MANONMANIAM SUNDARANAR UNIVERSITY

DIRECTORATE OF DISTANCE AND CONTINUING EDUCATION
TIRUNELVELI-627012, TAMILNADU

B.Com First Year

FINANCIAL ACCOUNTING - I

(From the Academic Year 2023-24)

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Text & Reference Books:

1.S.P.Jain&K.L.Narang, Advanced Accountancy, Kalyani Publishers, New Delhi.
2.R.L.Gupta and M.Radhaswamy, Advanced Accountancy , Sultan Chand &Sons, New Delhi.
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4.Dr.M.A.Arulanandam & K.S.Raman, Advanced Accountancy , Himalaya Publishing House , Mumbai.5.T.S.Reddy & A.Murthy, Advanced Accountancy , Margham Publications, Chennai.
6.R.S.N.Pillai, Bagavathi & D.Uma, Fundamentals of Advanced Accounting , S.Chand & Company Ltd.,New Delhi.

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UNIT -I

BASIC CONCEPT OF ACCOUNTING

INTRODUCTION:

A businessman invests capital with objective of making profit and thereby increasing his resources. He incurs various expenses like salaries, rent and stationery to operate his business. He receives income from different sources like Commission , interest and discount. He deals with several persons in the course of buying and selling of goods, purchasing and selling of assets and borrowing money for financing for financing the business . He acquire various properties and assets like machinery , furniture , building to generate revenue.

Effective management of business requires control over expenses to reduce the cost of operation and to make the business profitable. Assets must be properly maintained to increase their productivity. Liabilities of a business have to be repaid in due time. Dealings with customers and suppliers must be managed properly to keep satisfied. In order to maintain properly in good condition, to repay debts in time, to reduce the expenses and to increase sales, the businessman requires complete information about all his business transactions.

In practice, it is impossible for any businessman to memorize and recollect all his business dealings. Moreover, he will be interested in knowing at the end of each year (i) what he owns? (ii) what he owes? (iii) how much profit he has earned? (iv) what his financial position is? To relieve businessmen from the burden of memorizing all the business dealings and for providing necessary information, Accounting was developed.

Businessmen also require accounting records to submit in courts to prove their claims or to defend in courts against made by outsiders. They are required to produce business records to tax authorities whenever demanded. Similarly, financiers require accounting records of businessmen to decide about sanctioning of loans. Thus, transactions relating to business have become so important that their recording has become a necessity.

ACCOUNTING – DEFINITION:

According to the American Institute of Certified Public Accountant defined Accounting as "Accounting is the art of recording, classifying and summarizing in a significant manner and in term of Money, transactions and events which are, in part at least, of a financial character and interpreting the results thereof."

American Accounting Association defined accounting as "the process of identifying, measuring and communicating economic information to permit informed judgment and decisions by users of the information".

This definition highlights in a logical sequence the different steps in the accounting process and some important attributes of accounting.

ATTRIBUTES AND STEPS OF ACCOUNTING

1. **Recording :** Systematic recording of business transactions is the first step in the accounting process. Each and every transaction is recorded as and when it occurs, in chronological order. Every entry recorded has t be supported by reliable documentary evidence. Recording of business transactions is usually done in journal or in subsidiary books which are ' books of original entry'.
2. **Classification:** It is the process of grouping transactions or entries on a predetermined basis. The classification takes the form of 'accounts' in a separate book known as Ledger. Separate accounts are opened for each expense, income, property , liability and persons with whom the business has dealings. Classification facilitates segregation of numerous business transactions into identifiable groups.
3. **Summarising :** The classified data in the ledger is presented periodically in a manner which is understandable and useful to the owners and other interested parties. Summarising takes place in the form of trial balance , trading account, profit and loss account and balance sheet. The trial balance ensures the arithmetical accuracy of the recording and classification process.The trading account reveals the gross profit of the business . Profit and loss account shows net profit

or loss for the accounting period. The balance sheet portrays the financial position of the business.

4. **Significant manner:** The accounting process of recording , classifying and summarizing must be carried on in a significant manner . Each business has its own peculiarities, special problems and particular requirements. The management of the business needs specific types of information for controlling and decision-making purposes. Sales and purchases may have to be shown for each product , division , department , and branch separately. Profit or loss may be required independently for each product or service.

5. **In terms of money** :All business transactions have to be recorded in terms of money. It is the medium through which all the business transactions are expressed. Land and buildings in square feet, furniture and fixtures in number, stock in units are all recorded as per their monetary values. 'Money measurement ' is the basis for accounting.

6. **Transactions and events of financial character:** All those business transactions and events which are financial in character are recorded in accounts. All the events , dealings and happenings which have to no financial effect are completely ignored in the accounting process. For example, working conditions, skilled work force, sales policies , employees, morale etc., are all important for a business. But they have no 'financial character' and are omitted from accounting process.

7. **Interpreting the results:** Interpretation of the results is needed for various purposes. The trends observed in sales, purchases, expenses etc., are useful for future planning of operations. Data about customers and suppliers have to be interpreted to decide about credit policies. The owners are interested in the amount and growth of profit. The creditors are interested in the liquidity and stability of the business.

Interpretation is usually done through Ratios and Flow statements. They are useful in evaluating past performance and providing guidance for future plans and operations.

BRANCHES OF ACCOUNTING

The Modern business world has become highly competitive and technology oriented. Management of the business units has become highly complex, needing varied types of information. To satisfy the additional demand of management for information, several new branches of accounting have been developed.

1. **Financial Accounting :** The accounting for revenues, expenses , assets and liabilities that is commonly carried on the general offices of business is known as Financial Accounting. The financial accounting information is expressed in two main types of financial statements, viz:

(i) Profit & Loss Account(showing the incomes and expenses of the accounting period to ascertain the profit or loss)

(ii) The Balance sheet (showing assets and liabilities, revealing financial position as on that date)

The owners, creditors, management, employees, financiers etc., make use of information provided by financial accounting.

2. **Cost Accounting :** It is that branch of accounting which deals with classification, recording , allocation, summarization of current and prospective cost. It determines cost of production and distribution by departments, functions, products etc. Cost accounting is essential for pricing of product s and services and for cost reduction and cost control. Cost accounting data is useful to the management of the business ; outsiders are not usually provided with costing data.

3. **Management Accounting** : It is that branch of accounting which is meant exclusively for managerial decision making . It provides necessary information to the management for discharging its functions of planning, organizing, co-ordinating, directing and controlling. It usually provides data on the funds and cash flows, investment projects, preparation and implementation of budgets etc. Almost all the policy decisions of management are made on the basis of primary data provided by management accounting.

4. **Social Responsibility Accounting:** With the increasing awareness about the social issues and involvement of the various business houses in view to work for profit and support a cause

along with the advancement in the laws relating the CSR there has been a significant increase in the spending towards social causes. The companies who are spending towards CSR are highly interested in knowing whether the amount spent by them is able to fulfill the cause and generate the impact it had expected through the spending. The measurement of the social benefits created and the lives impacted is the main objective of the Social Responsibility Accounting. For Example: If Company ABC had spent Rs.1.00 Cr during F.Y.2017-2018 for promoting education among the low income kids. It would like to know the number of kids who got enrolled in the schools via their programs for which they had spent amount of Rs.1.00 Cr.

5. **Human Resource Accounting:** Of all the expenditure incurred by the businesses they can be measured by using the standards, measurements and valuation principles provided by various laws, regulations and AS. Except for the Human Resource, which is the only expenditure incurred by the company to develop and maintain the human resource which will be able to provide the company benefits across the years. However, it is written off as expense in the year it is incurred. Human Resource Accounting attempts to identify measure and report the investment made in the Human Resource of the entity.

FUNCTIONS OF ACCOUNTING

The functions of accounting include the systemic tracking, storing, recording, analysing, summarising and reporting of a company's financial transactions. Through the functions of the accounting department, the company can maintain a fiscal history that they can make accessible for audits. They can also use it to prepare reports, create budgets, reduce costs, increase profits, avail growth opportunities, assess future expenditure requirements and make financial predictions.

Keeping financial records: Accounting helps businesses maintain an accurate and up-to-date record of the day-to-day financial transactions of the company, such as supply purchases, product sales, receipts and payments.

Monitoring financial transactions: Accountants may track multiple financial transactions related to payments due to the company to ensure it receives the revenue and remains profitable.

Making Bill payments: Accounting involves checking invoices to ensure the legitimacy of the charges, setting payment dates and paying the bills that the company owes to various vendors and suppliers.

Paying employee salaries: Companies can use accounting to make payroll payments from company funds, manage employee benefits and issue employee work-related bonuses.

Keeping digital records: Accounting may involve creating, maintaining and updating digital accounting systems to store and calculate the company's financial data.

Writing financial reports: Accounting involves repairing detailed quarterly and annual financial reports about the company's assets, profits and losses for internal and external stakeholders.

Maintaining fiscal history: Accountants assist with creating, documenting and storing the fiscal history of the company's transactions and making it available for audits and assessments.

Achieving business goals: An accountant can analyse financial data to formulate and implement comprehensive financial policies and strategies to advance the company's business goals.

Preparing Budgets: The accounts department may reference the company's financial data to prepare the overall company budget, the department budgets and the project budgets.

Making financial projections: Accounting involves analysing the company's available financial resources, expected revenues and business goals and using this information to predict future business expansion and growth.

Auditing finances: Accountants may conduct financial audits of the company, identify accounting discrepancies and implement corrective solutions

Assessing Financial resources: Companies can use accounting to identify the financial weaknesses and strengths of the organisation, determine how to counter weaknesses and boost strengths and implement appropriate strategies.

Reviewing Performances: Accounting involves performing regular financial reviews of the company's departments to assess their performance and make changes to reduce waste, increase productivity and streamline expenses.

Complying Legal requirements: Accountants make sure the company complies with industry and government rules, regulations and policies related to taxation, financial reporting and employee wages.

Preventing mismanagement: The accounting department can keep accurate track of the company's financial transactions to ensure no mismanagement or wastage of money occurs in the company.

Ensuring Vigilance Fraud: Accounting includes implementing strong security measures to protect the company assets against data breaches and internal and external fraud

ADVANTAGES OF ACCOUNTING

Reliable Records

Transactions cannot be stored up in memory even in the case of small shops. The reliable record of transaction is necessary for reference at any time. Since all the transactions are recorded in the books, there is no need to rely on memory.

Calculation of Profit or Loss

The objective of any business is to earn profit. Therefore, the owner wishes to find out the profit or loss in his business at any time. With the help of accounting information, the profit and loss account is prepared to find out profit and loss of the business.

Calculation of Dues

The businessman has to know, how much others have to pay him and how much he has to pay others. This information can be gathered with the help of proper accounting records.

Prevention of Errors and Frauds

Proper accounting not only prevents and discovers errors but also prevents and discovers frauds.

Control over assets

The owner has to keep a check over the assets and find out the values year after year. Accounting provides such information which helps the owners and the management to make use of the assets in the best possible manner.

Ascertainment of the growth of business

When a owner prepares financial statements for several years, he is in a position to make year to year comparison. This will enable him to ascertain the growth of his business.

Fixing the selling price

Accounting information is essential for determining the selling price of the goods produced.

Taxation

For the income tax and sales tax purposes, the accounting information is essential.

LIMITATIONS OF ACCOUNTING

1. Accounting is historical in nature. It does not reflect the current financial position or worth of a business.
2. Transactions of non-monetary nature do not find place in accounting. Accounting is limited to monetary transactions only. It excludes qualitative elements like management, reputation, employee morale, labour strike etc.
3. Facts recorded in financial statements are greatly influenced by accounting conventions and personal judgement of the Accountant or management. Valuation of inventory, provision for doubtful debts, valuation of goodwill and assumption about useful life of an asset may therefore, differ from one business house to another.
4. Accounting principles are not static. Therefore, accounting statements do not always present comparable data.

5. Cost concept is found in accounting. Price changes are not considered. Money value is bound to change often from time to time. This is a strong limitation of accounting.

6. Accounting statements do not show the impact of inflation.

7. The accounting statements do not reflect those increase in net asset values that are not considered realized.

METHODS OF ACCOUNTING

Basically all methods of accounting are classified under two headings:-

1.Single entry system

2. Double entry system

Single entry system

The term single entry is vaguely used to define the method of maintaining accounts which do not conform to strict principles of double entry. It is wrong to define it as system. The term 'single entry' does not mean that there is only one entry for each transaction. It simply signifies that principles of double entry book-keeping have not been observes in all cases. Under this system , only the personal accounts of the debtors and creditors and cash book of the trader are maintained.

Double entry system

This system was invented by an Italian named Juco Pacioli in 1494 A.D. and it has spread all over the world, becoming as popular as Arabic numerals. According to this system, every transaction has two aspects. One is benefit receiving aspect or incoming aspect and the other one is benefit giving aspect or outgoing aspect. The benefit receiving aspect is said to be a 'debit' and the benefit giving aspect is said to be a 'credit '. For every transaction, one account is to be debited and another account is to be credited in order to have a complete record of the transaction. Therefore, every transaction affects two accounts in opposite direction.

TYPES OF ACCOUNTS

There are three types of accounts are as called as

- **Personal Accounts**
- **Real Accounts**
- **Nominal Accounts**

1. **PERSONAL ACCOUNTS:** An account of each person, or company with which the business deals or Accounts of persons with whom the business has dealings are known as personal Accounts .

(a) Natural Persons: The name of an individual - customers or suppliers.

(e.g) Murugan 's account , Raja's account

(b) Artificial persons or legal bodies: Firms's accounts, limited companies' accounts, educational institutions' accounts, bank account, co-operative society account etc., are known as artificial persons' accounts.

(c) Represetative personal accounts: All accounts representing outstanding expenses and accrued or prepaid incomes are personal accounts.

(e.g.) Prepaid insurance, outstanding wages, salary , rent etc.

2. **REAL ACCOUNTS:** Accounts in which the business records the records the real things owned by it. i.e., assets of the business are known as real accounts. Real accounts are of two types.

a) Tangible Real Accounts: Building, Furniture , Machinery , Cash etc.,

b) In **Tangible Real Accounts: Trademark , goodwill , patents and copyright etc.,**

3. **NOMINAL ACCOUNTS:** It relates to the items which exist in name only. Expenses, incomes etc., are there in business activities. Accounts which record expenses, losses, incomes and gains of the business are known as nominal accounts.

e.g., rent A/c, salaries A/c, telephone charges A/c, postage A/c, advertising A/c, commission received A/c, interest received A/c.

ACCOUNTING RULES

The benefit receiving aspect and benefit giving aspect. A transaction should be divided into two aspects.

1. Debit aspect 2. Credit aspect

The rules for making entries under double entry system can be summarized as follows;-

1.	Personal Accounts	Debit the receiver
		Credit the giver
2.	Real Accounts	Debit what comes in
		Credit what goes out
3.	Nominal Accounts	Debit all expenses and losses
		Credit all incomes and gains

ACCOUNTING CONCEPTS

The term accounting concepts refer to the basic assumption and conditions upon which the science of Accounting is based. There is no authoritative list of these concepts. In other words, concept means such ideas which are compiled with different accounting procedures. E.g. Appropriation and charge, reserve and provisions, depletion and amortization etc. The following are some of the important accounting concepts.

