of third year. The cash price was ₹ 20,000. Interest is charged @ 10% p.a. V closes his books on 31st December every year, by charging depreciation @ 15% p.a. on diminishing balance method. You are required to open the necessary ledger accounts in the books of V.

(Ans.: Interest: 1600, 500 and 3100; Depreciation: 3000, 2550 and 2160)

**SAQ 5:** 'P' Company purchased a machine on 1-1-2004 on Hire purchase system. The necessary details are given below:

	₹
1. Cash price	60,000
2. Amount paid on signing the agreement	20,000
3. First annual instalment	18,000
4. Second annual instalment	16,000
5. Last annual instalment	13,860
6. Rate of interest 10% p.a.	
7. Depreciation at 20% on cash price of machine by reducing instalment method is charged.	

Draft journal entries in the books of P Company.

(Ans.: Interest: 4,000, 2,600 and 1,260; Depreciation: 12,000, 9,600 and 7,680)

**SAQ 6:** Mr. A purchased a machine from Mr. B on 1-1-2003. Details regarding the contract were as under:

1. Cash price of the machine ₹ 22,000.
2. Amount paid on signing the contract ₹ 7,000.
3. Yearly instalments paid on December 31st first instalment ₹ 6,500, second instalment ₹ 6,000 and last instalment ₹ 5,500.
4. Depreciation is to be charged at 10% p.a. written down value.
5. Rate of interest payable 10% p.a.

(Ans.: Interest: 1,500, 1,000 and 500; Depreciation: 2,200, 1,980 and 1782)

**Steps:**

1. Prepare a table showing year, cash price, principal, interest and instalments columns as given below.

Year	Cash Price at the Beginning	Principal	Interest	Instalment	Closing Cash Price	Depreciation
1	2	3	4	5	6	7

2. Write total cash price against 1st year in Column No. 2.
3. Deduct down payment from total cash price and write it in principal column and instalment column.
4. Calculate amount outstanding at the beginning of the year.
5. Calculate interest on the outstanding cash price and enter it in interest column.
6. Deduct interest from instalment and write it in principal column.
7. Calculate cash price outstanding at the end of the year and carry forward it for next year (Column Nos. 2 – 3).  
Repeat Step Nos. 5, 6 and 7.

**EXERCISES****A. Short Answer Questions**

1. What is Hire Purchase Sale?
2. What is Instalment Sale?
3. What is HP Price?
4. What is Cash Price?
5. What is an instalment?
6. Who is Hire Vendor?
7. Who is Hire buyer?
8. What is Down Payment?
9. When ownership is transferred to buyer under HP sale?
10. What is the basis of charging depreciation?
11. What is hire?
12. When possession is transferred to buyer under HP system?
13. Which method is followed to account for HP transactions?
14. What is the basis of distribution of total interest over the instalments when interest rate is not given?

**B. Long Answer Questions**

1. What do you mean by HP System? How does it differ from Instalment System?
2. What entries are passed by the Hire Purchaser under the HP System?
3. What are the different methods of accounting HP and Instalment sale transactions?



**2. State whether the following statements are True or False:**

- (i) Initial payment made by hire purchase is termed as down payment.
- (ii) Instalment including interest paid to vendor is known as cash price.
- (iii) Interest is calculated on closing price of hire purchase for every year.
- (iv) Sale price excluding interest portion is termed as cash price.
- (v) Hire purchase price is equal to cash price.
- (vi) Hire purchase price is the purchase price payable if full payment is made immediately.
- (vii) Down payment means the total amount payable by the hirer.
- (viii) Cash price is the initial amount payable at the time of signing the agreement.
- (ix) As soon as full payment is made, the hirer gets possession of the article and can start using it immediately.
- (x) Down Payment is made up of part payment towards interest.
- (xi) Under the hire purchase system, depreciation is provided by the hire vendor.
- (xii) Under the hire purchase system, depreciation is provided by the hire purchaser on hire purchase price.
- (xiii) Full Cash Price method is also known as Asset Accrual Method.
- (xiv) Actual Cash Price method is known as Interest Suspense Method.
- (xv) Under the hire purchase system, depreciation is provided on hire purchase price.
- (xvi) Under the hire purchase system, depreciation is provided by hire vendor till full price is paid.
- (xvii) A hire purchase trader, desiring to prepare a separate Hire Purchase Trading Account will follow sales method.
- (xviii) Asset Accrual Method is also known as Credit Purchase Method.
- (xix) Actual Cash Price Method is also known as Credit Purchase Method.
- (xx) The hire purchaser has the right to terminate the agreement at any time before the property passes.
- (xxi) Though the instalments of a hire purchase agreement may be equal, the interest element in each instalment is not the same.
- (xxii) If the amount of each instalment is equal, the total interest can be allocated to different instalments by the fixed instalment method.
- (xxiii) When assets are acquired under hire purchase system, depreciation need not be provided as the vendor still continues to be the legal owner of such assets.
- (xxiv) Under hire purchase system, the asset account is not debited with the instalment paid but only with the principal amount included therein.
- (xxv) Under hire purchase, the buyer has the option to return the goods.
- (xxvi) Hire vendor should provide for depreciation in his books as he continues to be the legal owner of such goods.
- (xxvii) Hire purchase price is equal to cash price.
- (xxviii) In a hire purchase transaction, hire vendor pays interest to hirer.
- (xxix) Hire purchase transactions have to be for a minimum duration of five years.
- (xxx) Generally, small items like stationery are not sold on hire purchase basis.

**(Ans:** (i) True, (ii) False, (iii) False, (iv) True, (v) False, (vi) False, (vii) False, (viii) False, (ix) False, (x) False, (xi) False, (xii) False, (xiii) False, (xiv) False, (xv) False, (xvi) False, (xvii) False, (xviii) False, (xix) False, (xx) True, (xxi) True, (xxii) False, (xxiii) False, (xxiv) True, (xxv) True, (xxvi) False, (xxvii) False, (xxviii) False, (xxix) False, (xxx) True.)

**3. Match the Columns:****(A) Group A**

- (i) Down payment
- (ii) Interest
- (iii) Last Instalment
- (iv) Depreciation on hire purchase asset

**(Ans:** (i) — (b), (ii) — (a), (iii) — (d), (iv) — (c).)**(B) Group A**

- (i) Purchase price payable if full payment is made immediately
- (ii) Cash price of the article and interest
- (iii) Initial amount payable at the time of signing the HP agreement
- (iv) Part payment towards cash price plus interest

**(Ans:** (i) — (b), (ii) — (d), (iii) — (a), (iv) — (e).)**(C) Group A**

- (i) Depreciation
- (ii) A hire purchase trader
- (iii) Actual cash price method
- (iv) Full cash price method

**(Ans:** (i) — (c), (ii) — (f), (iii) — (e), (iv) — (a).)**Group B**

- (a) On opening balance
- (b) Initial payment
- (c) Calculated on cash price
- (d) Cash price – Interest

**Group B**

- (a) Down payment
- (b) Cash price
- (c) List price
- (d) Hire purchase price
- (e) Each HP instalment amount

**Group B**

- (a) Credit Purchase Method
- (b) Provided by the hire vendor, on cash price
- (c) Provided by the hire purchaser, on cash
- (d) Provided by the hire purchaser, on hire purchase price
- (e) Asset Accrual Method
- (f) Stock Method

**4. Multiple Choice Questions:**

- (i) Hire purchase comprise of hire purchaser and \_\_\_\_\_.
  - (a) Vendor
  - (b) Two parties
  - (c) Lawyer
  - (d) Goods
- (ii) Interest is equal to total price – \_\_\_\_\_.
  - (a) Instalment
  - (b) Cash price
  - (c) Opening balance
  - (d) Closing balance
- (iii) Last year interest amount = Instalment — \_\_\_\_\_.
  - (a) Closing price
  - (b) Cash price
  - (c) Opening price
  - (d) Total price
- (iv) For down payment, \_\_\_\_\_ A/c is debited in the books of hire purchaser.
  - (a) Asset
  - (b) Cash
  - (c) Depreciation
  - (d) Vendor

- (v) For depreciation, \_\_\_\_\_ A/c is credited.
- (a) Vendor (b) Asset  
(c) Cash (d) Interest
- (vi) ' \_\_\_\_\_ ' is the purchase price payable if full payment is made immediately.
- (a) Market Price (b) Cash Price  
(c) Hire Purchase Price (d) Down payment
- (vii) Hire Purchase Price means the total amount payable by the hirer, made up of \_\_\_\_\_.
- (a) The cash price of the article and interest  
(b) The cash price of the article less interest  
(c) The cash price of the article and the down payment  
(d) The instalments and the interest
- (viii) Total instalments in which the balance amount is payable is equal to the \_\_\_\_\_.
- (a) The cash price of the article and interest  
(b) Hire purchase price and down payment  
(c) Hire purchase price less down payment  
(d) Hire purchase price less interest
- (ix) The initial amount payable at the time of signing the hire purchase agreement is
- (a) The cash price (b) The down payment  
(c) The hire purchase price (d) The interest
- (x) As soon as the \_\_\_\_\_ payment is made, the hirer gets possession of the article and can start using it immediately.
- (a) Down (b) Full  
(c) Cash (d) Last
- (xi) Each HP instalment amount is made up of \_\_\_\_\_.
- (a) Part payment towards cash price only  
(b) Part payment towards interest only  
(c) Part payment towards cash price plus interest  
(d) None of the above
- (xii-xv). Answer Q. xii-xv on the basis of the following:**
- The purchase price of a motor car purchased by Car Mart Co. on hire purchase from Autoriders Company is ₹ 37,250. It is available on hire purchase on the following terms: (a) Initial amount payable is ₹ 10,000. (b) Total amount of interest @ 5% p.a. comes to ₹ 2,750. (c) Balance amount is payable in three instalments of ₹ 10,000 each.
- (xii) The hire purchaser or hirer is \_\_\_\_\_.
- (a) Autoriders Company (b) The Car Mart Co.  
(c) Either (a) or (b) (d) Neither (a) nor (b)
- (xiii) The hire vendor or vendor is \_\_\_\_\_.
- (a) Autoriders Company (b) The Car Mart Co.  
(c) Either (a) or (b) (d) Neither (a) nor (b)

- (xiv) The cash price is \_\_\_\_\_.
- (a) ₹ 40,000 (b) ₹ 10,000  
(c) ₹ 37,250 (d) ₹ 30,000
- (xv) Hire purchase price is \_\_\_\_\_.
- (a) ₹ 40,000 (b) ₹ 10,000  
(c) ₹ 37,250 (d) ₹ 30,000
- (xvi) Down payment is \_\_\_\_\_.
- (a) ₹ 40,000 (b) ₹ 10,000  
(c) ₹ 37,250 (d) ₹ 30,000
- (xvii) Interest included in 1st instalment is \_\_\_\_\_.
- (a) ₹ 916 (b) ₹ 1,863  
(c) ₹ 1,363 (d) ₹ 2,750
- (xviii) Under the hire purchase system, depreciation is provided \_\_\_\_\_.
- (a) By the hire purchaser, on hire purchase price  
(b) By the hire vendor, on hire purchase price  
(c) By the hire purchaser, on cash price  
(d) By the hire vendor, on cash price
- (xix) A hire purchase trader, desiring to prepare a separate hire purchase trading account will follow: \_\_\_\_\_.
- (a) Sales method (b) Full cash price method  
(c) Stock method (d) Asset accrual method
- (xx) Under this method, entries are made as if asset is purchased for full price on credit on the date of HP agreement itself.
- (a) Actual cash price method (b) Full cash price method  
(c) Asset accrual method (d) None of the above
- (xxi) Each instalment including down payment (if any) is treated as hire charges by the \_\_\_\_\_.
- (a) Buyer (b) Seller  
(c) None of these
- (xxii) The hire purchaser can record the asset under full cash price method at its \_\_\_\_\_.
- (a) Hire purchase price (b) Cash price  
(c) None of these
- (xxiii) Interest in a hire purchase transaction is charged on the cash price \_\_\_\_\_.
- (a) Outstanding (b) Full cash price  
(c) None of these
- (xxiv) Under hire purchase system, buyer becomes the owner of goods: \_\_\_\_\_.
- (a) immediately after the receipt of goods  
(b) immediately after the down payment  
(c) immediately after the payment of last instalment

- (xxv) For each period, interest is to be calculated on the balance of \_\_\_\_\_.
- (a) cash price remaining unpaid  
(b) instalment price remaining unpaid  
(c) cash price minus the instalment paid
- (xxvi) Under hire purchase agreement, the buyer agrees to pay \_\_\_\_\_.
- (a) cash price only (b) interest only  
(c) cash price and interest
- (xxvii) The last instalment paid under hire purchase comprises \_\_\_\_\_.
- (a) cash price only (b) interest only  
(c) cash price and interest

(Ans: (i) (a), (ii) (b), (iii) (c), (iv) (d), (v) (b), (vi) (b), (vii) (a), (viii) (c), (ix) (b), (x) (a), (xi) (c), (xii) (b), (xiii) (a), (xiv) (c), (xv) (a), (xvi) (b), (xvii) (c), (xviii) (c), (xix) (c), (xx) (b), (xxi) (b), (xxii) (b), (xxiii) (a), (xxiv) (c), (xxv) (a), (xxvi) (c), (xxvii) (c).)

## Practical Problems

### (Instalment Including Interest)

1. Sunil Manufacturing Company purchased Machinery from Jai Hind Agency on 1st January, 2011 on Hire Purchase System by paying ₹ 12,000 on delivery and the balance in four instalments payable at the end of each year including interest at 10% p.a. (a) ₹ 25,600; (b) ₹ 19,600; (c) ₹ 14,000 and (d) ₹ 8,800. The cash price of the machine was ₹ 68,000.

Sunil Manufacturing Company charged depreciation at 10% p.a. on Diminishing Balance System.

Give Machinery Account, Jai Hind Agency's Account in the books of Sunil Manufacturing Co. Show also Sunil Manufacturing Company's Account in the Books of Jai Hind Agency.

(Ans.: Interest: for 2011 – ₹ 5,600, for 2012 – ₹ 3,600, for 2013 – ₹ 2,000 and for 2014 – ₹ 800)

2. The BPCL Ltd. purchased from the HPCL Ltd. four machines on Instalment System. The payment arrangement was agreed upon as follows:

Date of Payment	Amount (₹)	No. of Instalments
01.01.2011	25,000	Down Payment
31.12.2012	25,500	First Instalment
31.12.2013	23,500	Second Instalment
31.12.2014	16,500	Final Instalment

The Vendor charged interest @ 10% p.a. Cash price was ₹ 80,000.

You are required to prepare ledger accounts in the books of HPCL Ltd.

(B.Com., PU Modified)

### (Half-yearly Instalments Plus Interest)

3. Ashoka Hotel agreed to purchase BPL TV Set on Hire Purchase System for ₹ 13,800. ₹ 4,200 were paid when TV Set was acquired on 1st July, 2011; and the balance was to be paid by half-yearly instalments of ₹ 2,400 plus interest of 5% p.a. Depreciation charged by Ashoka Hotel is 10% p.a. on Diminishing Balance Method. Accounts are closed on 30th June each year.

Prepare TV Set Account and Hire Vendor Account to record the above transactions in the books of purchaser.

(B.Com., MU Modified)

(Ans.: Interest: On 31st December, 2011 – ₹ 240; On 30th June, 2012 – ₹ 180; On 31st December, 2013 – ₹ 120; On 30th June, 2014 – ₹ 60)

4. On 1st January, 2010, Rakesh delivered to Sharda a machine on Hire Purchase System. ₹ 5,000 being paid on delivery and the balance is 5 instalments of ₹ 5,000 each, payable on 31st December year. The cash price of the machine was ₹ 25,000.

Rate of Interest = ?

Show the necessary ledger accounts in the books of both assuming that they close their books on 31st December every year.

(CS Modified)

(Ans.: Interest: 2010 – ₹ 1,667; 2011 – ₹ 1,333; 2012 – ₹ 1,000; 2013 – ₹ 667; 2014 – ₹ 333.)

### Working Note:

#### Calculation of Interest

Total amount of interest for 5 years

$$= ₹ 5,000 [(\₹ 5,000 + 5 \times ₹ 5,000) - ₹ 25,000]$$

Year	Opening Balance Due ₹	Instalment ₹	Closing Balance Due ₹	Rates ₹	Amount of Interest ₹
2010	30,000	5,000	25,000	5	$5000 \times \frac{5}{15} = 1,667$
2011	25,000	5,000	20,000	4	$5,000 \times \frac{4}{15} = 1,333$
2012	20,000	5,000	15,000	3	$5,000 \times \frac{3}{15} = 1,000$
2013	15,000	5,000	10,000	2	$5,000 \times \frac{2}{15} = 667$
2014	10,000	5,000	5,000	1	$5,000 \times \frac{1}{15} = 333$
				<b>15</b>	<b>5,000</b>

5. Cash price ₹ 79,250. Down payment ₹ 20%.

Remaining amount in four equal instalments with 10% interest.

(Ans.: Interest: 1st year ₹ 6,340; 2nd year ₹ 4,755; 3rd year ₹ 3,170; 4th year ₹ 1,585)

### (When Half-yearly Instalments are Given)

6. Sri Rajendra acquired a Motor Car from Tata Ltd. on 1st January, 2013.

The Cash price of the Motor Car was ₹ 18,870. He agreed to pay ₹ 4,000 on delivery of the Car to him and the balance in 4 half-yearly instalments of ₹ 4,000 each commencing with 30th June, 2013. The Motor Hirers Ltd. charges interest at 6% p.a. with half-yearly rest.

Sri Rajendra prepared his accounts annually on 31st December and writes off depreciation on Motor Car at 20%.