1. Separate Entity Concept
2. Dual Aspect Concept
3. Going Concern Concept
4. Money Measurement Concept
5. Cost Concept
6. Accounting Period Concept
7. Realization Concept
8. Matching Concept

9. Accrual Concept

10. Objective Concept

1. Separate Entity Concept

For accounting purposes, a business is considered to be different from the persons who own it. The accounting system deals only with the accounts of the firm and not that of the owners. Otherwise, the affairs of the business would get mixed up with the affairs of the owners. The balance sheet of a sole trader does not disclose the private assets of its owner, even though such assets might be claimed by the creditors in case of loss in the business. Thus, this concept prescribes the boundaries for recording and reporting the economic information of an enterprise. This concept also helps to record in the books of the firm, the transactions that take place between the business and its owners. Moreover, when a large business is divided into different departments or divisions, this principle of separate entity helps to measure the efficiency of such departments.

2. Dual Aspect Concept

Modern accounting is based on the dual aspect concept. For every debit, there should be a corresponding credit. Hence, the total of the debits will always be equal to the total of the credits. Further, assets of a firm are purchased by the funds provided by the owners and the creditors. Therefore, the total of the assets should always be equal to the total of the liabilities or equities. Equities are the claims of the owners and outsiders on the assets of the firms. Hence, the equation,

Assets = Liabilities + Capital (or) Assets –Liabilities =
Capital

3. Going Concern Concept

The general assumption is that a business will exist for a long time to come and will not be liquidated in the near future. People will not like to deal with a business that is to be closed down. Suppliers may not provide goods, workers may not provide their services and financial institutions may not provide credit facilities. If a business is to be closed down, its assets should be valued at current realizable values. But this is not so in case of going concern. Since the assets are meant for use, they are valued at their original cost only.

4. Money Measurement Concept

All the transactions of a business are recorded only in terms of money. Because, money is the medium of exchange and a common measure of value. This serves as a measuring rod with which different kinds of resources are measured. For instance, a business may own 2000 square meter of building space, cash Rs.1,00,000, raw materials of 5,000 tons, motor trucks 5 numbers, motor cars 3 numbers and 100 sets of table and chair. All these items cannot be added together to give a meaningful information. However, when the value of all these assets are expressed in terms of rupees or dollars, then they can be added together to give a meaningful information and a clear picture about the total value of the business.

5. Cost Concept

The meaning of this concept is that an asset will be recorded at its cost, that is price paid or to be paid for acquiring it. Any change in the market value of the asset is not recorded. The market value may fluctuate from time to time and create confusion if the change in value is recorded. The change is unrealized, hence they need to be recorded.

When the value of an asset is reduced due to its constant use, due to wear and becoming obsolescence, then they are shown as depreciation and reduced from the original cost of the asset.

6. Accounting Period Concept

The business activity is a continuous process and we cannot wait till the end of the business to evaluate its financial position. Hence for reporting purpose, the entire life of a business is divided into different accounting period. A period normally may cover 12 months. A profit and loss account is prepared once in a year and the balance sheet is prepared as on the closing date of the accounting period.

7. Realisation Concept

This concept is related to realization of revenue which arises from sale of goods or services.

But the question arises as to when the revenue should be recognized and how much of it should be taken into account. One must ascertain the revenue of the current year, past year and of the next year. Revenue arises when title to goods is transferred or when services is rendered to the customer. In the case of a credit sale, revenue arises when the sale is made, and not when the cash is received. Likewise, when an advance is received for supply of goods, it does not amount to revenue. Revenue, in fact, arises only when goods are supplied.

8. Matching Concept

The meaning of expenses against revenues for ascertaining the net profit or loss of a business is known as the matching concept. The matching concept required that costs should be recognized as expenses in the period in which the associated revenue is recognized. For example, when a radio is sold in the current year, all the costs associated with the production and sale of that radio should be recognized as expenses of the year, even though some of these expenses have not been paid. In other words, profits made by a business during a period can be measured only when the revenue earned during the period is compared with the expenses incurred for earning that revenue. The question as to when the payment for the expense is made does not arise at all.

Because of matching concept, adjustments are made for all outstanding and prepaid expenses and incomes receivable and received in advance at the time of preparing final accounts.

9. Accrual Concept

Under this concept, revenue recognition depends on its realization and not on actual receipt. Likewise, costs are recognized when they are incurred and not when paid. This necessitates certain adjustments in the preparation of Income statement. In relation to revenue, the accounts should exclude amounts relating to subsequent period and provide for revenue recognized but not received in cash.

Likewise in relation to costs, the accounts should exclude amount relating to subsequent period, provide for costs incurred but not paid and exclude costs paid for subsequent period.

The matching principle is not followed in the case of cash system of accounting and the operating results prepared on this basis are not in conformity with generally accepted accounting principles.

10. Objectivity Concept

As per this concept, all accounting must be based on objective evidence. In other words, the transaction recorded should be supported by various documents. Only in such an event, it would be possible for the auditors to verify accounts and certify them as true or otherwise. The evidence substantiating the business transactions should be objective and free from the bias of the accountants. It is not for this reason that assets are recorded at historical cost and shown thereafter at historical cost less depreciation. If the assets are shown on replacement cost basis, the objectivity is lost and it becomes difficult for auditors to verify such values.

ACCOUNTING CONVENTIONS

Accounting conventions refer to the traditions, customs and practices followed by accountants as a guide in the preparation of financial statements. That is, it is an accounting procedure followed by the accounting community on the basis of long- standing customers.

Convention of Disclosure

It implies that accounts must be honestly prepared and all material information must be disclosed therein. The contents of balance sheet and profit and loss account are prescribed by the Indian Companies Act. These are designed to make disclosure which means that there is to be a sufficient disclosure of information which is of material interest to proprietors, potential creditors and investors.

Now-a-days business is increasingly managed by professionally qualified managers. They owe a duty to make a full disclosure to the persons who have contributed the capital. Financial accounting requires the disclosure of all signified accounting policies adopted in the preparation of financial statements. Events like bad debts, destructions of plant and equipment due to natural calamities, and acquisition of another major asset are likely to have a substantial influence on the earnings of the enterprise. Hence, their non-disclosure would affect the ability of the users of such statements to make proper evaluations and decisions.

Convention of Materiality

This convention deals with the relative importance of the accounting information. Information which is unimportant need not be disclosed in the financial statements. It is left to the discretion of the accountant to decide what is material and what is immaterial. Generally information is said to be material if it would influence the judgement of an investor or creditor. Sometimes, an accountant may not go into minute details because the work involved may not justify the usefulness of the result.

For instance, in a large concern the entire value of stationery items issued for use in the office may be written off as expenses of the period. Strictly speaking stationery consumed should be treated as expenses and that which remains unused, should be treated as an asset. But it is difficult to find out the value of that part of the stationery which has been used up and that part which remains as stock. Many of the expenses for a period are mere estimates and an attempt to find out the exact amount of expenses involved may not be worthwhile. Moreover, while preparing financial statements, unimportant items can be merged with other items and decimal figures may be rounded off to the nearest rupees.

Convention of Consistency

In any organization, accounting practice should be followed consistently year after year. For example, if depreciation for a particular asset is provided on the basis of diminishing balance method, then the same method should continue in the subsequent years also. If there is no consistency in the accounting method, then comparison of accounting figures and the trading results of different years would become meaningless.

Convention of Conservation

This is the Policy of "Playing Safe". A business man is always conservative in estimating his profits. He never takes into account expected profits but takes into account all expected losses. This is rather a pessimistic attitude and is reflected in the preparation of accounting statements also. Stock is always valued at cost or market price whichever is lower. Provision for doubtful debts and discount on debtors is created. This convention is against the convention of full disclosure and is attracting a lot of criticism.

JOURNAL

Books used for recording transactions are called Books of Account. Every business must invariably maintain two books of accounts. They are: i) Journal and ii) Ledger.

The journal is the "day-by-day" book of the business where in both aspects of all transactions are recorded in chronological order (i.e.) date-wise. The very first record of a business transaction is made in order of date in the journal. The journal is thus, a "Book of Prime Entry". It is otherwise known as "Book of Original Entry". It is then posted from the journal into the ledger. As such, the ledger is known as the principal book or main book. The ledger is otherwise known as Book of Final Entry.

The journal merely helps the posting of entries from Journal into the Ledger. Hence, Journal is known as Subsidiary Record or Subsidiary Book. The journal is sub-divided into a number of Subsidiary Books which, for convenience and have certain specialized functions, i.e. one book is meant for Credit Purchases and another for Credit Sales and so on.

Specimen

Journal Entry

Date	Particulars	L.F.	Debit		Credit	
			Rs.	P.	Rs.	P.

LEDGER

So far we have learnt the method of recording the business transactions in the journal. Now we shall learn the second book namely ledger. Ledger is a main book of accounts. It contains accounts representing persons, properties and nominal items like expenses and gains.

All the transactions are recorded in the journal separately and date-wise. As such, the transactions of a similar nature or those relating to a person or property or expenses/gain are recorded in different places as they occur on different dates. Moreover, the journal simply dissects the given transactions as to which account is to be debited and which one to be credited without much bothering as to what is the„ final result‟.

To get the picture as a whole, journals are further processed. All similar transactions relating to particular account (eg.) cash a/c or Raman‟s a/c or salary a/c for a given period are brought together. In other words, they are recorded at one place in ledger.

Specimen

Ledger

Dr. Cr.

Date	Particulars	J. F.	Amount Rs.	Date	Particulars	J. F.	Amount Rs.

Illustration: 1

Journalise the following transactions in the books of Mr. Raman

2021		Rs.
June 1	Murugan commenced a business from cash	40000
2	Cash deposit in to the Indian bank	8000
4	Goods purchased for Cheque	2000
5	Sales to Mr. Arun Kumar	1600
12	Purchased from Mr. Ruban	4000
20	Cash sales	3000
22	Goods return to Mr. Ruban	1000
24	Goods returns from Mr. Anurn	100
30	Rent paid	400
	Salary paid	600
	Commission received	150

Solution:

Journal Entries of Mr. Raman

Date	Particulars		L.F.	Debit Rs.	Credit Rs.
2021 [{d; 1	Cash a/c To Capital a/c (Murugan start business	Dr.		40,000	 40,000
2	Bank a/c To Cash a/c (cash deposited in Indian Bank)	Dr.		8,000	 8,000
4	Purchase a/c To Bank a/c (Goods purchase for Cheque)	Dr.		2,000	 2,000
5	Mr. Arun Kumar a/c To Sales (Sales to Mr. Aurn Kumar)	Dr.		1,600	 1,600
12	Purchases a/c To Mr. Ruban (Goods from Mr. Ruban)	Dr.		4,000	 4,000
20	Cash a/c To Sales a/c (Cash sales)	Dr.		3,000	 3,000
22	Mr. Ruban a/c To Purchases returns a/c (Goods returns to Mr. Ruban)	Dr.		1,000	 1,000
24	Sales returns a/c To Mr. Arun a/c (Goods returns from Mr. Arun)	Dr.		100	 100
30	Rent a/c To Cash (Rent paid)	Dr.		400	 400
	Salary a/c To Cash (Salary paid)	Dr.		600	 600
	Cash a/c To Commission a/c (Commission received)	Dr.		150	 150

Illustration: 2

Journalise the following transactions in the books of Amar and post them in the ledger

2014 March		Rs.
1	Bought goods for cash Rs. 25,000	25,000
2	Sold goods for cash Rs. 50,000	50,000
3	Bought goods for credit from Gopi Rs. 19,000	19,000
5	Sold goods on credit to Robert Rs. 8,000	8,000
7	Received from Robert Rs. 6,000	6,000
9	Paid to Gopi Rs. 5,000	5,000
20	Bought furniture for cash Rs. 7,000	7,000

Solution:

Journal Entry of Amar

Date	Particulars	L.F.	Debit Rs.	Credit Rs.
2014 March 1	Purchases a/c Dr. To Cash a/c (Cash purchases)		25,000	25,000
2	Cash a/c Dr. To Sales a/c (Cash sales)		50,000	50,000
3	Purchases a/c Dr. To Gopi a/c (Credit purchases)		19,000	19,000
5	Robert a/c Dr. To Sales a/c (Credit sales)		8,000	8,000
7	Cash a/c Dr. To Robert a/c (Cash received)		6,000	6,000

9	Gopi a/c Dr. To Cash a/c (Cash paid)		5,000	5,000
20	Furniture a/c Dr. To Cash a/c (Furniture purchased)		7,000	7,000

Ledger of Mr. Amar Cash Account

Dr. Cr.

Date	Particulars	J. F.	Amount Rs.	Date	Particulars	J. F.	Amount Rs.
2014				2014			
Mar. 5	To Sales a/c		50,000	Mar. 1	By Purchases a/c		25,000
	To Robert a/c		6,000	9	By Gopi a/c		5,000
				20	By Furniture a/c		7,000

Purchases Account

Dr. Cr.

Date	Particulars	J. F.	Amount Rs.	Date	Particulars	J. F.	Amount Rs.
2014							
Mar. 1	To Cash a/c		25,000				
3	To Gopi a/c		19,000				

Sales Account

Dr. Cr.

Date	Particulars	J. F.	Amount Rs.	Date	Particulars	J. F.	Amount Rs.
				2014			
				Mar. 2	By Cash a/c		50,000
				5	By Robert a/c		8,000

Furniture Account

Dr. Cr.

Date	Particulars	J. F.	Amount Rs.	Date	Particulars	J. F.	Amount Rs.
2014 Mar 20	To Cash a/c		7,000				

Gopi Account

Dr. Cr.

Date	Particulars	J. F.	Amount Rs.	Date	Particulars	J. F.	Amount Rs.
2014 Mar 9	To Cash a/c		5,000	2014 Mar 3	By Purchase a/c		19,000

Robert Account

Dr. Cr.

Date	Particulars	J. F.	Amount Rs.	Date	Particulars	J. F.	Amount Rs.
2014 Mar 5	To Sales a/c		8,000	2014 Mar 7	By Cash a/c		6,000

RECTIFICATION OF ERRORS

INTRODUCTION :

Every concern is interested in ascertaining its true profit/loss and financial position at the close of the accounting year. The effort of the accountant is to prepare the final accounts in such a fashion which exhibits true and fair picture of the business. The basic information for the preparation of final accounts is supplied by the trial balance. Thus, the accuracy of the trial balance determines to a great extent the accuracy or otherwise of the information provided by final accounts. However, the trial balance is prepared to ensure the arithmetical accuracy of the records of a business and also to ensure that for every debit entry a credit of an equal amount has been recorded.

Thus, a trial balance in which the total of the debits does not equal the total of credits can be taken as an evidence for the existence of some errors in the records. On the other hand, a trial balance in which the total of the debits equal the total of credits is not a conclusive proof of accuracy of the records. Certain errors may not affect the agreement of a trial balance as the erroneous entries may not violate the dual aspect concept. It means that even if the trial balance agrees, steps should be taken to ensure that the records are free from errors. It, therefore, becomes utmost important to locate such errors and rectify them so that the correct financial position of the concern may be ascertained. So whenever errors in accounting records come to notice, they should be rectified without waiting till the end of the accounting year when trial balance is to be prepared. The objectives of rectification of errors are as follows:

a) Presenting correct accounting records;

b) Ascertaining correct profit or loss for the accounting period; and

c) Exhibiting a true financial position of the concern on a particular date.