You are required to show: (a) Tata Ltd. Account and (b) Motor Car Account for the year ended 31st December, 2013-2014. *(CA Modified)*

(Ans.: Interest 30.6.2013 – ₹ 446; 31.12.2013 – ₹ 339; 30.6.2014 – ₹ 230; 31.12.2014 – ₹ 115)

## Analysis of Payment

Year	Opening	Principal Balance of Cash Price	Interest	Instalment	Closing Balance of Cash Price
₹	₹	₹	₹	₹	₹
1.1.2013	18,870	4,000	–	–	14,870
30.6.2013	14,870	3,554	446	4,000	11,316
31.12.2013	11,316	3,661	339	4,000	7,655
30.6.2014	7,655	3,770	230	4,000	3,885
31.12.2014	3,885	3,885	115	4,000	
			(Bal. Fig.)		

7. Veera Transport Ltd. purchased a truck on 1st January, 2013, on hire purchase basis from Matadors Ltd. The cash down price of the truck was ₹ 30,000. Under the agreement, a sum of ₹ 12,000 was payable initially on 1st January, 2013, and the balance in 12 quarterly instalments of ₹ 1,920 each failing due from 1st April, 2013. The financial year of the Transport Ltd. ended on 30th June. On 30th September, 2014, the truck was sold for ₹ 20,000 and the amount due to Matador Ltd. was settled for ₹ 10,200.

Transport Ltd. opened the Truck Account at cash down price and spread the interest over the period of hire purchase payments proportionately. Depreciation was provided at 20% on cost.

Show the necessary ledger accounts in the books of Transport Ltd.

*(CIMA Modified)*

[Hint: Spread the interest over the period of hire purchase payments proportionately. That means, the total interest should be spread over 12 instalments in the ratio of hire purchase price outstanding at the beginning of each instalments. Accordingly, the total interest of ₹ 5,040 should be spread over the 12 instalments in the ratio of:

23,040 : 21,120 : 19,200 : 17,280 : 15,360 : 13,440 : 11,520 : 9,600 : 7,680 : 5,760 : 3,840 : 1,920  
or 12 : 11 : 10 : 9 : 8 : 7 : 6 : 5 : 4 : 3 : 2 : 1]

So, the interests for the various instalments will be:

$$\text{1st Instalment: } 5,040 \times \frac{12}{78} = ₹ 775$$

$$\text{2nd Instalment: } 5,040 \times \frac{11}{78} = ₹ 711$$

$$\text{3rd Instalment: } 5,040 \times \frac{10}{78} = ₹ 646$$

$$\text{4th Instalment: } 5,040 \times \frac{9}{78} = ₹ 582$$

$$\text{5th Instalment: } 5,040 \times \frac{8}{78} = ₹ 517$$

$$\text{6th Instalment: } 5,040 \times \frac{7}{78} = ₹ 452$$

$$\text{7th Instalment: } 5,040 \times \frac{6}{78} = ₹ 388$$

**(When Cash Price is Given)**

8. The Madras Trading Company purchased Motor Car from the Bombay Motor Co. on a Hire Purchase agreement on 1st January, 2012, paying cash ₹ 10,000 and agreeing to pay further three instalments of ₹ 10,000 each on 31st December each year. The cash price of the car is ₹ 37,250 and the Bombay Motor Company charges interest at 5% p.a. The Madras Trading Company writes off 10% p.a. as depreciation on the Reducing Instalment System. Journalise these transactions in the books of both the parties.

(Ans.: Interest: 2012 – ₹ 1,363; 2013 – ₹ 931; 2014 – ₹ 456)

9. Reliance Textiles Ltd. purchased Motor Lorries on Hire Purchase System, over a period of four years, ₹ 12,000 was payable on delivery on 1st January, 2011; and the balance by 4 annual instalments of ₹ 12,000 each on 31st December. Motor Ltd. who sold the lorries charged 5% p.a. interest on the yearly balances. The cash value of the lorries on delivery was ₹ 54,551. Depreciation @ 25% on diminishing balance was written off in each year. Show Journal Entries in the books of Reliance Textiles Ltd.

(Ans.: Interest: 2011 – ₹ 2,128; 2012 – ₹ 1,634; 2013 – ₹ 1,116; 2014 – ₹ 571)

**(Rate of Interest Not Given)**

10. Doshi Roadways purchased two trucks from Tata Ltd. on hire purchase system on 1st January, 2010. The cash price of each truck was ₹ 1,25,000. Payment was made as follows:

31.12.2010 ₹ 35,000 per truck

1.1.2013 ₹ 30,000 per truck

31.12.2013 ₹ 45,000 per truck

31.12.2014 ₹ 40,000 per truck

Depreciation at 20% per annum on original cost is charged.

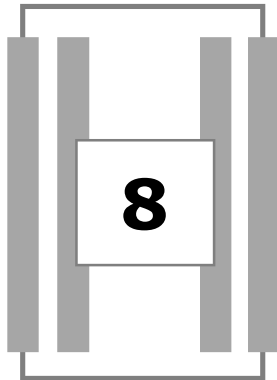
You are required to calculate interest per year; and show the necessary accounts in the books of Doshi Roadways. **(B.Com., MU Modified)**

(Ans.: Interest: ₹ 24,000; ₹ 17,000; ₹ 9,000. Depreciation per year ₹ 50,000)

[Hint: Total interest ₹ 50,000 to be spread over three years in the ratio of outstanding hire purchase price which is ₹ 3,00,000. Outstanding amounts are ₹ 2,40,000; ₹ 1,70,000; ₹ 90,000. Ratio 24 : 17 : 9.]

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## Chapter



# Final Accounts

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### **Final Accounts of Manufacturing Concerns (Proprietary Firms) along with Adjustments and Closing Entries:**

**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 are 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, 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 Materials 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 materials 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, e.g., 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 realised 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 pro forma of manufacturing account is given below:

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

Particulars	(₹)	Particulars	(₹)
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 to Trading A/c (bal. fig.)	xxx
Add: Purchases	xxx		
Less: 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 summarised 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 pro forma of a trading account is given below:

**Trading Account for the year ended.....**

Particulars	(₹)	Particulars	(₹)
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 (transfd. to Profit & Loss A/c)	xxx
To Gross Profit c/d (transfd. 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 .....**

Particulars	(₹)	Particulars	(₹)
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		
To Depreciation and Maintenance:	xx		
Depreciation	xx		
Repairs & maintenance	xx		
To Extraordinary expenses:			
Loss by fire (no covers by insurance)	xx		
Cash defalcations	xx		
To Net Profit transferred to Capital A/c	xx		

**Items Appearing on Debit Side of Profit & Loss A/c:** The business expenses are divided into two types. Direct expenses which are recorded in the Trading A/c and indirect expenses which are recorded in the debit side of Profit & Loss A/c. Indirect expenses can be further divided into two types:

- (i) **Operating Expenses:** It refers to those expenses which are incurred in order to operate the business efficiently and smoothly. These include administration, selling, distribution, finance and maintenance expenses.
- (ii) **Non-operating Expenses:** These expenses are not related to the operation of the business and include capital losses as loss on the sale of furniture, etc., writing off fictitious assets as preliminary expenses, underwriting commission, etc., writing off intangible assets as goodwill, copyright, patents etc.

**Items Appearing on Credit Side of Profit & Loss A/c:** Gross profit is shown on the credit side of Profit & Loss account. Also other gains and incomes of the business are shown on the credit side. The other incomes are generally classified into two types:

- (a) **Operating Income:** It refers to that portion of income which is earned for the operations of the business. Examples, interest, commission and discount earned etc.
- (b) **Non-operating Income:** This income is not earned from the routine operations of the business. Examples are profit on sale of any fixed assets, refund of tax, etc.

**Closing Entries for Profit & Loss A/c:**

- (i) For transferring the various expenses to Profit & Loss A/c:

Profit and Loss A/c	Dr.
To Various Expenses A/c	

- (ii) (a) For net profit:

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

- (b) For net loss:

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

**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 and 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 pro forma of balance sheet in the order of permanency is given below:

**Balance Sheet of ..... as on .....**

Liabilities	(₹)	Assets	(₹)
<p><b>Capital</b>  <i>Add:</i> Net profit  <i>Add:</i> Interest on capital  <i>Less:</i> Drawings  <i>Less:</i> Interest on drawings  <i>Less:</i> Loss if any</p> <p><b>Long-term liabilities:</b>            Loan on mortgage            Bank loan</p> <p><b>Current liabilities:</b>            Sundry creditors            Bills payable            Bank overdraft            Creditors for outstanding expenses            Income received in advance</p>		<p><b>Fixed assets:</b>            Goodwill            Land &amp; building            Loose tools            Furniture &amp; fixtures            Vehicles            Patents            Trademarks</p> <p><b>Long-term loans (advances):</b>            Investments</p> <p><b>Current assets:</b>            Closing stock            Sundry debtors            Bills receivable            Prepaid expenses            Accrued income            Cash at bank            Cash in hand</p> <p><b>Fictitious assets:</b>            Preliminary expenses            Advertising expenses            Underwriting commission            Discount on issue of shares            Discount on issue of debentures</p>	

**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	
	To Asset A/c		xxx

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	
	To Capital A/c		xxx

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	
	To Interest on Drawings A/c		xxx

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 and 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 and 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 realisable value.

Sometimes, bad debts may be written off during the year. Some additional bad debts are to be written off at the time of finalising 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	
		<hr/>	
Less: Existing provision (given in trial balance)		xxx	
		<hr/>	
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

**SAQ 1:** Pass necessary adjusting in Mr. X's journal on 31st December, 2014:

- (i) ₹ 20,000 for wages was outstanding.
- (ii) Write off depreciation on machinery ₹ 50,000
- (iii) ₹ 15,000 was received in advance as interest.

**SAQ 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 in the register ₹ 10,000.

**SAQ 3:** Pass necessary journal entries for the following while finalising 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.

**SAQ 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)

**SAQ 5:** Dawson, a businessman, has invested on 1-4-2014 ₹ 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)

**SAQ 6:** Pass journal entries for the following transactions:

- (i) Samples worth ₹ 5,000 distributed during a sale campaign programme.
- (ii) Proprietor brought his personal car into the business and the value of the same is ₹ 1,00,000.
- (iii) Interest of ₹ 9,000 received on investment amounting to ₹ 50,000 (20% Govt. of India Bonds).

The above interest was net of income tax.

**Illustration 1:** Prepare Trading Account of Archana for the year ending 30-12-14 from the following information:

Particulars	(₹)
Opening stock	80,000
Purchases	8,60,000
Freight inward	52,000
Wages	24,000
Sales	14,40,000
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 30-12-2014**

Particulars	(₹)	Particulars	(₹)
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		
	<b>12,24,000</b>		<b>12,24,000</b>

**Illustration 2:** From the following particulars, prepare Manufacturing account for the year ended 31st March, 2014.

Raw materials (1-4-2013)	33,000
Work-in-progress (1-4-2013)	17,000
Finished goods (1-4-2013)	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 (31-3-2014)	22,000
Work-in-progress (31-3-2014)	13,500
Finished goods (31-3-2014)	40,000

**Solution:****Manufacturing Account for the year ended 31-3-2014**

Particulars	(₹)	(₹)	Particulars	(₹)	(₹)
To Opening stock			By Sales of scrap		150
Raw materials (1-4-2013)	33,000		By Cost of production		1,27,900
Work-in-progress (1-4-2013)	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)		3,000			
To Insurance (20% for factory)		200			
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			
		<b>1,63,550</b>			<b>1,63,550</b>

**SAQ 1:** Mr. Gotham has ₹ 50,000 to the credit of his capital account on 1-1-2014. 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)

**SAQ 2:** 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)

**SAQ 3:** On 1st Jan 2014, 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 2014.

(Ans.: Debit to P & L A/c – ₹ 2,100)

**SAQ 4:** 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)

**SAQ 5: (i)** During the year ended 31-12-2014, a firm suffered the following losses. Explain how you would treat them in the accounts on 31-12-2014:

- (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 A/c ₹ 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)

**(ii)** 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 nature other than manager's commission are ₹ 12,000?

(Ans.: Manager's Commission ₹ 4,000, i.e.,  $84,000 \times 5/105$ )

**(iii)** 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)

**SAQ 6:** 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)

**SAQ 7:** 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

**SAQ 8:** The drawings of a proprietor for the year 2014 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)

**SAQ 9:** Prepare trading account of a trader for the year ending 31st December, 2014 from the following data:

	₹
Opening stock (1.1.14)	50,000
Goods purchased during 2014	2,80,000
Freight and packing on the above	20,000
Closing stock (31.12.14)	60,000
Sales	3,80,000
Packing expenses on sales for distribution	12,000

(Ans.: Gross profit – ₹ 90,000)

**Hint:** Ignore packing expenses.

**SAQ 10:** 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)

**Illustration 3:** From the following balance extracted at the close of the year ended 31st Dec. 2014, prepare profit and loss account of Mr. Raj as at that date:

Particulars	(₹)	Particulars	(₹)
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 30-12-2014**

Particulars	(₹)	Particulars	(₹)
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	360		
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		
	<b>56,700</b>		<b>56,700</b>

**Illustration 4:** The following are the balances in the Ledger of Mr. Sherif for the year ended 31st March, 2014.

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	20,000
Work-in-progress	4,000
Finished goods	8,000

Prepare Manufacturing and Trading Account for the year ended 31st March, 2014.

**Solution:****Manufacturing and Trading Account of Mr. Sherif for the year ending 31.3.14**

Particulars	(₹)	(₹)	Particulars	(₹)	(₹)
To Opening work-in-progress		3,000	By Closing work-in-progress		4,000
To Cost of Materials consumed			By Cost of goods manufactured		1,25,000
Opening stock	20,000		transferred to Trading A/c		
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		10,800	By Sales		2,40,000
To Cost of goods manufactured		1,25,000	By Closing stock		
To Gross Profit c/d		1,12,200	of finished goods		8,000
		<b>2,48,000</b>			<b>2,48,000</b>

**SAQ 11:** Following are some of the items extracted from the books of Mr. Mahesh as on 31st December, 2014.

Prepare Manufacturing and Trading Account for the year ending 31st December, 2014 and also pass closing and adjustment entries.

Particulars	(₹)	Particulars	(₹)
1. Stock as on 1.1.2014		2. Carriage on purchases	1,050
(a) Raw Materials	14,700		
(b) Work-in-progress	6,650		
(c) Finished Goods	10,850		
3. Purchases of Raw Materials	59,500	4. Plant and Machinery	49,000
5. Lighting	945	6. Sales	1,17,040
7. Direct Wages	9,100	8. Repairs to plant	770
9. Rent	4,200	10. Sales of Scrap	1,750

**Adjustment:**

- Stock as on 31st December, 2014 are: Raw Materials ₹ 11,340; Work-in-progress ₹ 5,460 and Finished goods ₹ 12,670.
- Direct wages are outstanding ₹ 630.
- Machinery is to be depreciated by 10%.

4. Office premises occupied  $\frac{1}{5}$  th of the total area.
5. Lighting is to be charged as to  $\frac{2}{3}$  for factory and  $\frac{1}{3}$  for office.

(Ans.: COP ₹ 82,740)

**SAQ 12:** From the following information, prepare Manufacturing Account in the books of Mr. Ajay for the year ended 30th June, 2012:

Particulars	(₹)	Particulars	(₹)
Factory Power	90,350	Insurance (13/20 Factory)	22,560
General expenses (2/5 Factory)	13,775	Plant and Machinery (Purchased on 1.7.2011)	3,75,000
Purchases	8,41,700	Plant and Machinery (Purchased on 31.12.2011)	1,00,000
Rent and Rates (5/6 Factory)	37,150	Wages (Factory)	5,17,500
Repairs to Plant	19,625	Following liabilities are to be provided for:	
Stock as on 1.7.2011		Factory Power	14,550
Raw Materials	1,30,750	Rent and Rates (5/6 Factory)	9,650
Work-in-progress	41,759	Lighting and Heating (2/3 Factory)	4,000
Finished Goods	1,84,500	Provide Depreciation at 15% p.a. on plant and machinery	
Stock at 30.06.2012			
Raw Materials	89,000		
Work-in-progress	43,808		
Finished Goods	2,41,250		
Lighting and Heating (2/3 Factory)	12,050		

(Ans.: COP ₹ 6,57,050)

**SAQ 13:** From the particulars given below, prepare a Manufacturing Account and a Trading Account for the year ended 31st December, 2011.

		₹
1.1.2011	Raw Materials	24,000
	Work-in-progress	16,000
	Finished Goods	18,000
	Purchases of Raw Materials	1,60,000
	Direct Wages	20,000
	Indirect Wages	16,000
	Sales	3,00,000
	Returns Inward	10,000
	Trading Expenses	10,000
	Depreciation of Assets (Factory)	8,000
31.12.2011	Raw Materials	12,000
	Work-in-progress	8,000
	Finished Goods	10,000

Goods are transferred from Production Dept. to Sales Dept. at cost plus 25%.

(Ans.: Cost of production ₹ 3,80,000; Gross Loss ₹ 1,08,000)

**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, 2014 under:

Particulars	Dr. (₹)	Cr. (₹)
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 30-12-14**

Liabilities	(₹)	(₹)	Assets	(₹)	(₹)
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
		<b>2,27,000</b>			<b>2,27,000</b>

**Illustration 6:** The following is the trial balance of Dhandapani of Madras as on 31st December, 2014:

Particulars	(₹)	Particulars	(₹)
<b>Debit balances:</b>		<b>Credit balances:</b>	
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

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	
	<b>1,24,080</b>	<b>1,24,080</b>

The value of stock on 31-12-2014 was estimated at ₹ 5,960. You are required to make the necessary closing and prepare Trading and Profit & Loss account and a Balance Sheet as on 31st December, 2014.