Accounting errors and rectification

Classification of ACCOUNTING errors

- The errors can be classified as follows: Clerical Errors

- Errors of Principle

Clerical errors

Clerical errors are those errors which are committed by the clerical staff during the course of recording the business transactions in the books of accounts. These errors are:

a) Errors of omission

b) Errors of commission

c) Compensating errors

a) Errors of Omission

When a transaction is either wholly or partially not recorded in the books of accounts, it is an error of omission. When a transaction is omitted completely, it is called "complete error of omission" and when a transaction is partly omitted, it is called a "partial error of omission". A complete error of omission does not affect the agreement of trial balance whereas partial error of omission may or may not affect the agreement of trial balance. For example, ₹ 100 paid to Ram is neither recorded in the cash book nor in the account of Ram, this error will not affect the agreement of trial balance. Only the total of the trial balance would be short by ₹ 100. But if posting is not done in one of the accounts, this will affect the agreement of trial balance.

b) Errors of Commission

Errors of commission take place when some transactions are incorrectly recorded in the books of accounts. Such errors include errors on account of wrong balancing of an account, wrong posting, wrong totaling, wrong carry forwards, etc. For example, if a sum of ₹ 255 received from Hari is credited to his account as ₹ 525, this is an error of commission. Similarly, if a sum of ₹ 500 paid to Suresh is credited to Sohan's account, such an error is an error of commission. Some of the errors of commission affect the agreement of trial balance whereas others do not. Errors affecting the agreement of trial balance can be easily revealed by preparing a trial balance.

c) ***Compensating Errors***

These errors, also called self-balancing or equalising errors, are a group of errors, the total effect of which is not reflected in the trial balance. These errors are of a neutralizing nature. One error is compensated by the other error or errors of an opposite nature. For example, Amitabh's account is credited with ₹ 500 instead of ₹ 600; Abhijit's account credited with ₹ 160 instead of ₹ 100 and Jaya's account credited with ₹ 150 instead of ₹ 110. Here the first error of under-credit of ₹ 100 is covered by second and third errors of over-credit of ₹ 60 and ₹ 40 respectively.

Errors of Principle

When a transaction is recorded against the fundamental principles of accounting, it is an error of principle. These errors arise because of the failure to differentiate between capital and revenue items i.e.a capital expenditure is taken as a revenue expenditure or vice-versa. Similarly, a capital receipt may have been taken as a revenue receipt or vice-versa. For example, a sum of ₹ 50 paid on the repairs of furniture should be debited to repairs account, but if it is debited to the furniture account, it will be termed as an error of principle. Repair of furniture is revenue expenditure. If it is debited to furniture account, it has been taken as a capital expenditure. Such errors do not affect the agreement of the trial balance because they are correctly recorded so far as the debit or credit side of the wrong class of account is concerned. It would be appreciated that such an error arises through lack of knowledge of principles of accounting.

Location of errors

The location of errors of omissions, compensations and principles are slightly difficult because of the fact that such errors do not affect the agreement of trial balance. However, the locations of some errors of commission are comparatively easier because they affect the agreement of the trial balance. Thus, the errors can be classified into two categories from the point of view of locating them:

Errors which do not affect the agreement of Trial Balance

As stated, errors of omission, errors of compensating nature and errors of principle do not affect the agreement of the trial balance. Their location is, therefore, a difficult task. These are usually found out when the statements of accounts are sent to the customers or received by the business or during the course of audit and sometimes by chance. For example, if a credit sale of ₹ 2000 to Suresh has not been recorded in the books of accounts, the error will not affect the agreement of the trial balance and therefore, at the time of finalizing the accounts it may not be traced out. However, this will be found out when a statement of account is received from Suresh showing the money payable by him or when a statement of account is sent to Suresh showing the money due from him.

Errors which affect the agreement of Trial Balance

The errors which cause a mismatch in the trial balance totals are frequently referred to as errors disclosed by a trial balance. However, the mismatch does not automatically point out the actual errors. Itis only the diligence and ingenuity of the person preparing the accounts which would help in the location of errors. The procedure to be followed for location of such errors can be put as follows:

i) The totals of the trial balance itself should be thoroughly rechecked in order to find out exact or correct difference.

ii) Make sure that the balances of cash and bank is included.

The difference of the two sides of the trial balance should be found and be divided by two and then find out whether a figure equal to the same (i.e. half the difference) appearsin the trial balance. This procedure would enable to locate the amount placed on the wrong side.

i) If the error remains undetected, divide the exact difference by 9. If it is divisible by 9, this will mean that there may be transposition error or slide error. A transposition error is committed when the digit of an amount is misplaced. For example, machinery account has a balance of ₹ 5689, but it has been written as ₹ 5869 in the trial balance. The resulting error is ₹ 180, which is divisible by 9. A slide error is committed when the decimal point is placed incorrectly. For example, ₹ 3670 is copied as ₹ 36.70. The resulting error is ₹ 3633.30 which is also divisible by 9.

ii) See that there is no mistake in balancing of the various accounts.

iii) The schedules of debtors and creditors should be scrutinised so as to find out that all the debtors and creditors have been included in these schedules; their totals are correct.

iv) If the difference is of a substantial amount, compare the figures of trial balance of the current year with the trial balance of the preceding year and see whether there is any abnormal difference between the balances of important accounts of the two trial balances.

The total of subsidiary books should be checked and it should be seen whether posting has been done from these books correctly to respective accounts in the ledger or not.

iii) It should be checked that opening balances have been correctly brought forward in the current year's books.

iv) If the difference is still not traced, check thoroughly the books of original entry and their posting into the ledger and finally the balancing of various accounts.

v) If the error still remains undetected, repeat the above steps with the help of other members of the staff, who are not involved in maintaining the books of accounts.

Rectification of errors

From the point of view of rectification of errors, these can be divided into two groups:

a) Errors affecting one account only.

b) Errors affecting two or more accounts.

Errors affecting One Account

The following errors affect only one account:

(a) Errors of posting

(b) Carry forward

(c) Balancing

(d) Omission from trial balance

(e) Casting

Such errors should first of all be located and rectified. These are rectified either with the help of journal entry or by giving an explanatory notes in the account concerned and not by simply crossing the wrong amount and inserting the right one.

Errors affecting two or more accounts

The following errors affect two or more accounts:

(a) Errors of omission

(b) Posting to wrong account

(c) Principle

As these errors affect two or more accounts, rectification of such errors is done with the help of a journal entry.

Stages of rectification of errors

All types of errors can be rectified at two stages:

i) Before the Preparation of Final Accounts.

ii) After the Preparation of Final Accounts.

Rectification of errors before the preparation of Final Accounts

If the error is located before the preparation of final accounts, it is either rectified by recording or posting the necessary amount in the respective account or by recording the necessary journal entry to rectify that error. If the error is one sided, it can be rectified by recording or posting the necessary amount in that account. If it is two sided, the necessary journal entry is recorded.

a) Rectification of One sided errors

These are the errors which affect one account and will affect the agreement of trial balance. Such errors are rectified by debiting or crediting the affected account in the ledger. For example:

i) Purchase Book has been undercast by ₹ 2,000.

The error is only in Purchases Account. If ₹ 2000 is now posted in the debit side of Purchase Account as“To undercasting of Purchase Book”, the error will be rectified.

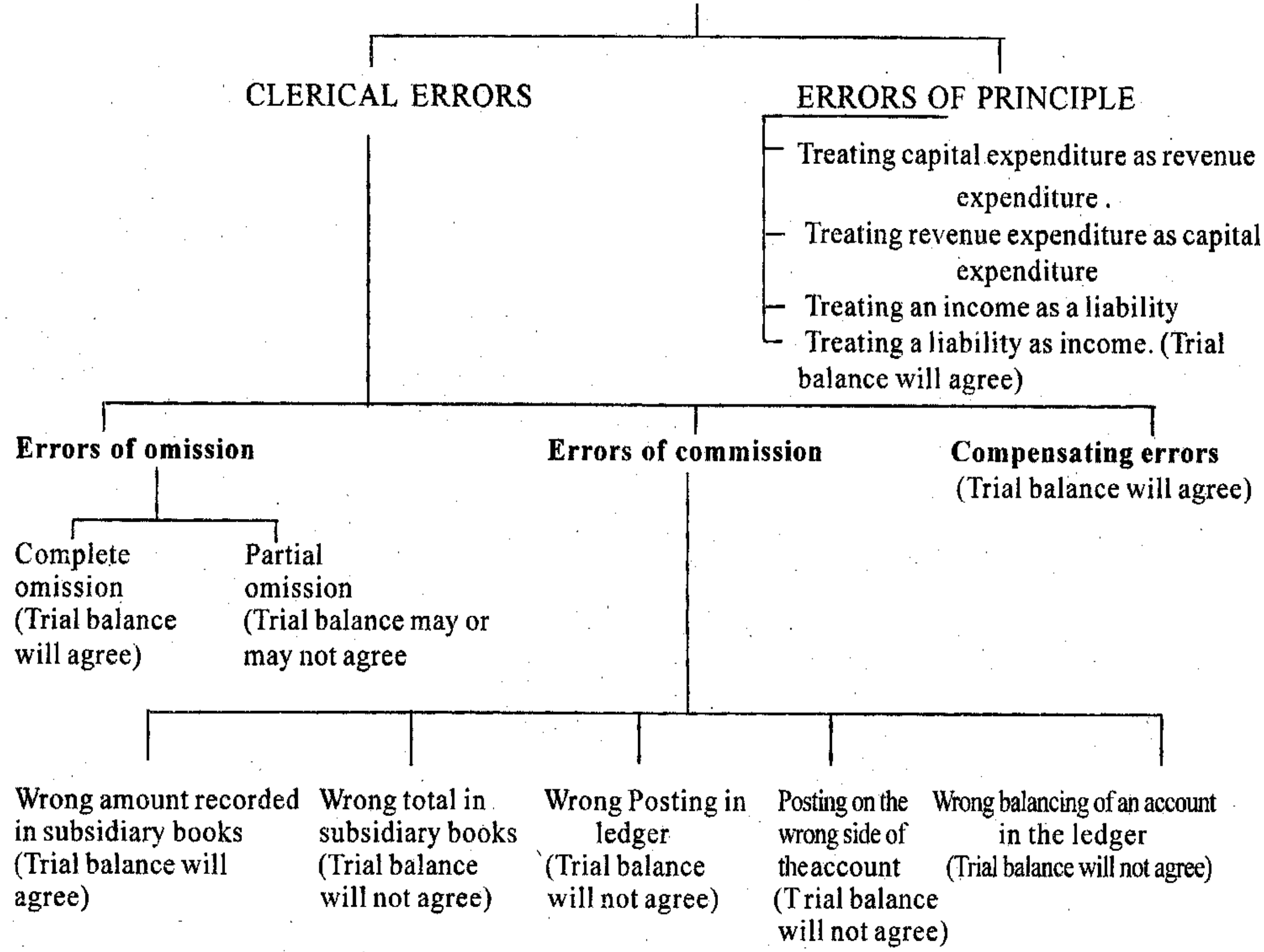
ii) Amount of ₹ 1000 paid to Hari not debited to his personal account.

This error is affecting the personal account of Hari and its debit side is less by ₹ 1000 because of omission to post the amount paid. We shall now write on the debit side of Hari Account as “To Cash (omitted to be posted) ₹ 1000 to rectify this error.

iii) Goods sold to Khan wrongly debited in Sales Account.

This error is affecting the Sales Account only as the amount which should have been posted on thecredit side has been wrongly placed on the debit side of the same account. By putting double the amountof transaction on the credit side of Sales Account by writing “By sales to Khan wrongly debited previously”, this error shall be rectified.

CLASSIFICATION OF ERRORS



b) **Rectification of two sided errors**

As these errors affect two or more accounts, rectification of such errors can often be done with the help of a journal entry. These types of errors do not affect the agreement of trial balance. For example, if furniture purchased has been recorded through purchase book, two accounts viz. Purchases Account andFurniture Account are affected. Thus, rectification will be made by taking these two accounts. When such errors are to be rectified, the following procedure should be followed:

Illustration 1: An amount of ₹ 4000 paid to R. Ramesha has been credited to the account of S.Ramesha.

It is obvious that the credit, placed wrongly to the account of S.Ramesha, should be transferred to theaccount of R. Ramesha. The correcting entry is:

S. Ramesha's Account	Dr.	4,000	
To R.Ramesha's Account			4,000

Rectification of errors after the preparation of Final Account

The rectification of errors after the preparation of final accounts depends upon the nature of error. If an error is a one sided error, it can be corrected by passing a rectifying entry with the help of the Suspense

Account and if the error is two sided, it is rectified by passing a rectifying entry in both the affected accounts and such errors are not rectified through Suspense Account.

Suspense account

In case, the accountant is not in a position to locate the difference in the totals of the trial balance and heis in a hurry to close the books of accounts, he may transfer the difference to an account known as "Suspense Account". After transferring the difference, the trial balance is totalled and balanced. On locating the errors in the beginning or during the course of next year, suitable accounting entries are passed and the Suspense Account is closed. However, the Suspense Account should be opened only when the accountant has failed to locate the errors in spite of his best efforts. It should not be by way of a normal practice, because the very existence of the Suspense Account creates doubt about the authenticity of the books of accounts.

a) Rectification of one sided errors

It may be noted that one sided errors affect the agreement of trial balance. Hence, one sided errors are rectified through the Suspense Account. For example:

i) An item of ₹ 68 was posted as ₹ 86 in the Sales Account.

In this case, the Sales Account has been credited by ₹ 86 instead of ₹ 68, so the entry with the help of Suspense Account shall be as follows:

		₹	₹
Sales A/c	Dr.	18	
To Suspense A/c			18

(Being Sales account wrongly credited with ₹ 86 instead of ₹ 68, now corrected

ii) The total of purchase book has been taken ₹ 9 short.

In this case, the purchase book has been undercast by ₹ 9 so we should further debit the Purchase Account by Rs. 9.

		₹	₹
Purchases A/c	Dr.	9	
To Suspense A/c			9

(Being total of purchase book now corrected)

iii) A sum of ₹ 102 written off as depreciation on furniture has not been posted toDepreciation Account.

In this case, Depreciation Account has not been debited, so the entry shall be:

		₹	₹
Depreciation A/C	Dr.	102	
To Suspense A/C			102

(Being depreciation on furniture not posted previously now posted)

b) Rectification of two sided errors

As already stated, two sided errors do not affect the agreement of trial balance. These errors are rectified by means of journal entries in the affected account. The procedure for rectification of two sided errors is same whether they are located either before the preparation of final accounts or after the preparation of final accounts.

Effect of errors on final accounts

It is desirable to know the effect of errors on the final accounts i.e. on the Trading and Profit and Loss Account and the Balance Sheet. Some of the errors affect the Trading and Profit and Loss Account while others affect the Balance Sheet. How these two statements will be affecteddepends upon the nature of the accounts in which the error lies. If the error affects the nominal account/accounts, it will increase or decrease the profit because all nominal accounts are transferred to Trading and Profit and Loss Account. In this regard, the following points are to be noted:

1. Profit will increase or loss will reduce if a transaction is omitted to be posted to the debit side of a nominal account. On rectification of such a type of error, profit will decrease or loss will increase. For example salary paid to an employee is wrongly posted to his personal account and consequently salary paid is omitted to be posted to Salary Account. This error will increase the profit or reduce the loss because salary paid will not be transferred to Profit and Loss Account. At the time of the rectification of error, Salary Account will be debited and consequent thereupon, profit will decrease or loss willincrease.