**Solution:**

Date	Particulars	Dr.	Cr.
2014	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 31-12-14**

Particulars	(₹)	Particulars	(₹)
To Opening stock	6,200	By Sales	82,920
To Purchases	42,400	Less: Return inwards	2,040
Less: Return outwards	840	By Closing stock	5,960
To Wages	10,400		
To Freight on purchase	1,120		
To Gross Profit c/d	27,560		
	<b>86,840</b>		<b>86,840</b>
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		
	<b>28,040</b>		<b>28,040</b>

## Balance Sheet of Dhandapani as on 31-12-14

Liabilities	(₹)	Assets	(₹)
Sundry Creditors	9,840	Cash in hand	2,600
Bank loan	6,000	Sundry debtors	12,000
Capital A/c		Stock	5,960
Balance	24,000	Furniture	2,000
Add: Net profit	16,720	Buildings	34,000
	<b>56,560</b>		<b>56,560</b>

**Illustration 7:** Pass necessary adjustment entries for the following adjustment:

- Depreciation at 10% is to be charged on machinery standing in the books at ₹ 1,00,000.
- Insurance unexpired is ₹ 200.
- Salaries outstanding ₹ 10,000.
- To provide provision for doubtful debts at 2% on sundry debtors worth ₹ 20,000.
- Closing stock ₹ 55,000.
- Interest has accrued on investment ₹ 500.
- Commission received in advance ₹ 1,000.
- To provide 10% interest on capital of ₹ 2,50,000.
- Interest charged on drawings of ₹ 520.
- The proprietor has withdrawn goods worth ₹ 200 from stock.
- Goods in stock worth ₹ 8,000 are destroyed by fire. Insurance company accepts the claim of ₹ 6,000.
- ₹ 2,000 to be transferred to Reserve fund.
- Goods worth ₹ 2,000 distributed as free samples to customers.

**Solution:**

## Adjustments Entries

Particulars	Dr.	Cr.	
(a) Depreciation A/c To Machinery A/c (Being depreciation on machinery)	Dr.	10,000	10,000
(b) Prepaid Insurance A/c To Insurance A/c (Being insurance prepaid)	Dr.	200	200
(c) Salaries A/c To Outstanding Salaries A/c (Being salaries outstanding)	Dr.	10,000	10,000

(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 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

**SAQ 14:** Show the necessary entries to adjust the following:

- Outstanding salaries ₹ 1,200; Rent ₹ 300
- Prepaid insurance premium ₹ 450
- Income outstanding: interest on investments ₹ 400; dividend ₹ 350
- Discount received in advance ₹ 150
- Bad debts written off ₹ 200
- Interest on securities received in advance ₹ 500

**SAQ 15:** Show the necessary entries to adjust the following in the books of X on 30th June, 2014:

- Salaries for the month of June 2008 ₹ 1,500 unpaid.
- Insurance includes annual premium of ₹ 170 on a policy, expiring on 31-12-14.
- Wages include a sum of ₹ 2,000 spent on the erection of a cycle shed for employees.
- Goods issued as samples ₹ 200.
- Rent paid in advance ₹ 250.

**SAQ 16:** Pass journal entries to incorporate the following at the time of preparing final accounts:

- Provide 2.5% for discount on debtors and a bad debts provision at 10% of debtors (debtors ₹ 30,000).
- Closing stock was valued at ₹ 43,000.
- Wages owing ₹ 2,500.
- Insurance paid in advances ₹ 1,500.
- Included in debtors is ₹ 1,000 owing by the proprietor.
- 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.

**Illustration 8:** The sundry debtors on 31st Dec. 2014 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:**

Dr.	Journal	(₹)	Cr. (₹)
2014 Dec. 31	Profit & Loss A/c <span style="float: right;">Dr.</span> To Provision for Bad Debts & Doubtful Debts A/c (Being amount of provision for bad debts and doubtful debts – 1/3rd of ₹ 3,000, i.e., ₹ 1,000 doubtful and ₹ 1,000 bad)	2,000	2,000

## Ledger

Dr. **Provision for Bad Debts & Doubtful Debts A/c** Cr.

Date	Particulars	(₹)	Date	Particulars	(₹)
2014 Dec. 31	To Balance b/d	2,000	2014 Dec. 31	By Profit & Loss A/c	2,000
		<b>2,000</b>			<b>2,000</b>
			2015 June 1	By Balance b/d	2,000

Dr. **Profit & Loss A/c for the year ended 31-12-14** Cr.

Date	Particulars	(₹)	Date	Particulars	(₹)
	To Provision for doubtful debts	2,000			
		<b>2,000</b>			<b>2,000</b>

## Balance Sheet as on 31-12-2014

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

**Illustration 9:** The provision for bad and doubtful debts account shows a balance of ₹ 2,000 on 1st January, 2014. The bad debts during the year 2014 amount to ₹ 1,600. The sundry debtors on 31st December, 2014 are ₹ 32,000. Create a new provision for bad debts @ 5%. Show the journal, ledger, profit & loss account and balance sheet.

## Solution:

Dr. **Journal** Cr.

Date	Particulars	(₹)	(₹)
2014 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

Dr.			Ledger Bad Debts A/c			Cr.		
Date	Particulars	(₹)	Date	Particulars	(₹)			
2014 Dec. 31	To Balance b/d	1,600	2014 Dec. 31	By Provision for Bad Debts & Doubtful Debts A/c (transfer)	1,600			
		<b>1,600</b>			<b>1,600</b>			

Dr.			Provision for Bad Debts and Doubtful Debts A/c			Cr.		
Date	Particulars	(₹)	Date	Particulars	(₹)			
2014 Dec. 31	To Bad Debts A/c	1,600	2014 Jan. 1	By Balance b/d	2,000			
Dec. 31	To Balance c/d	1,600	Dec. 31	By Profit & Loss A/c	1,200			
		<b>3,200</b>			<b>3,200</b>			
			2015 Jan. 1	By Balance b/d	1,600			

## Profit &amp; Loss A/c for the year ended 31-12-14

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

## Balance Sheet as on 31-12-14

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

**Illustration 10:** The provision for bad and doubtful debts shows a balance of ₹ 1,600 on 1st January, 2014. The bad debts during the year 2014 amount to ₹ 600. The sundry debtors on 31st December, 2014 are ₹ 16,000. Create a provision of 5% for bad and doubtful debts.

## Solution:

Dr.		Journal		Cr.	
Date	Particulars	(₹)	(₹)		
2014 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

Dr.		Ledger Bad Debts A/c				Cr.	
Date	Particulars	(₹)	Date	Particulars	(₹)	(₹)	
2014 Dec. 31	To Balance b/d	600	2014 Dec. 31	By Provision for Bad & Doubtful Debts A/c (transfer)	600		
		<b>600</b>				<b>600</b>	

Dr.		Provision for Bad Debts and Doubtful Debts A/c				Cr.	
Date	Particulars	(₹)	Date	Particulars	(₹)	(₹)	
2014 Dec. 31	To Bad debts	600	2014 Jan. 1	By Balance b/d	1,600		
Dec. 31	To P&L A/c	200					
	To Balance c/d	800					
		<b>1,600</b>				<b>1,600</b>	

## Profit &amp; Loss A/c for the year ended 31-12-14

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

## Balance Sheet as on 31-12-14

Liabilities	(₹)	(₹)	Assets	(₹)	(₹)
			Sundry Debtors	16,000	
			Less: Provision for B.D.	800	15,200

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

		₹
2014		
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, 2014.

**Solution:**

Dr.		Bad Debts A/c			Cr.	
Date	Particulars	(₹)	Date	Particulars	(₹)	
2014			2014			
Dec. 31	To Balance b/d	4,700	Dec. 31	By Provision for Bad Debts A/c	7,100	
Dec. 31	To Sundry Debtors A/c	2,400				
		<b>7,100</b>			<b>7,100</b>	

Dr.		Provision for Bad Debts and Doubtful Debts A/c			Cr.	
Date	Particulars	(₹)	Date	Particulars	(₹)	
2014			2014			
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 A/c (bal. fig.)	4,920	
		<b>16,920</b>			<b>16,920</b>	
			2015			
			Jan. 1	By Balance b/d	9,820	

Dr.		Bad Debts Recovered A/c			Cr.	
Date	Particulars	(₹)	Date	Particulars	(₹)	
2014			2014			
Dec. 31	To Profit & Loss A/c	250	Dec. 31	By Balance b/d	250	
		<b>250</b>			<b>250</b>	

Dr.		Discount on Debtors A/c			Cr.	
Date	Particulars	(₹)	Date	Particulars	(₹)	
2014			2014			
Dec. 31	To Balance b/d	9,300	Dec. 31	By Provision for Discount on Debtors A/c	9,300	
		<b>9,300</b>			<b>9,300</b>	

Dr.

## Provision for Discount on Debtors A/c

Cr.

Date	Particulars	(₹)	Date	Particulars	(₹)
2014 Dec. 31	To Discount on Debtors A/c To Balance c/d	9,300.00 1,767.60	2014 Jan. 1 Dec. 31	By Balance b/d By P & L A/c	5,600.00 5,467.60
		<b>11,067.60</b>			<b>11,067.60</b>
			2015 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 31-12-14**

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 31-12-14**

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

**Provision on Debtors and Creditors**

**SAQ 17:** 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 2014	Provision for bad debts ₹ 2,500
	Dec. 31 2014	Bad debts ₹ 2,870
	Dec. 31 2014	Debtors ₹ 20,000

**Information:** Make provision for bad debts at 5% on debtors.

(Ans.: Debit to P & L A/c: ₹ 370)

**SAQ 18:** The provision for bad and doubtful debts stood at ₹ 3,200 on 31st December, 2013. On 31st December, 2014, debtors stood at ₹ 1,42,250 out of which ₹ 2,250 had to be written off. On December 2015, 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 2014 and 2015.

(Ans.: In 2014, debit P & L A/c = ₹ 6,050 and in 2015 credit P & L A/c = ₹ 1,350)

**SAQ 19:** On 1st Jan., 2014, M/s. Kamakshi had a bad debt provision of ₹ 2,600. On 31st December, 2014, 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, 2015, 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 2014, debit P & L A/c = ₹ 2,600 and in 2015, credit P & L A/c = ₹ 320).

**SAQ 20:** The books of a firm had the following balance on Jan. 1, 2014.

	₹
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, 2014 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)

**Illustration 12:** The following is the schedule of balance on 31-3-2014 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 1-4-13		Sales	4,60,000
Raw materials	50,000	Provision for bad debts	6,000
Work-in-progress	50,000	Loan from Gopu	60,000
Finished goods	24,000	Sundry creditors	1,06,000
Furniture & fixtures	42,800		
Office equipments	3,200		
Buildings	1,20,000		
Motor car	40,000		
Purchases of raw materials	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		
	<b>9,64,400</b>		<b>9,64,400</b>

Prepare Trading and Profit and Loss A/c for the year ended 31-3-2014 and the balance sheet as at that date after making provision for the following:

- (i) Value of stock on 31-3-2014 was ₹ 88,000:
 

Raw materials	30,000
Work-in-progress	30,000 and
Finished goods	28,000
- (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 1-5-2013.
- (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 1-4-13 to 30-6-14.
- (vii) Depreciate:
- Buildings used for business by 5%.
  - 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.
  - Office equipments by 15%. Purchase of a typewriter during the year for ₹ 8,000 has been wrongly debited to Purchase A/c.
  - Motor car by 20%.

**Solution:****Manufacturing A/c for the year ended 31-3-14**

Particulars	₹	₹	Particulars	₹	₹
To Opening stock of Raw materials	50,000		By Cost of Production (bal. fig.)		
Work-in-progress	50,000	1,00,000	(trfd. to Trading A/c)		3,09,200
To Purchase of Raw Material	2,80,000		By Closing Stock of Raw Materials	30,000	
Less: Purchase of office equipment	(8,000)		Work-in-progress	30,000	60,000
Less: Purchase Returns	(5,200)	2,66,800			
To Freight on Purchases		2,400			
		<b>3,69,200</b>			<b>3,69,200</b>

**Trading and Profit & Loss A/c for the year ended 31-3-14**

Particulars	₹	₹	Particulars	₹	₹
To Opening stock of Finished goods		24,000	By Sales	4,60,000	
To Cost of Production form Manufacturing A/c		3,09,200	Less: Sale of Fittings	2,800	
To Gross Profit A/c c/d		1,43,600		4,57,200	
		<b>4,76,800</b>	Less: Returns	8,400	4,48,800
			By Closing Stock of Finished Goods		28,000
To Salaries	22,000				<b>4,76,800</b>
Add: Outstanding	2,000	24,000	By Gross Profit b/d		1,43,600
To Rent for godown	11,000		By Discount received		3,200
Add: Outstanding	1,000	12,000			

To Interest on loan	5,400			
<i>Add:</i> 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			
<i>Less:</i> Premium on own life policy	8,000			
	3,000			
<i>Less:</i> Prepaid	3,000	Nil		
To General office expenses		6,000		
To Bad debts	4,000			
<i>Add:</i> New provision	8,600			
	12,600			
<i>Less:</i> 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		
		<b>1,46,800</b>		<b>1,46,800</b>

## Balance Sheet as on 31.3.14

Liabilities	(₹)	(₹)	Assets	(₹)	(₹)
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 (24,000 + 8,000)	32,000	3,31,200	Furniture & fittings	42,800	
Loan from Gopu	60,000		<i>Less:</i> Sale	2,800	
<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	

<b>Outstanding expenses:</b>			<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
		<b>5,01,400</b>			<b>5,01,400</b>

**Illustration 13:** From the following particulars presented by Mr. S. Tendulkar, prepare a Trading A/c and Profit & Loss A/c for the year ended 31st Dec., 2014 and Balance sheet as on that date.

Debit Balances	(₹)	Credit Balances	(₹)
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:			
Raw materials	10,000		
Work-in-progress	10,000		
Finished goods	4,000		
Land & buildings	80,000		
Furniture	20,000		
Discount	40,000		
Suspense A/c	32,000		
	<b>6,00,000</b>		<b>6,00,000</b>

**Adjustment:**

- (i) Closing stock ₹ 60,000: Raw Materials ₹ 20,000, Work-in-progress ₹ 20,000 and Finished Goods ₹ 20,000.
- (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 customer's 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:****Manufacturing A/c of S. Tendulkar for the year ended 31-12-14**

Particulars	(₹)	(₹)	Particulars	(₹)	(₹)
To Opening stock:			By Cost of Production		
Raw materials	10,000		(bal. fig. trfd. to		
Work-in-progress	10,000	20,000	Trading A/c)		98,000
To Purchases	1,20,000		By Closing Stock of:		
Less: Buildings	10,000		Raw Materials	20,000	
	1,10,000		Work-in-progress	20,000	40,000
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			
		<b>1,38,000</b>			<b>1,38,000</b>

**Trading and Profit & Loss A/c of S. Tendulkar for the year ended 31-12-14**

Particulars	(₹)	(₹)	Particulars	(₹)	(₹)
To Opening Stock of Finished Goods		4,000	By Sales	4,00,000	
To Cost of Production (trfd. form Manufacturing Account)		98,000	Less: Furniture	(2,000)	3,98,00
To Gross Profit c/d		3,36,000	By Stock destroyed by fire		2,000
		<b>4,20,000</b>	By Closing Stock of Finished Goods		20,000
					<b>4,20,000</b>

To Salaries		14,000	By Gross Profit b/d		3,36,000
To Rent	12,000		By Provision for bad debts		4,000
Less: Drawings	2,000	10,000			
To Repairs	6,000				
Less: Stationery	200	5,800			
To Insurance		10,000			
To Discount	40,000				
Less: 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			
		<b>3,40,000</b>			<b>3,40,000</b>

## Balance Sheet of Mr. S. Tendulkar as on 31-12-14

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

**Illustration 14:** The following figures have been extracted from the records of Fancy Stores, a proprietor concern as at 31<sup>st</sup> December 2014.

Particulars	(₹)	Particulars	(₹)
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:		Sales	60,00,000
Raw Materials      2,00,000		Advertisements	1,00,000
Work-in-progress    2,00,000		Postage & telephone	34,000
Finished Goods      1,00,000	5,00,000	Bad debts	20,000
Fixed Deposits	13,46,000	Printing & stationery	90,000
Drawings	50,000	General charges	1,30,000
Provision for bad debts	30,000	Sundry creditors	4,00,000
Cash at Bank	1,00,000	Deposit from customers	60,000
Purchases	30,00,000		
Salaries	1,90,000		
Carriage Inwards	4,10,000		

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

- (i) The closing stock as on 31-12-2014 was ₹ 1,00,000: Raw materials ₹ 50,000, Work-in-progress ₹ 40,000 and Finished goods ₹ 10,000.
- (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 2014 had been debited to the Salary A/c.
- (x) The office premises were sublet from December 2014 for a monthly rental of ₹ 10,000, but the rent for December has not yet been received.

## Solution:

## Trading and Profit &amp; Loss A/c of Fancy Stores for the year ended 31-12-14

Particulars	(₹)	(₹)	Particulars	(₹)	(₹)
To Opening Stock of Finished Goods		1,00,000	By Sales		62,50,000
To Cost Production (trfd. form Manufacturing Account)		39,70,000	By Closing Stock of Finished Goods		10,000
To Gross Profit c/d		21,90,000			
		<b>62,60,000</b>			<b>62,60,000</b>
To Salaries	1,90,000		By Gross Profit b/d		21,90,000
Add: Under recording in Cash book	10,000		By Interest on deposit		54,000
	1,80,000		By Rent from subletting		10,000
Less: Advance Salary	10,000	1,90,000	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			
		<b>23,04,000</b>			<b>23,04,000</b>

## Balance Sheet of Fancy Stores as on 31-12-14

Liabilities	(₹)	(₹)	Assets	(₹)	(₹)
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	
Add: Addition	1,00,000		Less: Provision for B.D.	30,000	6,70,000
	6,40,000		Advance Salary		10,000
Less: Drawings	50,000		Rent outstanding		10,000
	5,90,000		Furniture	2,00,000	
Add: Net Profit	14,20,000	20,10,000	Less: Depreciation	20,000	1,80,000
			Fixed Deposits		14,00,000
		<b>24,90,000</b>			<b>24,90,000</b>

**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, 2014 and
- (ii) Sasikala's Trading and Profit & Loss Account for the same period.