2. Similarly, profits will reduce or loss will increase if a nominal account is wrongly debited. With the rectification of such an error, profit will increase or loss will decrease. For example, an amount of ₹ 2000 spent on erection of machinery wrongly debited to Repairs Account instead of Machinery Account will reduce net profit by ₹ 2000 On rectification of this error, Machinery Account will be given debit and Repairs Account will be credited and consequently profit will increase or loss will decrease.

3. Profit will increase or loss will decrease if a nominal account is wrongly credited. With the rectification of this type of error, profit will decrease or loss will increase. For example, if ₹ 5000 received on account of sale of old furniture was posted to Sales Account instead of Furniture Account, the error will increase profit or decrease loss because sales will be shown at an increased amount of ₹ 5000 on the credit side of the Trading and Profit and Loss Account. At the time of the rectification of error, Sales Account will be given debit. As a result, profit will decrease or loss will increase.

4. Profit will decrease or loss will increase if an item is omitted to be posted to the credit side of a nominal account. With the rectification of the error, profit will increase or loss will decrease. For example, interest on debentures of ₹ 2,000, received is omitted to be posted to the credit side of the Interest on Debentures Account. This error will decrease profit or increase loss because interest on debentures received will not be transferred to the credit side of the Profit and Loss Account as an item of income. At the time of the rectification of the error, Interest on Debentures Account will be given a credit and, as a result, profit will increase or loss will decrease.

5. Due to increase or decrease in profit/loss by the errors in nominal accounts, the Capital Account will also, be increased or decreased. Thus, the errors in nominal accounts will also affect the Balance Sheet because the Capital Account is shown on the liability side of the Balance Sheet. So, an error in a nominal account will affect both the Profit and Loss Account and the Balance Sheet.

If there is an error in the personal accounts of the debtors or creditors of the business concern, their respective accounts will be increased or decreased. This will have its effect on the Balance Sheet only because debtors and creditors are shown in the Balance Sheet as Assets and Liabilities.

respectively. Similarly, if an error is in a real account, such as Plant and Machinery Account, Cash Account, Land and Building Account, the Balance Sheet alone will be affected because assets are shown in the Balance Sheet only.

Illustration The trial balance of a trader has agreed but the following errors are discovered after the preparation of the final accounts:

i) ₹ 500 posted to the Depreciation Account as Depreciation on Plant and Machinery was not posted to the Plant and Machinery Account.

ii) Return Outward Book is overcast by ₹ 10.

iii) Purchases Book is overcast by ₹ 4,000.

iv) An amount of ₹ 1,000 received as dividend on shares has been posted to the debit of the Interest Account.

v) Furniture was purchased from Rahim for ₹ 9,600 but the entry was passed for ₹ 6,900.

vi) ₹ 1,200 received from Anil Kapoor in settlement of account, posted to the credit of theSales Account.

vii) Outstanding interest on loan ₹ 500 omitted to be recorded.

viii) ₹ 600 paid for the purchase of office stationery was wrongly debited to the Purchases Account.

ix) Sales of ₹ 6,000 to Mushtaq omitted to be posted to his account.

x) ₹ 200 paid for repairs were written as ₹ 20 in the Repairs Account.

xi) Discount Received ₹ 50, omitted to be posted to the Discount Received Account.

Show the effect of these errors on the Final Accounts.

Solution

EFFECT OF ERRORS ON THE FINAL ACCOUNTS

	Trading and Profit and Loss Account		Balance Sheet
1.	No effect because depreciation has been posted to the Depreciation Account and hence already debited to the Profit and Loss Account.	1.	Plant and Machinery Account is overstated by ₹ 500 because depreciation has not been deducted from the Plant and Machinery Account.
2.	Gross Profit is over casted by ₹ 10, so net Profit is also overstated by ₹ 10.	2.	Capital Account is overstated by ₹ 10 because of the increase in Profit.
3.	Gross Profit is understated by ₹ 4,000 and net profit has also been understated by ₹ 4,000.	3.	Capital Account is understated by ₹ 4,000 because of the decrease in Net Profit.

4.	Net Profit is understated by ₹ 2,000 because Interest Account has been debited instead of being credited.	4.	Capital Account is understated by ₹ 2,000 because of the decrease in Net Profit.
5.	No effect because the error relates to a Personal and real Accounts.	5.	Creditors and Furniture have been understated by ₹ 2,700.
6.	Gross Profit and Net Profit overstated by ₹ 1,200 because of higher sales shown in the Trading Account.	6.	Capital Account and Sundry Debtors are overstated by ₹ 1,200.
7.	Net Profit has been overstated by ₹ 500.	7.	Capital Account is overstated by ₹ 500 and creditors understated by ₹ 500.
8.	Gross Profit understated by ₹ 600. No effect on Net Profit.	8.	No effect on Balance Sheet.
9.	No effect on Gross Profit and Net Profit.	9.	Sundry Debtors are understated by ₹ 6,000.
	Trading and Profit and Loss Account		Balance Sheet
10.	Net Profit has been overstated by ₹ 180 because Repairs Account is posted with ₹ 20 instead of ₹ 200.	10.	Capital Account has been overstated by ₹ 180 because of decrease in Net Profit.
11.	Net profit has been understated by ₹ 50 because Discount Received Account is omitted to be posted.	11.	Capital Account has been understated by ₹ 50 because of the decrease in Net Profit.

BANK RECONCILIATION STATEMENT

INTRODUCTION:

Generally all the transactions made through Cash or by cheques are not recorded at the same time in the Cash Book and the Pass Book regularly, because there are some transactions which are recorded in the cash book first and recorded in the pass book after some days. On the other hand, some transactions are recorded in the pass book first and later in the cash book. Here lies the problem to a trader or the business. So, on a particular date, both the books do not show an identical balance. Those transactions which appear on any one of the books only are the main causes of differences /discrepancies or disagreements.

In order to reconcile those differences / disagreements with the cash book or the pass book balance on a particular date a statement is prepared known as bank reconciliation statement. For preparing a Bank Reconciliation Statement with the help of the balance of a particular book, the disagreements are to be considered as follows:

Suppose , the balance of a Cash Book is given and for a particular disagreement or mistake, if the said balance is-----.

a) Less than the Pass Book balance , then the difference is to be added to the Cash Book balance and

b) Similarly,if the said balance is greater than the Pass Book balance , then the difference is to be deducted from the Cash Book balance.

Hence, all the disagreements are to be considered as stated above.

By preparing the bank reconciliation statement, it is generally confirmed that there are no other undetected causes of differences, because when this statement is prepared by taking one of the book's balance as the basis, then the result which will come out after the adjustment of the disagreements would be the other book's balance. But if the resultant balance is not tallying with the original balance of the said book, then it indicated that still there are some undetected causes of differences or disagreements or mistakes which are to be found out. Here lies the importance of preparing the bank reconciliation statement.

CAUSES OF DIFFERENCE

The following are the causes of difference between a cash book balance and a pass book balance:

a) Cheques deposited but not collected or credited by bank.
b) Cheques issued but not cashed.
c) Bank interest and bank charges not reflected in the cash book.
d) Direct collections or payments on behalf of the customers made by the bank.
e) Errors in recording of transaction in the cash book or the pass book.

BANK CHARGES

The bank charges some amount to a customer's account for any services done on behalf of the customers by way of incidental charges, collection charges or as service charges and for this reason, the customer's account is debited . As a result , it will reduce the customer's account balance or will increase the overdraft balance at the bank. Generally , an entry is made in the cash book for bank charges after receiving the bank statement.

ADJUSTMENT OF CASH BOOK AND BANK RECONCILIATION STATEMENT

Where a trader wants to adjust his cash book first before preparing the bank reconciliation statement, then the following steps are to be taken:

a) Identify those causes or disagreements which are not entered in the cash book but are required to be shown in the cash book (bank column only). Those disagreement are, for example, bank interest and bank charges , direct deposits and payment made by bank, etc.

b) Rectifications are to be made in the cash book for those errors which are committed in the cash book only.

After considering the above two steps, the bank reconciliation statement is to be prepare with the help of the remaining disagreements, i.e. cheques issued but not presented, uncredited cheques and those errors which are committed in the pass book only . But under such circumstances, the bank reconciliation statement will start by taking the cash book-adjusted bank balance as the basis.

BANK PASS BOOK/ BANK STATEMENT

It is prepared and provided by a Bank to its customer's (i.e. firm or an individual) regarding the transactions recorded by the bank for a certain period. Actually, it is the identical copy of the transactions recorded by the bank within their own books which are supplied to the bank customers according to their desire/demand . It shows a customer's account balance on a particular date.

General Guidelines to Solve the Problems

Nature of the items or disagreements		In case of favourable balances			In case of overdraft balances		
		Effects of disagreements or mistakes	Cash book Dr. bal. is given	Pass book Cr. Bal. is given	Effects of disagreements or mistakes	Cash book Cr. bal. is given	Pass book Dr. Bal. is given
S.No							
1.	A debtor deposited cash directly into bank , not recorded in the cash book.	Pass book balance is greater than the cash book balance.	Add	Less	It has decreased the pass book balance than the cash book balance.	Less	Add
2.	Cheques deposited or paid into bank but not collected by the bank (or not credited by the bank)	Cash book balance is greater than the pass book balance.	Less	Add	Cash book balance is less than the pass book balance.	Add	Less
3.	Cheques issued but not cashed or	Cash book balance is Less than the	Add	Less	Cash book balance is greater than	Less	Add

	presented for payment.	pass book balance.			the pass book balance.		
4.	As per instruction, bank collected dividend but not recorded in the cash book.	Pass book balance is greater than the cash book balance.	Add	Less	Pass book balance is less than the cash book balance.	Less	Add
5.	Credit side of the cash book bank column undercaseted by some amount.	Cash book balance is greater than the pass book balance.	Less	Add	Cash book balance is Less than the pass book balance.	Add	Less
6.	A Periodic payment understandin g instruction not recorded in the cash book	Pass book balance is less than the cash book balance	Less	Add	Pass book balance is greater than the cash book balance	Add	Less
7.	A cheque deposited and credited by bank but not recorded in the cash book	Cash book balance is less than the Pass book balance	Add	Less	Cash book balance is greater than the pass book balance	Less	Add
8.	A Party's cheque (deposited cheque) returned dishonoured but not reflected in the cash book	Cash book balance is greater than the pass book balance.	Less	Add	Cash book balance is Less than the pass book balance.	Add	Less

9.	A cheque issued and cashed but omitted to be recorded in the cash book.	Cash book balance is greater than the pass book balance.	Less	Add	Cash book balance is Less than the pass book balance.	Add	Less
10.	As per instruction, bank honoured a bill (payment of a bill made by the bank)	Pass book balance is less than the cash book balance	Less	Add	Pass book balance is greater than the cash book balance	Add	Less
11.	A cheque shown in the cash book as deposited into the bank but was wrongly kept inside the cash box	Cash book balance is greater than the pass book balance	Less	Add	Cash book balance is Less than the pass book balance	Add	Less
12.	A cheque issued and cashed but shown in the cash column wrongly.	Cash book balance is greater than the pass book balance	Less	Add	Cash book balance is Less than the pass book balance	Add	Less
13.	A bill of Rs.320 discounted with the bank at Rs.280 recorded in the book without deducting the	Cash book balance is greater than the pass book balance by Rs.40	Less Rs.40	Add Rs.40	Cash book balance is Less than the pass book balance by Rs.40	Add Rs.40	Less Rs.40

	discount.						
14.	A bill of Rs.540 discounted with the bank at Rs.520 became dishonoured but not reflected in the cash book Noting charge incurred Rs.40	Cash book balance is greater than the pass book balance by Rs.(540 + 40) = Rs.580	Less Rs.580	Add Rs.580	Cash book balance is Less than the pass book balance by Rs.580	Add Rs.580	Less Rs.580
15.	A cheque drawn by another customer but wrongly charged to Trader's A/c.	Pass book balance is less than the cash book balance.	Less	Add	Pass book balance is greater than the cash book balance.	Add	Less
16.	Interest on bank deposits credited in the pass book but not reflected in the cash book.	Pass book balance is greater than the cash book balance.	Add	Less	This item does not arise for overdraft balance.		
17.	Interest on overdraft balance debited in the pass book but not shown in the cash book.	This item does not arise for favouable balance.			Pass book balance is greater than the cash book balance	Add	Less

18.	Bank charge not recorded in the cash book.	Cash book balance is greater than the pass book balance.	Less	Add	Cash book balance is Less than the pass book balance.	Add	Less
19.	A cheque of Rs. 540 deposited into bank but recorded in the cash book as Rs. 450	Cash book balance is less than the pass book balance by Rs.90	Add Rs.90	Less Rs.90	Cash book balance is greater than the pass book balance by Rs.90	Less Rs.90	Add Rs.90
20.	An issued cheque became dishonoured not reflected in the cash book	Cash book balance is less than the pass book balance.	Add	Less	Cash book balance is greater than the pass book balance.	Less	Add

Illustration: 1

G.P.Traders submits the following particulars for particulars for preparing their bank reconciliation statement as on January 31, 2021.

a) Bank balance as per cash book as on January 31: Rs.21,600.

b) Cheques totaling Rs.3,900 drawn in favor of suppliers, out of which presented only Rs. 2,850 for payment.

c) Cheques amounting to Rs.4,600 deposited into bank but out of that, the bank credited Rs.3,850

d) A debtor deposited Rs.750 cash directly into bank.

e) As per instruction, bank honored a bill for Rs.1,280 and collected dividend of Rs.2,650.

f) Debit side of the cash book bank column under casted by Rs.100

g) A bill of Rs.3,200 discounted with the bank at Rs.3,050 but shown in the cash book without deducting the discount.

h) A deposited cheque of Rs. 850 became dishonoured but no entry has been made in the books for such dishonor.

i) Cheque of Rs.350 drawn by another customer but wrongly charged to Trader's account.

j) A cheque of Rs.780 shown in the cash book as deposited into bank but wrongly it was kept inside the cash box.

k) Bank interest and bank charge of Rs.1,260 and Rs.90 respectively not shown in the cash book.

Solution:

Bank Reconciliation Statement of G.P.Traders as on 31st January 2021.			
Rs. Bank Balance as per Cash Book			Rs. 21,600
Add:	i) Cheques issued but not cashed (Rs.3,900 – 2,850) ii) A debtor deposited cash directly into bank iii) As per instruction, bank collected dividend iv) Debit side of the cash book bank column undercasted v) Bank interest not shown in the cash book	1,050 750 2,650 100 1,260	5,810
			27,410
Less:	i) Cheques deposited but not credited by bank Rs.(4,600 – 3,850) ii) Bank honoured a bill iii) Discount charger by bank Rs.150 but not shown in the cash book for a bill discounted with the bank iv) Deposited cheque became dishonoured but not shown in the cash book v) Cheque drawn by another customer but wrongly charged to Trader's A/c by the bank vi) A cheque appears in the cash book as deposited into bank but not sent to bank vii) Bank charge not shown in the cash book	750 1,280 150 850 350 780 90	4,250

	Balance as per the Pass Book		23,160

Illustrations: 2

RECONCILIATION FROM FAVOURABLE CASH BOOK BALANCE:

From the under-mentioned particulars of Mr.M.Ragavan prepare a Bank Reconciliation Statement as on 31st July 2021.

a) Cheques paid into Bank on the 28th July 2021 but credited to Ragavan account in the first week of August 2021.