<b>Stock as on 1st Jan 2014</b>		Travelling expenses	5,400
Raw materials	7,000	Manufacturing expenses	5,400
Work-in-progress	10,000	<b>Miscellaneous:</b>	
Finished goods	25,400	Return outwards	4,000
Purchase of raw materials	90,000	Discount allowed	1,000
Carriage of raw materials	2,000	Discount received	600
Sale of finished goods	3,80,000	Import duty on raw materials	24,000
<b>Stock on 31st Dec. 2014:</b>		Sale of waste materials	6,000
Raw materials	13,000	Carriage outwards	1,600
Work-in-progress	12,000	Factory insurance, rent & taxes	12,000
Finished goods	28,000	Bad debts	1,200
Factory wages	60,000	Salaries (including Sasikala's salary ₹ 9,600)	25,600
Factory expenses	4,800	Salary of works manager	14,400
Return inwards	4,600	Office rent & insurance	3,000
Depreciation on machinery	10,800	Motive power	7,000
Repairs to machinery	9,200		
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 31-12-14**

Particulars	(₹)	Particulars	(₹)
To Work-in-progress on 1-1-14	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 31-12-14	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	
	<b>2,46,000</b>	<b>2,46,000</b>

**Trading and Profit & Loss A/c of Sasikala for the year ended 31-12-14**

Particulars	(₹)	Particulars	(₹)
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	Less: Returns inwards	4,600
To Gross Profit c/d	1,50,000		
	<b>4,03,400</b>	By Stock of finished goods (on 31-12-04)	28,000
			<b>4,03,400</b>
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	1,600		
To Bad debts	1,200		
To Salaries	25,600		
Less: 2/3 of Sasikala's salary	6,400		
To Office rent & insurance	3,000		
To Net profit transferred to Capital A/c	1,03,400		
	<b>1,50,600</b>		<b>1,50,600</b>

**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., 2014 and a balance sheet as on that date.

Capital A/c (1-1-14)	7,32,000	Factory buildings	2,00,000
Drawings A/c	1,00,000	Furniture & fixtures	51,500
Purchases of Raw Materials	21,30,000	Plant & machinery	95,000
Rates & taxes	25,000	Sundry debtors	1,87,000
Salaries	1,00,000	4% Govt. Promissory Notes (subscribed on 1-1-14)	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		
<b>Opening stock:</b>			
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., 2014 but was collected only in 2015.
- (ix) Carriages include ₹ 8,000 towards outwards charges.
- (x) Stock in trade as on 31-12-14: Raw material ₹ 50,000; finished goods ₹ 40,000.

**Solution:****Manufacturing, Trading and Profit & Loss A/c of Ajay Sharma for the year ended 31.12.2014**

Particulars	(₹)	Particulars	(₹)
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:			
Plant & machinery	9,500		
Patents	1,200		
Factory buildings	5,000		
	<b>21,63,700</b>		<b>21,63,700</b>
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		
	<b>25,69,500</b>		<b>25,69,500</b>
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		
	<b>3,71,600</b>		<b>3,71,600</b>

**Balance Sheet of Ajay Sharma as on 31-12-14**

Liabilities	(₹)	(₹)	Assets	(₹)	(₹)
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 (1,00,000+5,000)	1,05,000	8,14,936	Furniture & fittings	51,500	
Sundry Creditors		1,30,000	Less: Depreciation	2,576	48,924
			Patents	12,000	

(1,05,000+25,000)			Less: 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	1,65,000
			Sundry debtors (1,87,000 – 5,000+5,000–3,500)	1,83,500	
			Less: 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
		<b>9,44,936</b>			<b>9,44,936</b>

## EXERCISES

### 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 the 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?

### Objective Type Questions

#### 1. Fill in the Blanks

- (i) Expenses due but not yet paid are known as \_\_\_\_\_.
- (ii) Income earned but not received is called \_\_\_\_\_.
- (iii) Depreciation is for \_\_\_\_\_ of an asset.
- (iv) Unrecovered debts are called \_\_\_\_\_.

(Ans.: (i) Outstanding expenses, (ii) Accrued or Outstanding income, (iii) Wear and Tear, (iv) Bad debts.)

#### 2. State whether the following statements are True or False:

- (i) Prepaid expenses appear on the assets side of balance sheet.
- (ii) Any income received in advance is a liability.
- (iii) Bad debts are not expenses but they incur loss to the firm.
- (iv) Provision for Doubtful debts is a charge against the profits of the firm.
- (v) Bad debts incurred in the subsequent period are written off against reserve for bad debts.
- (vi) Provision for Discount on Debtors is a charge against P & L A/c.
- (vii) Provision for discount on debtors appears as a liability in the Balance Sheet.
- (viii) Discount on creditors is an item of income.
- (ix) Provision for discount on creditors is shown as an anticipated income.
- (x) Closing stock always appears as an asset in balance sheet.
- (xi) Overvaluation of opening stock shows less gross profit.
- (xii) Overvaluation of closing stock shows more gross profit.
- (xiii) Sale of old furniture is credited to Tracing Account.
- (xiv) Income received in advance is an asset.
- (xv) Balance Sheet shows profitability of business.
- (xvi) Plants means tree plants around the factory.

(Ans.: (i) True, (ii) True, (iii) True, (iv) True, (v) True, (vi) True, (vii) True, (viii) True, (ix) True, (x) True, (xi) True, (xii) True, (xiii), False, (xiv), False, (xv) False, (xvi) False.)

#### 3. Match the Column:

(A) Column A	Column B
(a) Goods lost by fire	(i) Shown on debit side of Trading Account and Profit and Loss Account debit side
(b) Goods distributed as sample	(ii) Debit of Trading Account
(c) Bad debts	(iii) Deduct from debtors and shown on debit side of Profit and Loss Account
(d) Prepaid expenses in Trial Balance	(iv) Balance sheet asset side
	(v) Shown on credit side of Trading Account and Profit and Loss Account debit side
(e) Expenses payable in Trial Balance	(vi) Balance Sheet liability side

(Ans.: (a) (v), (b) (i), (c) (iii), (d) (iv), (e) (vi).)

<b>(B)</b>	<b>Column A</b>	<b>Column B</b>
	(a) Depreciation in Trial Balance	(i) Profit and loss Account debit side
	(b) Income received in advance	(ii) Deduct from income, show on liability side
	(c) Accrued income	(iii) Add to income, show on asset side
	(d) Closing stock	(iv) Profit and Loss Account debit, deduct from asset in Balance sheet
	(e) Depreciation	(v) Trading account credit balance sheet asset side
		(vi) Add to expenses

**(Ans.:** (a) (i), (b) (ii), (c) (iii), (d) (v), (e) (iv).)

<b>(C)</b>	<b>Column A</b>	<b>Column B</b>
	(a) Opening balance – Debtors Account	(i) Debit
	(b) Opening balance – Creditors Account	(ii) Debit
	(c) Opening balance – Bills Receivable Account	(iii) Credit
	(d) Opening balance – Bills Payable Account	(iv) Debit
	(e) Cash Account balance	(v) Credit
		(vi) Credit

**(Ans.:** (a) (iv), (b) (iii), (c) (ii), (d) (v), (e) (i) ]

#### 4. Multiple Choice Questions:

- (i) Opening stock of finished goods is shown on debit side of \_\_\_\_\_.
  - (a) Trading Account
  - (b) Profit and Loss Account
  - (c) Balance Sheet
- (ii) Goodwill is shown on \_\_\_\_\_.
  - (a) Asset side of Balance Sheet
  - (b) Credit side of Trading Account
  - (c) Credit side of Profit and Loss Account
- (iii) Sale of scrap is shown on \_\_\_\_\_.
  - (a) Credit side of Trading Account
  - (b) Credit side of Manufacturing Account
  - (c) Credit side of Profit and Loss Account
- (iv) Livestock is \_\_\_\_\_.
  - (a) Current asset
  - (b) Fixed asset
  - (c) Fictitious asset
  - (d) Intangible asset
- (v) Patents and copyright is a \_\_\_\_\_.
  - (a) Current asset
  - (b) Fixed asset
  - (c) Fictitious asset
  - (d) Intangible asset
- (vi) Drawing reduces \_\_\_\_\_.
  - (a) Capital
  - (b) Profit
  - (c) Income
  - (d) Purchases