Govind Rs.2,000 ; Raja Rs. 400 ; Ramkumar Rs.600

b) The following cheques were issued by Ragavan on 30th July 1994 but presented to bank for payment after the close of the year.

Ramya Rs. 1,000 ; Selvi Rs. 1,200 ; Lakshmi Rs. 800

c) A cheque for Rs. 300 was credited direct to the account and was not passed through the cash book.

d) The bank balance as per cash book on 31st July 2021 amounted to Rs.30,000.

Solution:

Bank Reconciliation Statement of Ragavan as on 31st July 2021.			
Rs. Bank Balance as per Cash Book			Rs. 30,000
Add:	i) Cheques issued but not presented for payment Govind Rs.2,000 Raja Rs. 400 Ramkumar Rs.600	3,000	
	ii) Cheque credited direct to the account but not passed through the cash book	300	3,300
			33,300

Less:	i) Cheques paid into bank but not credited in the pass book Ramya Rs. 1,000 Selvi Rs. 1,200 Lakshmi Rs. 800	3,000	3,000
	Bank balance as per pass book		30,300

Activity:

1. From the following particulars, prepare a Bank Reconciliation Statement as on 31st December, 2021.

a) Bank balance as per cash book as on 31-12-2021, Rs.5,000

b) Cheques issued but not presented for payment Rs. 500.

c) Cheques deposited into bank but not credited in the pass book Rs.250

d) Bank charges debited in pass book Rs. 50

e) Interest on current account credited by the bank but not recorded in the cash book Rs.40

2. On March 31 2018, the cash book of Babu showed a bank balance of Rs. 4,500 While verifying with the pass book the following facts were noted:

a) Cheques sent in for collection before March 31 2018, and not credited by the bank amounted in all to Rs.855.

b) Cheques issued before March 31 2018, but not presented for payment amounted to Rs.885.

c) The banker has charged a sum of Rs. 100 towards incidental charges and credited interest Rs.250

d) The banker has given a wrong credit for Rs. 250.

3. The cash book of Rajkumar showed a balance of Rs. 3,000 on 23rd September 2020. This did not agree with the pass book. From the following particulars ascertain the balance as per pass book:

a) Cheque paid in but not cleared by bank before 23-09-2020 – Rs. 500

b) Cheques issued in favour of customers but not presented prior to 23.09.2020 Rs.675.

c) Commission charged by bank but not entered in cash book Rs. 25.

d) Interest on government securities collected and credited by bank not yet entered in cash book Rs. 500.

e) No record has been made in the cash book relating to a dishonor of a cheque for Rs. 50.

RECONCILIATION FROM FAVOURABLE PASS BOOK BALANCE:

4. From the following particulars, prepare a bank reconciliation statement as at 31st December 2020 to find out the balance as per cash book of Ms.Akalya.

i) The following cheques were paid into bank in December 2020 but were credited by the bank in January 2021.

Mahendren -Rs. 1,300 ; Nithya – Rs. 1,500 ; Rajesh – Rs.1,400.

ii) The following cheques were issued in December 2020 but were presented for payment in January 2021.

Shamli – Rs. 1,200; Barath Rs.700

iii) The following charges were made by the bank which were not recorded in the cash book. Incidental charges for the half year ended 31-12-2020 Rs. 60. Collection charges for outstanding cheques Rs.40

iv) The following payments made by the bank direct as per standing instructions were not entered in the cash book.

Insurance premium – Rs. 600; Subscription for commerce – Rs.250

v) A cheque for Rs.1,200 which was received from a customer was entered in the bank column of cash book in December 2020 but was omitted to be banked in December 2020.

vi) A bill for Rs. 2,000 was retired by the bank under rebate of Rs.50 but the full amount of the bill was credited in bank column of the cash book.

The bank balance as per pass book was Rs.31,000 on 31st December 2020.

Solution:

Bank Reconciliation Statement of Ms.Akalya as on 31st December 2020.			
			Rs.
Rs. Bank Balance as per Pass Book			31,000
Add:	i) Cheques paid into bank but not yet cleared and creditied: Mahendran Rs.1,300 Nithya Rs. 1,500 Rajesh Rs.1,400	4,200	
	ii) Cheque recorded in the pass book but not in the cash book: Incidental charges Rs. 60 Collection charges Rs. 30	100	
	iii) Payment made by the bank directly as per standing instructions, not recorded in the cash book: Insurance Premium Rs. 600 Subscription for commerce Rs. 250	850	
	iv) Cheques entered in the cash book but omitted to be banked	1,000	6,350
			37,650
Less:	Cheques issued but not yet presented for payment Shamli - Rs. 1,200 Bharath - Rs. 700	1,900	
	Rebate allowed for the bill retired but not entered in the	50	1,950

	cash book Bank balance as per Cash book		35,700

5. From the following particulars prepare a bank reconciliation statement showing the balance as per cash book on 31-03-2021.

a) Bank balance as on 31st March 2021 as per pass book Rs. 15,200

b) Bank charges debited Rs. 150.

c) Cheques issued but not presented to bank for payment Rs. 2,000

d) Cheques deposited into bank not credited in the pass book Rs.7,000

e) A Cheque entered as deposit in the cash book instead of as a payment Rs.200

f) Rs.365 paid into bank had been entered twice in the cash book.

g) The receipt column of the cash book has been over cash by Rs.1,000

h) A cheque drawn for Rs.8 had been incorrectly entered in the cash book as Rs.88.

6. The pass book of Mr.Arun showed a credit balance of Rs.7,500 on 30-09-2017. On comparison with the cash book, the following omissions were found out. Prepare a bank reconciliation statement with the help of the following:

a) Cheques received from customers for Rs.450 and 220 were not yet collected .

b) A cheque for Rs.100 received form 'A' though debited in the bank column in the cash book was not paid into the bank.

c) The pass book showed a credit of Rs.85 being interest on investment collected.

d) There was a debit of Rs.120 in the pass book in respect of a cheque dishonoured.

RECONCILIATION FROM OVERDRAWN CASH BOOK BALANCE

The bank overdraft of VijayKumar on 31-12-2021 as per cash book is Rs. 10,000 . From the following particulars, prepare bank reconciliation statement:

i) Unpresented cheque Rs. 5,000

ii) Uncleared cheque Rs. 2,700

iii) Bank interest debited in the Pass book only Rs.600

iv) Bill collected and credited in the pass book only Rs. 900

v) Cheque of Basker dishonoured . Rs. 400

vi) Cheques issued to Balu entered in the Cash column of cash book Rs. 300.

Solution:

Bank Reconciliation Statement of VijayaKumar as on 31-12-2021				
Rs. Bank Overdraft as per cash book				Rs. 10,000
Add:	i)	Uncleared cheques	2,700	
	ii)	Interest debited	600	
	iii)	Dishonoured cheques	400	4,000
	iv)	Cheques omitted from the Bank column	300	
				14,000
Less:	i)	Unpresented cheques	5,000	5,900
	ii)	Bill Collected	900	
		Bank Overdraft as per pass book		8,100

RECONCILIATION FROM OVERDRAWN CASH BOOK BALANCE:

7. From the following particulars ascertain the bank as would appear in the pass book as on 31-12-2021.

a) The bank overdraft (credit balance) as per cash book on 31-12-2021 was Rs. 7,000

b) Interest on overdraft , for six months ending 31-12-2021 amounting to Rs.300 was debited in the pass book.

c) Bank charges for the above period also debited in the pass book which amounted to Rs. 60

d) Cheques issued but not presented for payment before 31-12-2021 amounted Rs.2,000

e) Cheques paid into the bank but not cleared and credited before 31-12-2021 were Rs. 2,500.

f) Interest on government securities collected by the bank and credited in the pass book amounted to Rs. 1,700.

8. From the following particulars ascertain the balance by means of a statement that would appear in the pass book of Mr.Revanth as on 30th June 2018.

a) Overdraft as per cash book as on 30-06-92 Rs. 14,380

b) Interest on overdraft for six months shown in pass book Rs. 320

c) Bank charges of the above period shown in pass book Rs. 140

d) Cheques drawn but not cashed before 30-06-2018 Rs. 2,540

e) Cheques paid into bank but not cleared before 30-06-2018 Rs. 4,420

f) A bills receivable discounted with the bank in May 2018 now dishonoured ,but not entered in cash book Rs. 1,200

RECONCILIATION FROM OVERDRAWN PASS BOOK BALANCE

Prepare a bank reconciliation statement from the following data as on 30-11-2021.

a) Balance as per pass book as on 30-11-2021 overdrawn Rs. 19,000

b) Cheques drawn on 30-11-2021 but not cashed till 1st December 2021 Rs. 6,400; Rs. 1,400 ; Rs. 1,800.

c) Cheques received on 29-11-2021 entered in cash book, but not deposited into bank till 31-12-2021 Rs. 22,600 and Rs. 3,400.

d) Bank overdraft interest charged on 28-11-2021 not entered in cash book Rs. 3,200.

e) Cheque received amounting to Rs.100 entered in the cash book twice.

f) Bills receivable due on 29-11-2021 was sent to bank for collection on 28-11-2021 and was entered in cash book forthwith but the proceeds were not credited in bank pass book till 3rd December 2021. Rs. 5,900.

g) A periodic payment by bank for Rs. 200 under standing instruction not entered in cash book.

h) Cheque deposited on 30th November 2021 dishonoured but the entry thereof was not made in the cash book Rs.3,700.

Solution:

Bank Reconciliation Statement as on 30th November 2021			
			Rs.
Rs. Overdraft Balance as per pass book			19,000
Add:	Cheques drawn but not cashed (Rs.6,400 + Rs. 1,400 + Rs. 1,800)	9,600	9,600
			28,600
Less:	a) Interest on bank overdraft not entered in cash book		
	b) Cheque received and entered in the cash book as deposited into bank but actually not deposited till 3rd December 2021.	3,200	
	(Rs. 22.600 + Rs. 3,400)	26,000	
	c) Cheque received and entered in the cash book twice		
	d) Bill sent to bank for collection but not credited till 3rd December 2021.	100	
	e) Periodic payment made by bank not entered in cash book	5,900	
	f) Cheque deposited dishonoured but not entered in cash book	200	
		3,700	39,100
	Bank Balance as per cash book(Dr.)		

			10,500

RECONCILIATION FROM OVERDRAWN PASS BOOK BALANCE

9. On 31st December 2021, my pass book showed an overdraft of Rs. 12,500. On scrutiny the following were noticed:

iii) Cheques amounting Rs. 2,100 were paid into the bank on 29th December of which only Rs. 175 was credited by the bank in the pass book.

iv) Cheques for Rs. 4,000 were issued by me of which only one cheque for Rs.600 was presented for payment.

v) There is a debit of Rs.150 for interest and Rs.50 for bank charges in the pass book which have not been entered in my books.

vi) Cash of Rs.250 debited in bank column in my books has been omitted to be banked.

Prepare a reconciliation statement to show the balance as per my books.

10. Prepare Bank Reconciliation statement as on 31-12-2021 from the following information:

i) Balu's overdraft as per pass book on 31-12-2021 Rs.12,000

ii) On 30-12-2021 cheques had been issued for Rs. 7,000 of which cheques worth Rs.3,000 only had been encashed upto 31-12-2021.

iii) Cheques amounting to Rs.3,500 had been paid into bank for collection but of these only Rs. 500 had been credited in the pass book.

iv) Bank charged Rs. 500 as interest on overdraft and the intimation of which has been received on 2nd January 2022.

v) The Bank pass book shows credit for Rs.1,000 representing Rs.400 paid by a debtor into the bank and Rs.600 collected directly by the bank as income from investment. Balu had no knowledge of these.

11. (6.28) Prepare Bank Reconciliation statement as on 30th April 2016 from the following particulars:

Ramya's Overdraft as per Bank Pass Book was Rs.12,000 as on 30th April 2016.

a) On 28th April 2016, cheques have been issued for Rs.7,000 of which cheques worth Rs.3,000 only had been encashed upto 30t April.

b) Chequest amounting toc Rs. 3,500 had been deposited into Bank for collection but of theses, only Rs.500 had been credited in the Bank pass book.

c) Bank had charged Rs. 500 interest on overdraft, the intimation of which was received on 4th May.

d) Bank pass book shows credit for Rs.1,000 representing Rs. 400 paid by a debtor directly into the bank and Rs. 600 collected by Bank in respect of interest on Mr.Ramya's Investment. Ramya had no knowledge of these items.

e) Bank had debited Rs. 1,200 on account of life insurance premium of Mr.Ramya a per his standing advice which was not recorded in the cash book.

f) Credit side of the cash book bank column was cast short by Rs.1,000.

When both , pass book and cash book of a period are given

Prepare a bank reconciliation statement as on 30th June 2019 from the bank pass book and cash book (Bank column only).

Cash Book (Bank Column Only)

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UNIT - 2

FINAL ACCOUNTS

The final account of business concern generally includes two parts. The first part is Trading and Profit and Loss account. This is prepared to find out the net result of the business. The second part is Balance sheet which is prepared to know the financial position of the business.

Trading Account

Trading means buying and selling. The trading account shows the result of buying and selling of goods.

Specimen

Trading Account for the year ending 31st March, 2021

Dr. Cr.

Particulars		Amount Rs.	Particulars		Amount Rs.
To Opening stock		***	By Sales	***	
To Purchases	***		Less: Sales returns	***	***
Less: Purchase returns	***		By Closing stock		***
To Wages		***	To Gross Loss c/d (Transferred to Profit and Loss a/c)		***
To Fright		***			
To Carriage inwards		***			
To Clearing charges		***			
To Packing charges		***			
To Power		***			
To Octroi Duty		***			
To Gross profit c/d (Transferred to Profit and Loss a/c)		***			
		***			***

Profit and Loss Account

After calculating the gross profit or gross loss the next step is to prepare the profit and loss account. To earn net profit a trader has to incur many expenses apart from those spent for purchases and manufacturing of goods. If such expenses are less than gross profit, the result will be net profit. When total of all these expenses are more than gross profit the result will be net loss.

Specimen

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

Dr. Cr.

Particulars	Amount Rs.	Particulars	Amount Rs.
To Gross Loss b/d (Transferredfrom trading a/c) To Salaries To Rent & Rates	*** *** ***	By Gross profit b/d (Transferred from trading a/c)By Commission earned By Rent received	*** *** ***
To Stationeries	***	By Interest received	***
To Postage expenses	***	By Discount received	***
To Insurance	***	To Net Loss	***
To Repairs expenses	***	(Transferred to capital a/c)	
To Office expenses	***		
To Interest paid	***		
To Bank charges	***		
To Sundry expenses	***		
To Commission paid	***		
To Discount allowed	***		
To Advertisement	***		
To Carriage outwards	***		
To Travelling expenses	***		
To Distribution expenses	***		

To Repacking charges	***		
To Bad debts	***		
To Depreciation	***		
To Net profit	***		
(Transferred to capital a/c)			
	***		***

If Net Profit

Journal Entry

Date	Particulars	L.F.	Debit Rs.	Credit Rs.
	Profit & Loss a/c Dr. To Capital a/c (Net profit transferred to capital a/c)		***	***

If Net Loss

Journal Entry

Date	Particulars	L.F.	Debit Rs.	Credit Rs.
	Capital Dr. To Profit & Loss a/c (Net loss transferred to Profit and loss a/c)		***	***

BALANCE SHEET

This forms the second part of the final accounts. It is a statement showing the financial position of a business. Balance sheet is prepared by taking up all personal accounts and real accounts (assets and properties) together with the net result obtained from profit and loss account. On the left hand side of the statement, the liabilities and capital are shown. On the right hand side, all the assets are shown. Balance sheet is not an account but it is statement prepared from the ledger balances. So we should not prefix the accounts with the words “To” and “By”

Balance sheet is defined as „a statement which sets out the assets and liabilities of a business firm and which serves to ascertain the financial position of the same on any particular date".

Specimen

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Balance sheet as on 31st March 2021

Liabilities		Amount Rs.	Assets	Amount Rs.
Capital	***		Cash in hand	***
Add:			Cash at bank	***
Net Profit	***		Bills receivable	***
	***		Sundry debtors	***
(Or)			Investments	***
Less:			Closing stock	***
Net Loss	***		Prepaid expenses	***
	***		Furniture & fittings	***
Less: Drawings	***		Plant & machinery	***
	***		Land & buildings	***
Less:			Business premises	***
Income Tax	***	***	Patents & Trade marks	***
Sundry creditors		***	Goodwill	***
Bills payable		***		
Bank overdraft		***		
Loan		***		
Reserve fund		***		
Outstanding expenses		***		
		***		***

Difference between Trial Balance and Balance Sheet

No.	Basis Distinction	Trial balance	Balance sheet
1.	Objective	To know the arithmetical accuracy of the accounting Work	To know the true and fair financial position of the Business
2.	Format	The columns are debit balances and credit balances	The two sides are assets and Liabilities
3.	Content	It is summary of all the ledger balances – personal, real and nominal account	It is statement showing closing balances of personal & real accounts
4.	Stage	It is the middle stage in the preparation of accounts	It is the last stage in the preparation of accounts
5.	Period	It can be prepared periodically say at the end of the month, quarterly or half yearly etc.,	It is generally prepared at the end of the accounting period
6.	Preparation	It is prepared before the preparation of trading, profit and loss account.	It is prepared after the preparation of trading, profit and loss account.

Illustration: 3

Prepare trading account for the year ending 31st March 2012 from the following information.

Solution:

	Rs.
Opening stock	1,70,000
Purchase returns	10,000
Sales	2,50,000
Wages	50,000
Sales returns	20,000
Purchases	1,00,000
Carriage inwards	20,000
Closing stock	1,60,000

Solution:

Trading Account for the year ending 31st March 2012

Dr. Cr.

Particulars	Amount Rs.	Particulars		Amount Rs.
To Opening stock	1,70,000	By Sales	2,50,000	
To Purchases 1,00,000		Less		
Less: Purchases return 10,000	90,000	Sales return	20,000	2,30,000
To wages	50,000		By Closing stock	1,60,000
To Carriage inwards	20,000			
To Gross profit c/d (transferred to P & L a/c)	60,000			
	3,90,000			3,90,000

Illustration: 4

Prepare profit and loss account, from the following balances of Mr. Kandan for the year ending 31.12.2013.

	Rs.		Rs.
Office rent	30,000	Salaries	80,000
Printing expenses	2,000	Stationeries	3,000
Tax, Insurance	4,000	Discount allowed	6,000
Advertisement	36,000	Travelling expenses	26,000
Gross profit	2,50,000	Discount received	4,000

Solution:

Profit and Loss Account of Mr. Kandan for the year ending 31st December 2013

Dr. Cr.

Particulars	Amount Rs.	Particulars	Amount Rs.
To Office rent	30,000	By Gross profit b/d (transferred from the trading a/c) By Discount	2,50,000
To Printing expenses	2,000		
To Tax, Insurance	4,000		

To Advertisement	36,000	received	4,000
To Salaries	80,000		
To Stationeries	3,000		
To Discount allowed	6,000		
To Travelling expenses	26,000		
To Net profit (transferred to capital a/c)	67,000		
	2,54,000		2,54,000

Illustration: 5

Prepare trading and profit loss account for the year ending 31st March 2012 from the books of Mr. Siva Subramanian.

	Rs		Rs
Stock (31.3.2011)	15,000	Carriage outwards	4,000
Purchases	1,65,000	Wages	30,000
Purchases return	10,000	Sales return	5,000
Postage	3,000	Salaries	20,000
Discount received	5,000	Stationeries	2,000
Bad debts	1,000	Interest	8,000
Sales	3,00,000	Insurance	4,000
Stock (31.3.2012)	80,000		

Solution:

Trading and Profit & Loss Account of Mr. Siva Subramanian for the year ending 31st March 2012

Dr. Cr.

Particulars	Amount Rs.	Particulars	Amount Rs.

To Opening stock		15,000	By Sales	3,00,000	
To Purchases	1,65,000		Less		
Less:			Sales return		2,95,000
Purchases return				5,000	80,000
	10,000	1,55,000	By Closing stock		
		30,000			
To wages		60,000			
To Gross profit c/d					
(transferred to P & L a/c)					
		3,75,000			3,75,000
To Postage To		3,000	By Gross profit b/d (transferred		1,75,000
Bad debts		1,000	from the		
To Carriage outwards		4,000	trading a/c) By Discount		
To Salaries		20,000	received		
To Stationeries		2,000			5,000
To Interest		8,000			
To Insurance		4,000			
To Net profit		1,38,000			
(transferred to capital a/c)					
		1,80,000			1,80,000

Illustration: 6

From the following trial balance of M/s Ram & Sons, prepare trading and profit and loss account for the year ending on 31st March 2012 and the balance sheet as on the date

Trial balance as on 31st March 2012

Particulars	Debit Rs.	Credit Rs.
Opening stock (1.4.2011)	5,000	
Purchases	16,750	
Discount allowed	1,300	
Wages	6,500	
Sales		30,000
Salaries	2,000	

Travelling expenses	400	
Commission	425	
Carriage inwards	275	
Administration expenses	105	
Trade expenses	600	
Interest	250	
Building	5,000	
Furniture	200	
Debtors	4,250	
Creditors		2,100
Capital		13,000
Cash	2,045	
	45,100	45,100

Stock on 31st March 2012 was Rs. 6,000

Solution:

M/S Ram & Sons Trading and Profit and Loss Account for the year ending 31st March 2012

Dr. Cr.

Particulars	Amount Rs.	Particulars	Amount Rs.
To Opening stock	5,000	By Sales	30,000
To Purchases	16,750	By Closing stock	6,000
To Wages	6,500		
To Carriage inwards	275		
To Gross profit c/d	7,475		
(transferred to P & L a/c)			
	36,000		36,000

To Discount allowed	1,300	By Gross profit b/d	7,475
To Salaries	2,000	(transferred from the	
To Travelling expenses	400	trading a/c)	
To Commission	425		
To Administration expenses	105		
To Trade expenses	600		
To Interest	250		
To Net profit	2,395		
(transferred to capital a/c)			
	7,475		7,475

Balance sheet as on 31st March 2012

Liabilities		Amount Rs.	Assets	Amount Rs.
Capital	13000		Cash	2,045
Add:			Debtors	4,250
Net Profit	2395	15,395	Stock	6,000
Creditors		2,100	Furniture	200
			Building	5,000
		17,495		17,495

ADJUSTMENTS

Some important and common items, which need to be adjusted at the time of preparing the final accounts are discussed below.

1. Closing stock
2. Outstanding expenses
3. Prepaid expenses
4. Accrued incomes
5. Incomes received in advance

6. Interest on capital

7. Interest on drawings

8. Interest on loan

9. Interest on investments

10. Depreciation

11. Bad debts

12. Provision for bad and doubtful debts

13. Provision for discount on debtors

14. Provision for discount on creditors

Note: All adjustments are given outside the trial balance

1. Closing stock

The value of closing shown outside the trial balance on 31.03.2014 is Rs.55,000

Adjusting Entry

Date	Particulars	L.F.	Debit Rs.	Credit Rs.
31.03.14	Closing stock a/c Dr. To Trading a/c (Closing stock recorded)		55,000	55,000

Value of Closing Stock

i. On the credit side of trading account.

ii. On the assets side of balance sheet.

Trading account for the year ending 31st March, 2014

Dr. Cr.

Particulars	Amount Rs.	Particulars	Amount Rs.
		By Closing stock	55,000

Balance sheet as on 31st March, 2014

Liabilities	Amount Rs.	Assets	Amount Rs.
		Closing stock	55,000

2. Outstanding expenses

Expenses which have been incurred but not yet paid during the accounting period for which the final accounts are being prepared are called ass outstanding expenses.

Trial balance shows remuneration paid Rs. 25,000

Adjustments

Remuneration for March 2014, Rs. 3,000 not yet paid.

Solution:

Adjusting Entry

Date	Particulars	L.F.	Debit Rs.	Credit Rs.
31.03.14	Remuneration a/c Dr. To Remuneration outstanding a/c (Salary outstanding)		3,000	3,000

Outstanding Remuneration

i. On the debit side of profit and loss account by way additions to the particular expenses.

ii. On the liabilities side of the balance sheet.

Trading account for the year ending 31st March, 2014

Dr. Cr.

Particulars	Amount Rs.	Particulars	Amount Rs.
Remuneration 25,000			

Add: Outstanding Remuneration	3,000	28,000		

Balance sheet as on 31st March, 2014

Liabilities	Amount Rs.	Assets	Amount Rs.
Outstanding remuneration	3,000		

3. Prepaid expenses

Expenses which have been paid in advance are called as prepaid expenses.

31st March, 2014 Trial balance shows Loan Rs. 32,000

Adjustments

Prepaid interest on loan Rs. 4,300

Solution:

Adjusting Entry

Date	Particulars	L.F.	Debit Rs.	Credit Rs.
31.03.14	Prepaid interest on loan a/c Dr. To Interest a/c (Prepaid interest on loan)		4,300	4,300

Prepaid interest on loan

i. On the debit side of the profit and loss account by way of deduction from the particular expenses

ii. On the assets side of the balance sheet.

Particulars		Amount Rs.	Particulars	Amount Rs.
Interest	32,000			
Less: Prepaid interest				
on loan	4,300	27,700		

Balance sheet as on 31st March, 2014

Liabilities	Amount Rs.	Assets	Amount Rs.
		Prepaid interest on loan	27,700

4. Accrued incomes

Income which has been earned but not received during the accounting period is called as accrued income.

Credit side of Trial balance shows commission received Rs. 3,000

Adjustment

Commission accrued but not yet received Rs. 1,500

Solution:

Adjusting Entry

Date	Particulars		L.F.	Debit Rs.	Credit Rs.
31.03.14	Accrued commission a/c	Dr.		1,500	
	To Commission a/c				1,500
	(Accrued commission)				

Accrued commission

i. On the credit side of profit and loss account by way addition to particular income.

ii. On the assets side of the balance sheet.

Trading account for the year ending 31st March, 2014

Dr. Cr.

Particulars	Amount Rs.	Particulars		Amount Rs.
		By Commission Add: Accrued commission	3,000 1,500	 4,500

Balance sheet as on 31st March, 2014

Liabilities	Amount Rs.	Assets	Amount Rs.
		Accrued commission	1,500

5. Incomes received in advance

Income received during a particular accounting period for the work to be done in future period is called as income received in advance.

Trial balance for the period ending 31st March 2014 shows received dividend 22,000

Adjustment

Dividend received in advance Rs. 3,000

Solution:

Adjusting Entry

Date	Particulars	L.F.	Debit Rs.	Credit Rs.
31.03.14	Dividend received Dr. To Dividend received in advance (Dividend received in advance)		3,000	 3,000

Dividend received in advance

i. On the credit side of the profit and loss account by way of deducting from the particular income.

ii. On the liabilities side of the balance sheet.

Trading account for the year ending 31st March, 2014

Dr. Cr.

Particulars	Amount Rs.	Particulars	Amount Rs.
		By Dividend received Less: Dividend 22,000 received in advance 3000	19,000

Balance sheet as on 31st March, 2014

Liabilities	Amount Rs.	Assets	Amount Rs.
Dividend received in advance	3,000		

6. Interest on capital

In order to see whether the business is really earning profit or not, it is desirable to charge interest on capital at a certain rate.

As per trial balance, capital as on 31.3.2014 Rs. 2,00,000

Adjustment

Provide 6% interest on capital

Solution:

Adjusting Entry

Date	Particulars	L.F.	Debit Rs.	Credit Rs.
31.03.14	Interest on capital a/c Dr. To Capital a/c (Interest on capital)		12,000	12,000

Interest on capital

i. On the debit side of profit and loss account.

ii. On the liabilities side of the balance sheet by way of addition to the capital

Trading account for the year ending 31st March, 2014

Dr. Cr.

Particulars	Amount Rs.	Particulars	Amount Rs.
To Interest on capital a/c	12000		

Balance sheet as on 31st March, 2014

Liabilities		Amount Rs.	Assets	Amount Rs.
Capital	2,00,000			
Less: Interest on				
Capital	12,000	2,12,000		

7. Interest on drawings

Amount withdrawn by the owner for his personal use is called as drawings. When interest on capital is allowed, then interest on drawings charged from the owner. Interest on drawings is an income for the business and will reduce the capital of the owner.

Trial Balance showing : Capital Rs. 4,00,000 Drawing: Rs. 30,000

Adjustments: Charge interest on drawings @ 5%

Solution:

Adjusting Entry

Date	Particulars	L.F.	Debit Rs.	Credit Rs.
31.03.14	Capital a/c Dr. To Interest on drawings a/c (Interest on drawings)		1,500	 1,500

To bring interest on drawings to profit and loss account the following transfer entry is required.

Date	Particulars		L.F.	Debit Rs.	Credit Rs.
31.03.14	Interest on drawings a/c	Dr.		1,500	
	Transfer Entry				
	To Profit and Loss a/c (Interest on drawings)				1,500

Interest on drawings

i. On the credit side of profit and loss account

ii. On the liabilities side of the balance sheet by way of addition to the drawings which are ultimately deduced form the capital.

Trading account for the year ending 31st March, 2014

Dr. Cr.

Particulars	Amount Rs.	Particulars	Amount Rs.
		To Interest on drawings a/c	1,500

Balance sheet as on 31st March, 2014

Liabilities		Amount Rs.	Assets	Amount Rs.
Capital		4,00,000		
Less				
Drawings	30,000			
Interest on drawings	1,500	31,500		
		3,68,500		

8. Interest on investments

Interest receivable on investments is an income for the business.

The trial balance 31.03.2014 shows investments @ 10% Rs. 1,00,000. Interest received on investments Rs. 90,000

Adjustment

Provide for accrued interest on investments Rs. 10,000

Solution:

Adjusting Entry

Date	Particulars	L.F.	Debit Rs.	Credit Rs.
31.03.14	Accrued interest on investments Dr. To Interest received a/c (Accrued interest on investments)		10,000	10,000

Accrued interest on investments (outstanding interest receivable will be shown)

i. On the credit side of the profit and loss account by way of addition to the appropriate interest account.

ii. On the asset side of the balance sheet by way of addition to the investment account.