- (vii) For a sugar mill, sugarcane is a \_\_\_\_\_.
- (a) Raw material (b) WIP  
(c) Finished goods (d) Asset
- (viii) For a sugar mill, sugar is a \_\_\_\_\_.
- (a) Raw material (b) WIP  
(c) Finished goods (d) Assets
- (ix) WIP in the books of a manufacturer is \_\_\_\_\_.
- (a) Partly finished goods (b) Finished goods  
(c) Raw material (d) None of the above
- (x) Opening stock of WIP is shown on \_\_\_\_\_.
- (a) Debit side of Trading Account  
(b) Debit side of Manufacturing Account  
(c) Credit side of Profit and Loss Account  
(d) Balance Sheet asset side
- (xi) Closing stock of finished goods is shown on \_\_\_\_\_.
- (a) Credit side of Manufacturing Account  
(b) Credit side of Trading Account  
(c) Credit side of Profit and Loss Account  
(d) None of the above
- (xii) Discount represents \_\_\_\_\_.
- (a) Discount allowed (b) Discount received  
(c) Asset (d) Liability
- (xiii) Productive wages are \_\_\_\_\_.
- (a) Debited to Trading Account  
(b) Debited to Profit and Loss Account  
(c) Shown as asset  
(d) None of the above
- (xiv) Closing stock appearing in the Trial Balance is shown on \_\_\_\_\_.
- (a) Asset side of Balance sheet  
(b) Liability side of Balance Sheet  
(c) Credit side of Trading Account  
(d) None of the above
- (xv) Prepaid insurance is \_\_\_\_\_.
- (a) Deducted from insurance (b) Added to insurance  
(c) Shown on asset side (d) (a) and (b)
- (xvi) Income received in advance is shown on \_\_\_\_\_.
- (a) Liability side (b) Asset side  
(c) Debit side of Profit and Loss Account (d) None of the above
- (xvii) Which of the following account is not closed?
- (a) Expenses (b) Interest received  
(c) Prepaid insurance (d) Drawings
- (xviii) Classification of assets and liabilities as current or long term depends on \_\_\_\_\_.
- (a) Order of listing in the ledger  
(b) Whether they appear on Balance Sheet or the income statement

- (c) Relative liquidity of the items.  
 (d) Format of balance sheet
- (xix) Cost of goods sold can be computed by adding opening inventory and net purchases and subtracting \_\_\_\_\_.
- (a) Net Sales (b) Sales discount  
 (c) Closing Stock (d) Net Purchase
- (xx) Closing entry sales discount is \_\_\_\_\_.
- (a) Sales Discount A/c Dr.  
     To Profit and Loss A/c  
 (b) Sales Discount A/c Dr.  
     To Sales A/c  
 (c) Profit and Loss A/c Dr.  
     To sales Discount
- (xxi) Which income statement format reports income from operations?  
 (a) Account format (b) Single step format  
 (c) Multiple step format
- (xxii) Balance sheet gives information regarding \_\_\_\_\_.
- (a) Result of operations  
 (b) Financial position on a particular date  
 (c) Operating efficiency of the firm
- (xxiii) Closing stock is shown in the Balance Sheet under \_\_\_\_\_.
- (a) Fixed assets (b) Current assets  
 (c) Current liabilities
- (Ans.: (i) (a), (ii) (a), (iii) (b), (iv) (b), (v) (b), (vi) (a), (vii) (a), (viii) (c), (ix) (a), (x) (b), (xi) (b), (xii) (a), (xiii) (a), (xiv) (a), (xv) (d), (xvi) (a), (xvii) (c), (xviii) (c), (xix) (c), (xx) (c), (xxi) (c), (xxii) (b), (xxiii) (b).)

**5. Answer in One Word:**

- (i) Advertisement expenses outstanding for the year ending March 2005 is ₹ 5,000. Give the journal entry.
- (ii) What entry is drawn if furniture costing ₹ 50,000 is depreciated at 5% under straight-line method?
- (iii) 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%.
- (iv) If bad debts are recovered, what entry can be drawn?
- (v) What is the difference between bad debts and doubtful debts?
- (vi) Give the journal entry for writing off of bad debts against RBD.
- (vii) What is the entry for adjusting the closing stock?
- (Ans.: (i) Advertisement Expenses A/c Dr. To Outstanding Advertisement Expenses A/c, (ii) Depreciation A/c Dr. 2,500 To Furniture A/c 2,500 (Being furniture depreciated), (iii)  $(7,50,000 - 75,000) = 6,75,000 \times 10\% = 67,500$ , (iv) Cash A/c To Bad Debts Recovered A/c, (v) Bad Debts are totally not recoverable, doubtful debts may be recovered, (vi) Reserve for Bad Debts A/c Dr. To Bad Debts A/c, (vii) Closing Stock A/c Dr. To Trading A/c.)

### Practical Problems

1. Prepare manufacturing, trading and profit and loss account from the information given below:

Particulars	(₹)	Particulars	(₹)
<b>Opening Stock:</b>		Rent (factory)	400
Raw Materials	1,000	Rent (offices)	500
Work-in-progress	1,000	Sales return	700
Finished Goods	1,600	Purchase returns	900
Purchases	18,260	General expenses	900
Wages	3,620	Discount to customers	360
<b>Closing Stock:</b>		Interest from bank	200
Raw Materials	2,000		
Work-in-progress	1,000		
Finished Goods	1,420		
Sales	32,000		
Carriage on purchases	500		
Carriage on sales	400		

(Ans.: Gross Profit: ₹ 10,240; Net Profit: ₹ 8,200)

2. From the following balances of Arvind, prepare Manufacturing A/c, Trading A/c and Profit & Loss A/c and Balance Sheet as at 31st December, 2014.

Particulars	(₹)	Particulars	(₹)
<b>Credit Balances:</b>		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	<b>Stock (1.1.05):</b>	
<b>Debit Balances:</b>		Raw Materials	10,000
Debtors	7,770	Work-in-progress	5,000
Salaries	8,000	Finished Goods	4,890
Discount	2,000	Purchases	1,24,184
		Wages	8,600
		Buildings	47,560
		Furniture	32,310

Value of goods on hand 31.12.14

Raw Materials	20,000
Work-in-progress	4,000
Finished Goods	4,600

(Ans.: COP: 20,880, Gross Profit – ₹ 32,290; Net Profit – ₹ 17,746; Balance Sheet total – ₹ 1,36,240)

3. The following balances were extracted from the books of Prasad on 31st March, 2014.

Particulars	(₹)	Particulars	(₹)
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
<b>Stock:</b>		Motor car	4,000
Raw Materials	10,000	Reserve Fund (Cr.)	180
Work-in-progress	10,000	Commission (Cr.)	2,640
Finished Goods	12,400	Car expenses	3,600
Power	4,480	Bills payable	6,700
Taxes & insurance	2,630	Cash	160
Wages	14,400		
Debtors	12,560		
Bank overdraft	6,600		
Charity	210		

Prepare the final accounts for the year ended on 31st March, 2014.

Stock on 31st March 2014 valued at:

Raw Materials	15,000
Work-in-progress	15,000
Finished Goods	17,000

(Ans.: Gross Profit – ₹ 32,440; Net Profit – ₹ 22,540; Balance Sheet total – ₹ 1,04,400)

4. From the following trial balance of Ravi, prepare trading and profit and loss account for the year ended 31st December, 2014 and a balance sheet as on that date.

#### Trial Balance

Particulars	(₹)	(₹)
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	

<b>Stock 1.1.14:</b>	5,200	
Raw Materials	2,000	
Work-in-progress	2,000	
Finished Goods	1,200	
Debtors and Creditors	2,500	1,000
	<b>66,000</b>	<b>66,000</b>

**Adjustment required:**

- (i) Stock on 31.12.14:
- |                  |       |
|------------------|-------|
| Raw Materials    | 1,500 |
| Work-in-progress | 1,500 |
| Finished Goods   | 1,900 |
- (ii) Salaries unpaid ₹ 300
- (iii) Rent paid in advance ₹ 200
- (iv) Insurance prepaid ₹ 90

(Ans.: COP = ₹ 16,000, Gross Profit = ₹ 9,700, Net Profit = ₹ 5,890; B/S total = ₹ 42,190)

5. From the following trial balance, prepare Trading, Profit & Loss A/c for the year ended 31.12.2014 and a balance sheet as on that date:

**Trial Balance**

Purchases	11,870	Capital	8,000
Debtors	7,580	Bad debts recovered	440
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		
<b>Stock (01.01.14):</b>			
Raw Materials	1,000		
Work-in-progress	1,000		
Finished Goods	450		
Discount allowed	40		
Drawings	600		
	<b>27,460</b>		<b>27,650</b>

**Adjustments:**

- (i) The Closing Stock on 31.12.14 was
- |                  |       |
|------------------|-------|
| Raw Materials    | 1,500 |
| Work-in-progress | 1,500 |
| Finished Goods   | 1,200 |

- (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.: COP = ₹ 10,520, Gross Profit = ₹ 4,470, Net Profit = ₹ 2,370; Balance Sheet total = ₹ 14,060)

6. Edward's books show the following balances. Prepare Manufacturing, Trading and Profit & Loss A/c for the year ended 31st December, 2014 and a Balance Sheet as at that date:

Debit Balance	(₹)	Credit Balance	(₹)
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		
<b>Stock on 1-1-2014:</b>			
Raw Materials	30,000		
Work In Progress	30,000		
Finished Goods	29,680		
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		
	<b>5,50,550</b>		<b>5,50,550</b>

**Adjustments:**

- (i) Closing Stock on 31-12-2014
- |                  |        |
|------------------|--------|
| Raw Materials    | 50,000 |
| Work-in-progress | 50,000 |
| Finished Goods   | 28,960 |
- (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)

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