Trading account for the year ending 31st March, 2014

Dr. Cr.

Particulars	Amount Rs.	Particulars		Amount Rs.
		By Interest received	90,000	
		Add: Accrued interest	10,000	1,00,000

Balance sheet as on 31st March, 2014

Liabilities	Amount Rs.	Assets		Amount Rs.
		Investments	10,00,000	

		Add: Accrued interest	10,000	10,10,000

9. Interest on loan

Borrowing from banks, financial institutions and outsiders for business are called loans. Amount payable towards interest on loan is an expense for the business.

The trial balance (31.3.2014) shows the following: Bank loan @ 10% on 1.4.2013 Rs. 4,00,000 Interest paid Rs. 14,000

Adjustment

Provide for interest on bank loan outstanding

Adjusting Entry

Date	Particulars	L.F.	Debit Rs.	Credit Rs.
31.03.14	Interest on bank loan a/c Dr. To Interest on outstanding a/c (Interest on bank loan)		26,000	26,000

Interest outstanding on Loan

i. On the debit side of the profit and loss account by way of addition to the appropriate interest account.

ii. On the liability side of the balance sheet by way of addition to the particular loan account.

Trading account for the year ending 31st March, 2014

Dr. Cr.

Particulars		Amount Rs.	Particulars	Amount Rs.
To Interest on loan	14,000			
Add: Interest outstanding	26,000	40,000		

Balance sheet as on 31st March, 2014

Liabilities		Amount Rs.	Assets	Amount Rs.
To Bank loan Add: Interest Outstanding	4,00,000 26,000	 4,26,000		

10. Depreciation

Depreciation is the reduction in the value of fixed assets due to its use or obsolescence. Generally depreciation is charged at some percentage on the value of fixed assets.

The trial balance shows the value of machinery 31.3.2014 as Rs. 50,000.

Adjustment

Furniture is to be depreciated at 10%.

Solution:

Adjusting Entry

Date	Particulars	L.F.	Debit Rs.	Credit Rs.
31.03.14	Depreciation a/c Dr. To Machinery a/c (Depreciation on machinery)		5,000	 5,000

To bring depreciation into profit and loss account the following transfer entry is required.

Transfer Entry

Date	Particulars	L.F.	Debit Rs.	Credit Rs.
31.03.14	Profit & Loss a/c Dr. To Depreciation a/c (Depreciation transferred to Profit and Loss a/c)		5,000	 5,000

Depreciation

i. On the debit side of profit and loss account

ii. On the assets side of the balance sheet by way of deducted from the value of concerned asset.

Trading account for the year ending 31st March, 2014

Dr. Cr.

Particulars	Amount Rs.	Particulars	Amount Rs.
To Depreciation on Machinery	5,000		

Balance sheet as on 31st March, 2014

Liabilities	Amount Rs.	Assets		Amount Rs.
		Machinery	50>000	
		Less: Depreciation	5>000	45>000

11. Bad debts

Debts which cannot be recovered are called bad debts. It is a loss for the business.

The trial balance on 31st March 2014 shows, Sundry debtors Rs. 60,000.

Adjustment

Write off Rs. 4,000 as bad debts.

Solution:

Adjusting Entry

Date	Particulars	L.F.	Debit Rs.	Credit Rs.
31.03.14	Bad debts a/c Dr.		4,000	
	To Sundry debtors a/c (Bad debts written off)			4,000

To transfer bad debts to profit and loss account the following transfer entry is required.

Transfer Entry

Date	Particulars	L.F.	Debit Rs.	Credit Rs.

31.03.14	Profit & Loss a/c Dr. To Bad debts a/c (Bad debts transferred to Profit and Loss a/c)		4,000	 4,000

Bad debts

i. On the debit side of profit and loss account

ii. On the assets side of the balance sheet by way of deduction from sundry debtors.

Trading account for the year ending 31st March, 2014

Dr. Cr.

Particulars	Amount Rs.	Particulars	Amount Rs.
To Bad debts a/c	4,000		

Balance sheet as on 31st March, 2014

Liabilities	Amount Rs.	Assets		Amount Rs.
		Sundry Debtors Less: Bad debts Written off	60,000 4,000	56,000

Illustration: 7

From the following trial balance of a trader, make out a Trading and Profit and Loss account and Balance sheet as on 31st March 2014

Particulars	Debit Rs.	Credit Rs.
Sales		4,20,000
Purchases	1,05,000	

Printing charges	2,500	
Wages	77,500	
Salaries	12,500	
Opening stock	2,25,000	
Carriage inwards	8,800	
General expenses	26,250	
Trade marks	5,000	
Rates and taxes	2,500	
Capital		1,74,800
Discount received		1,250
Loan		1,75,000
Buildings	2,00,000	
Furniture	25,000	
Machinery	50,000	
Cash	1,000	
Bank	30,000	
	7,71,050	7,71,050

Adjustments

1. The closing stock was value at Rs. 3,20,000
2. Outstanding salaries Rs. 10,000
3. Prepaid rates & taxes Rs. 500

Solution:

Trading and Profit and Loss Account for the year ending 31st March, 2014 Dr. Cr.

Particulars	Amount Rs.	Particulars	Amount Rs.
To Opening stock	2,25,000	By Sales	4,20,000
To Purchases	1,05,000	By Closing stock	3,20,000
To Wages	77,500		

To Carriage inwards To Gross profit c/d (Transferred to Profit and Loss a/c)	8,800 3,23,700		
	7,40,000		7,40,000
To Printing charges To Salaries 12,500 Add: Outstanding 10,000 To General expenses To Rates and taxes 2,500 Less: Prepaid 500 To Net profit (Transferred to capital a/c)	2,500 22,500 26,250 2,000 2,71,700	By Gross profit b/d (Transferred from trading a/c) By Discount received	3,23,700 1,250
	3,24,950		3,24,950

Balance sheet as on 31st March 2014

Liabilities		Amount Rs.	Assets	Amount Rs.
Capital	1,74,800		Trade marks	5,000
Add:			Building	2,00,000
Net Profit	2,71,700	446500	Furniture	25,000
Outstanding salary		10000	Machinery	50,000
Loans		175000	Cash	1,000
			Bank	30,000
			Prepaid rates & taxes	500
		631500		6,31,500

Theory Questions

1. What is trading account?
2. What is outstanding expense?
3. What is prepaid expense?
4. What is accrued income?
5. What is income received in advance?
6. What is bad debt?
7. Write notes on provision for bad and doubtful debts.
8. Write notes on provision for discount on debtors.
9. Write notes on provision for discount on creditors.
10. What are the items appearing in the debits and credit side of trading account?
11. What are the items appearing in the debits and credit side of profit and loss account?
12. Write the difference between trial balance and balance sheet.

Problems

1. Record the following transactions in the Journal of Tmt. Bhanumathi

2014 Feb.		Rs.
3	Bought goods for cash	84,500
7	Sold goods to Dhanalakshmi on credit	55,000
9	Received commission	3,000
10	Cash sales	1,09,000
12	Bought goods from Mahalakshmi	60,000
15	Received five chairs from Revathi & Co., at Rs. 400 each	2,000
20	Paid Revathi & Co., cash for five chairs	2,000
28	Paid salaries	10,000
	Paid Rent	5,000

2. Enter the following transactions in journal and post them in the ledger of Mr. Govindarajan and balance them.

2013 Dec.		Rs.
1	Govindarajan commenced his business with the following assets and liabilities	
	Plant and Machinery	2,50,000
	Stock	90,000
	Furniture	7,000
	Cash	50,000
	Sundry creditors	1,50,000
2	Sold goods to Sundar	1,50,000
3	Bought goods from Natarajan	65,000
4	Sundar paid cash	1,25,000
6	Returned damaged goods to Natarajan	2,000
10	Paid to natarajan	28,000
31	Paid rent	5,000
	Paid salaries	9,000

3. The trial balance of Mrs. Kalpana shows the following balances on March 31, 2011

Debit balances	Amount Rs.	Credit balances	Amount Rs.
Purchase	1,40,000	Capital	2,40,000
Sales returns	10,000	Sales	3,00,000
Opening stock	40,000	Discount received	2,000
Discount allowed	4,000	Commission received	8,000
Bank charges	1,000	Sundry creditors	58,000
Salaries	9,000		
Wages	10,000		

Freight inwards	8,000		
Freight outwards	2,000		
Rent, Rates & Taxes	10,000		
Advertising	12,000		
Cash in hand	2,000		
Plant & machinery	1,00,000		
Sundry debtors	1,20,000		
Cash at bank	1,40,000		
	6,08,000		6,08,000

Adjustments

The closing stock was valued at Rs. 60,000

You are required to prepare the profit and loss account for the year ending 31st March 2011 and the balance sheet as on that date.

(Ans. Gross profit Rs. 1,52,000; Net Profit Rs. 1,24,000;

Balance sheet Rs. 4,22,000))

4.The following balances have been extracted from the books of Mrs. Kumar as on 31st March, 2016

Debit balances	Amount Rs.	Credit balances	Amount Rs.
Buildings	30,000	Capital Purchase	40,000
Machinery	31,400	returns Sales	2,000
Furniture	2,000	Sundry creditors Discount received	2,80,000
Motor car	16,000	Provision for bad and	9,600
Purchases	1,88,000	doubtful debt	1,000
Sales returns	1,000		
Sundry debtors	30,000		600
General expenses	1,600		
Cash at bank	9,400		

Rates and taxes	1,200		
Bad debts	400		
Insurance premium	800		
Discount allowed	1,400		
Opening stock	20,000		
	3,33,200		3,33,200

Adjustments

- Outstanding rates and taxes Rs. 1,600
- Insurance premium prepaid Rs. 2,000
- Maintain provision for bad and doubtful debts at 5% on debtors
- Depreciate Motor car by 10%. Furniture by 4% and Buildings by 3% 5) Stock on 31.12.2016 Rs. 20,000

(Ans. Gross profit Rs. 93,000; Net Profit Rs. 83,720;

Balance sheet Rs. 1,34,920)

5.Trial balance of Anuradha Agencies as on 31.03.2011

Debit balances	Amount Rs.	Credit balances	Amount Rs.
Drawings	1,800	Capital	80,000
Buildings	15,000	General reserve	20,000
Furniture & Fittings	7,500	Loan 6%	15,000
Computer	25,000	Sales	1,00,000
Interest on loan	900	Commission received	7,500
Loose tools	6,100	Sundry creditors	10,000
Purchase	75,000		
Stock (1.4.2010)	25,000		
General expenses	15,000		
Freight inwards	2,000		

Freight outwards	1,000		
Sundry debtors	28,000		
Bank	20,200		
Goodwill	10,000		
	2,32,500		2,32,500

Adjustments

1) Closing stock is Rs. 32,000

2) Depreciate computer @ 10%; Buildings @ 5%; Furniture and Fittings @ 10%

3) Provide for bad and doubtful debts @ 5% and for discount on debtors @ 2%.

4) Provide interest on drawings @ 6% and on capital @8%

Prepare final accounts for the period after giving effect to the adjustments.

(Ans. Gross profit Rs. 30,000; Net Profit Rs. 8,376;

Balance sheet Rs. 1,37,868)

UNIT –III
DEPRECITION AND BILLS OF EXCHANGE

DEPRECIATION

INTRODUCTION:

The term 'depreciation' refers to the reduction in or loss of quality or value of a fixed asset throughwear or tear in use, effusion of time, obsolescence through technology and market changes or from any other cause. Depreciation take place in case of all fixed assets with certain possible exceptions e.g. land and antiques etc, although the process may be invisible or gradual. Depreciation does take place irrespective of regular repairs and proper maintenance of assets.

The word 'depreciation' is closely related to the concept of business income. Unless it is charged against revenues, we cannot say that the business income has been ascertained properly. This is because of the fact that the use of long-term assets tend to consume their economic value and at some point of time these assets become useless. The economic value so consumed must be recovered from the revenue of the firm to have a proper measure of its income. Hence, the reader's must understand that the process of charging depreciation is the technique used by accountants for recovering the cost of fixed assets over a period.

The following definition will make the understanding of the concept of depreciation more convenient to the learner's. According to IAS-4, "Depreciation is the allocation of the depreciable amount of an asset over its estimated useful life,"

DEFINITION

i. According to AS-6, "depreciation is a measure of wearing out, consumption or other of value of a depreciable asset arising from use, effusion of time or obsolescence through technology and market changes. Depreciation is allocated so as to charge a fair proportion of the depreciable amount in each accounting period during the expected useful life of the assets. Depreciation includes amortisation of assets whose useful life is pre determined."

The American Institute of Certified Public Accountants (AICPA) employed the definition as given below:

ii. "Depreciation Accounting is a system of accounting which aims to distribute the cost or other basic value of tangible capital assets, less salvage value (if any) over the estimated useful life of unit (which may be a group of assets) in a systematic and rational manner. It a process of allocation not of valuation.Depreciation for the year is the portion of the total charge under such a system that is allocated to the year."

From the above definitions, it is clear that each accounting period must be charged with a fair proportion of the depreciable amount of the asset, during the expected useful life of the asset. Depreciable amount of an asset is its historical cost less the estimated residual value. Finally, it could beconcluded that depreciation is a gradual reduction in the economic value of an asset from any cause.

Depreciation, Depletion and Amortisation

The terms 'depreciation', 'depletion' and 'amortisation' are used often interchangeably. However, these different terms have been developed in accountingusage for describing this process for different types of assets. These terms have been described as follows:

Depreciation

Depreciation is concerned with charging the cost of man made fixed assets to operation (and not with determination of asset value for the balance sheet). In other words, the term 'depreciation' is used when expired utility of physical asset (building, machinery, or equipment) is to be recorded.

Depletion

This term is applied to the process of removing an available but irreplaceable resource such as extracting coal from a coal mines or oil out of an oil well. Depletion differs from depreciation in that the former implies removal of a natural resource, while the latter implies a reduction in the service capacity of an asset.

Amortisation

The process of writing off intangible assets is termed as amortisation. The intangible assets like patents, copyrights, leaseholds and goodwill are recorded at cost in the books of account. Many of these assets have a limited useful life and are, therefore, written off.

Obsolescence

It refers to the decline in the useful life of an asset because of factors like (i) technological advancements, (ii) changes in the market demand of the product, (iii) legal or other restrictions, or (iv) improvement in production process.

CAUSES OF DEPRECIATION

The depreciation occurs because of the following:

1. Constant use: The constant use of assets results into their wear and tear, which in turn reduces their working capacity. Hence, a decrease in the value of assets may be seen due to reduced capacity. The value of assets like, machinery, furniture, etc., declines with the constant use of them.

2. Passage of Time: Many fixed assets lose their value with the passage of time. This holds true in case of intangible fixed assets such as patents, copy rights, lease hold properties, etc. The term "amortisation" is generally used to indicate the reduction in the value of such assets.

3. Depletion: Depletion also causes decline in the value of certain assets. This is true in case of wasting assets such as mines, oil wells and forest-stands. On account of continuous extraction of minerals or oils, these assets go on declining in their value and finally they gets completely exhausted.

4. Obsolescence: There may not be any physical deterioration in the asset itself. Despite of this, there may be reduction in the utility of an asset that results from the development of a better method, machine or process. For example, an old machine which is still in good working condition may have to be replaced by a new machine because of the later being more economical as well as efficient. In fact, new inventions, developments in production processes, changes in demand for product or services, etc. make the asset out of date.

5. Accidents: An asset may get reduction in its value if it meets an accident.

6. Permanent Fall in the Market Value: Certain assets may get permanent fall in their value and this decline in their value is treated as depreciation. For example, a permanent decline in the market value of securities and investment may be assumed as depreciation

NEED FOR PROVIDING DEPRECIATION

The need for providing depreciation arises on account of the following points:

- To Ascertain the Profits or Losses: The true profits or losses could be ascertained when all costs of earning revenues have been properly charged against them. Fixed assets like building, plant and machinery, furniture, motor vehicles etc. are important tool in earningbusiness income. But the cost of the fixed asset is not charged to profit and loss of the accounting period in which the asset is purchased. Therefore, the cost of the fixed asset less its salvage value must be allocated rationally to the periods that receive benefit from the use of the asset. Thus, depreciation is an item of business expense and must be provided for a proper matching of costs with the revenue.
- To show the Asset as its Reasonable Value: The assets get decrease in their value overa period of time on account of various such as passage of time, constant use, accidents, etc. Therefore, if the depreciation is not charged then the asset will appear in the balance sheet at the over stated value. This practice is unfair as the Balance Sheet fail to present the true financial position.
- Replacement of assets: Business assets become useless at the expiry of

their life and, therefore, need replacement. The cash resources of the concern are saved from being distributed by way of dividend by providing for depreciation. The resources so saved, if set aside in each year, may be adequate to replace it at the end of life of the asset.

- To Reduce Income Tax: If tax is paid on the business income without providing for depreciation then it will be in excess to the actual income tax. This is a loss to the business man. Thus, for calculating tax, depreciation should be deducted be from incomesimilar to the other expenses.

Basic Elements of Depreciation

In order to assess depreciation amount to be charged in respect of an asset in an accounting period, thefollowing three important factors should be considered:

Cost of the asset: The knowledge about the cost of the asset is very essential fordetermining the amount of depreciation to be charged to the Profit and Loss Account.

The cost of the asset includes the invoice price of the asset less any trade discount plus all costs essential to make the asset usable. Cost of transportation and transit insurance are included in acquisition cost. However, the financial charges such as interest on money borrowed for the purchase for the purchase of the asset should not be included in the cost of the asset.

Estimated life of the asset: Estimated life generally means that for how many years or hours anasset could be used in business with ordinary repairs for generating revenues. For estimating useful life of an asset, one must begin with the consideration of its physical life and the modifications, if any, made, factors of obsolescence and experience with similar assets. In fact, the economic life of an asset is shorter than its physical life. The physical life is based mostly oninternal policies such as intensity of use, repairs, maintenance and replacements. The economic life, on the other hand, is based mostly on external factors such as obsolescence from technological changes.

Scrap Value of the Asset: The salvage value of the asset is that value which is estimatedto be realised on account of the sale of the asset at the end of its useful life. This value should be calculated after deducting the disposal costs from the sale value of the asset. If the scrap value is considered as insignificant, it is normally regarded as nil

Methods of recording depreciation

There are two methods of recording depreciation in the books of accounts:

When a provision for depreciation account is maintained

The following journal entries are passed in case. This method is followed:

i) Depreciation account Dr.
To Provision for Depreciation Account

(For providing depreciation)

ii) Profit and Loss Account Dr.
To Depreciation Account
(For closing depreciation account)

iii) Provision for Depreciation Account Dr.

To Asset Account
(Entry on sale of an asset)

iv) Any amount realised on account of sale of the asset is credited to the Asset Account. Thebalance, if any, in the Asset Account is transferred to the Profit and Loss Account.

When a provision for depreciation account is not maintained

i) The following journal entries are passed in this method:

ii) Depreciation Account Dr.

To Asset Account

(Entry for providing depreciation)

iii) Profit and Loss Account Dr.

To Depreciation Account

(Entry for closing Depreciation Account)

iv) In case the asset is sold, the amount realised is credited to the Asset Account. Any profitor loss on sale of the asset is transferred to the Profit and Loss Account.

Methods of calculating depreciation

The following are various methods of depreciation in use:

1. Fixed instalment method or straight line method.
2. Machine hour rate method.
3. Diminishing Balance method.
4. Sum of years digits method
5. Annuity method
6. Depreciation Fund Method
7. Insurance Policy Method
8. Depletion Method.

The detailed description of all these methods is as follows:

1. *Straight Line Method*

This is also known as fixed instalment method. Under this method, the depreciation is charged on the uniform basis year after year. When the amount of depreciation charged yearly under this method is plotted on a graph paper, we shall get a straight line. Thus, the straight line method assumes that depreciations is a function of time rather than use in the sense that each accounting period received the same benefit from using the asset as every other period. The formula for calculating depreciation chargefor each accounting period is:

Amount of annual Depreciation =Original cost of the fixed

assets – Residual valueEstimated Life in years

For example, if an asset cost ₹ 50,000 and it will have a residual value of ₹ 2000 at the end of its usefullife of 10 years, the amount of annual depreciation will be ₹ 4800 and it will be calculated as follow:

Depreciation

This method has many shortcomings. First, it does not take into consideration the seasonal fluctuations, booms and depression. The amount of depreciation is the same in that year in which the machine is usedday and night to that in another year in which it is used for some months. Second, it ignores the interest on the money spent on the acquisition of that asset. Third, the total charge for use of asset (i.e., depreciation and repairs) goes on increasing form year to year though the assets might have been use uniformly from year to year. For example, repairs cost together with depreciation charge in the beginning years is much less than what it is in the later year. Thus, each subsequent year is burdened with greater charge for the use of asset on account of increasing cost on repairs.

Illustration 1: H. Ltd. purchased a machinery on 1st January 2010 for ₹ 29000 and spent ₹ 2000 on its carriage and ₹ 1,000 on its erection. Machinery is estimated to have a scrap value of ₹ 5000 at the end of its useful life of 5 year. The accounts are closed every year on 31st December. Prepare the machineryaccount for five years charging depreciation according to straight line method.

Solution

MACHINERY ACCOUNT

Date	Particular	₹	Date	Particular	₹
2010	To Bank	22000	2010	By Depreciation	4000
Jan. 1			Dec. 31		
	To Bank	2000		By Balance c/d	21000
	To Bank	1000			
		25000			25000
2011	To Balance b/d	21000	2011	By Depreciation Balance c/d	4000
Jan.1			Dec.31		17000
		21000			21000
2012	To Balance b/d	17000	2012	By Depreciation By Balance c/d	4000
Jan.1			Dec. 31		13000
		17000			17000
2013	To Balance b/d	13000	2013	By Depreciation	4000
Jan.1			Dec.31	By Balance c/d	9000
		13000			13000

2014 Jan.1	To Balance b/d	9000	2014 Dec.31	By Depreciation By Balance c/d	4000 5000
		9000			9000

This method is very suitable particularly in case of those assets which get depreciated more on account of expire of period e.g. lease hold properties, patents, etc.

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2. Written Down Value Method / Diminishing Balance Method

This is also known as Written Down Value method [WDV]. Under the diminishing balance method, depreciation is charged at fixed rate on the reducing balance (i.e., cost less depreciation) every year. Thus, the amount of depreciation goes on decreasing every year. Under this method also, the amount of depreciation is transferred to Profit and Loss Account in each of the year and in the Balance Sheet the asset is shown at book value after reducing depreciation from it. For example, if an asset is purchasedfor ₹ 10,000 and depreciation is to be charged at 20% p.a. on reducing balance system, then the depreciation for the first year will be ₹ 2000. In the second year, it will ₹ 1600 (i.e. 20% of 8000), in the third year ₹ 1280 (i.e. 20% of 6400) and so on. The rate of depreciation under this method can be computed by using the following formula:

Depreciation rate = $1 \sqrt{\frac{\text{Netscrap value}}{\ }}$

For example, if the cost of an asset is ₹ 27000, scrap value ₹ 3375, economic life 3 year, the rate ofdepreciation would be:

Depreciation Rate $= 1 - \sqrt[3]{\frac{3375}{...}}$

$= 1 - \frac{15}{30} = 50\%$

Merits of Diminishing Balance Method

(i) It is very easy to understand and calculate the amount of depreciation despite the early variation in the book value after depreciation (ii) This method put an equal burden for use of the asset on each subsequent year since the amount of depreciation goes on decreasing for each subsequent year while thecharge for repairs goes on increasing for each subsequent year. (iii) This method has also been approvedby the Income Tax Act applicable in India (iv) Asset is never reduced to zero.

Demerit

(i) It ignores the interest on the capital committed to purchase that asset. (ii) It does not provide adequately for replacing the asset at the end of its life. (iii) The calculation of rate of depreciation is not so simple. (iv) The formula for calculating the rate of depreciation can be applied only when there is some residual of the asset.

Suitability

This method is suitable in those cases where the receipts are expected to decline as the asset gets older and, it is believed that the allocation of depreciation of depreciation ought to be related to the pattern of assets expected receipts.

Illustration 2: A company purchases Machinery on 1st April 2010 for ₹ 20,000. Prepare the machinery account for three years charging depreciation @ 25% p.a. according to the

Written Down ValueMethod.

MACHINERY ACCOUNT

Date	Particular	₹	Date	Particular	₹
2010 Apr. 1	To Bank	20000	2010 Mar. 31	By Depreciation By Balance c/d	5000 15000
		20000			20000
2011 Apr.1	To Balance b/d	15000	2011 Mar.31	By Depreciation By Balance c/d	3750 11250
		15000			15000
2012 Apr 1	To Balance b/d	11250	2012 Mar.31	By Depreciation By Balance c/d	2812.5 8437.5
		11250			11250

3. Annuity Method

So far we have described such methods of charging depreciation which ignore the interest factor. Also, sometimes it becomes inconvenient for a company to follow any of the methods discussed earlier. Under such circumstances, the company may use some special depreciation systems. Annuity method isone of these special systems of depreciation. Under this system, the depreciation is charged on the basis that besides losing the acquisition cost of the asset the business also loses interest on the amount used for purchasing the asset. Here, interest refers to that income which the business would have earned otherwise if the money used in buying the asset would have been committed in some other profitable investment. Therefore, under the annuity method, the amount of total depreciation is determined by adding the cost and interest

thereon at an expected rate. The annuity table is used to help in the determination of the amount of depreciation. A specimen of Annuity Table is as follows:

ANNUITY TABLE

Year	3%	4%	5%	6%
4	0.269027	0.275490	0.282012	0.288591
5	0.218335	0.224627	0.230975	0.237376
6	0.184598	0.190762	0.197012	0.203363
7.	0.160506	0.166610	0.172820	0.179135
8.	0.142456	0.148528	0.154722	0.161036
9.	0.128434	0.134493	0.140690	0.147022
10.	0.117231	0.12391	0.129505	0.135868

In case depreciation is charged according to this method, the following accounting entries are passed:

(i) Purchase of an asset Asset

Account Dr.

To Bank A/c

(ii) For charging interest

Asset Account Dr.

To Interest Account

(iii) For charging depreciation:

Depreciation Account Dr.

To Asset Account

Evaluation of Annuity Method

Illustration 3: On 1st January, 2010 a firm purchased a leasehold property for 4 year at a cost of ₹ 24000. It decides to depreciate the lease by Annuity Method by charging interest at 5% per annum. The Annuity Table shows that the annual necessary to write off ₹ 1 at 5% ₹ 0.282012. You are required to prepare the lease Hold Property Account for four years and show the net amount to be charged to the Profit and Loss Account for these four years.

Solution

LEASE HOLD PROPERTY ACCOUNT

Date	Particular	₹	Date	Particular	₹
2010	To Bank	24000.00	2010	By Depreciation	6768.29
Jan. 1			Dec. 31		
	To interest	1200.00	Dec.31	By balance c/d	18431.71
		25200.00			25200.00
2011	To balance b/d	18431.71	2011	By Depreciation	6768.29
Jan.1			Dec.31		
Dec.31	To Interest	921.59	Dec.31	By Balance c/d	12585.01
		19353.30			19353.30
2012	To balance b/d	12585.01	2012	By Depreciation	6768.29
Jan.1			Dec.31		
Dec. 31	To Interest	629.25	Dec.31	By Balance c/d	6445.97
		13214.26			13214.26
2013	To balance b/d	6445.97	2013	By Depreciation	6768.29

Jan.1 Dec.31	 To Interest	 322.30	Dec.31	By Balance c/d	9000 13000
		6768.27			6768.27

NET AMOUNT CHARGEABLE TO THE PROFIT AND LOSS ACCOUNT

Year	Depreciation Debited	Interest Credited	Net Charge against Profit
2010	6768.29	1200.00	5568.29
2011	6768.29	921.59	5846.70
2012	6768.29	629.25	6139.04
2013	6768.29	322.30	6445.99
₹	27073.16	3073.14	24000.02

BILLS OF EXCHANGE – MEANING

A trader very often buys and sells goods on credit. In such cases, the value of goods will be paid or received only at a future date. A written proof or document is prepared to acknowledge the amount payable or receivable. Such a document is called a Bills of Exchange. For example, Rajan sells goods on credit to Balan. In such case. Rajan drawn a Bills of Exchange of Balan for the amount due, directing Balan to pay the amount at a certain future date. Balan accepts the bill by signing it without the word „Accepted and sends the bills to Rajan.

DEFINITION

Section 5 of the Negotiable Instruments Act1881 defines a Bills of Exchange as "an instrument in writing containing an unconditional order signed by the maker, directing a certain person to pay a certain sum of money only to or to the order of a certain person or to the bearer of the instrument".

The following is the specimen of a bill of exchange.

FEATURE OF BILLS OF EXCHANGE

1. The instrument must be in writing

2. The order contained in the instrument must be unconditional No condition should be attached to the order of the bill.

3. It must be duly signed by the maker or drawer.

4. The order contained in the instrument must related to the payment of certain sum of money with must be easily determinable.

5. The person on whom the order is directed must be a certain person whose name must be mentioned in the bill.

6. The instrument must be drawn in favour of a payee whose name must also be mentioned in the bill.

7. The sum of money must be payable either on demand or ager a certain period.

PROMISSORY NOTE – MEANING

A promissory note is an instrument is writing, containing an unconditional undertaking signed by the maker to pay a certain sum of money only to or to the order of certain person. Under Section 31(2) of the Reserve Bank of India Act, a promissory note cannot be made payable to a bearer.

FEATURES

1. It must be in writing.

2. It must contain a clear promise to pay. Mere acknowledgement of debt is not a promise.

3. The Promise to pay must be unconditional. “I promise to pay Rs. 50 as soon as I can” – It is not an unconditional promise.

4. The promisor or maker must sign the promissory note.

5. The maker must be a certain person.

6. The payee (the person to whom payment is promised) must also be certain.

7. The sum payable must be certain "I promise to pay Rs. 500 plus all fines" is not certain.

8. Payment must be in legal money of the country.

9. It should not be made payable to bearer.

10. It should be properly stamped.

SPECIMEN OF A PROMISSORY NOTE

PROMISSORY NOTE

Rs. 10,000/- Madurai

November 5, 2015

Three months after date we promise to pay M/S Chendur& Co., or order the sum of

Stamp

M/S Chendur& Co.,

HUNDIES

Instruments drawn in Indian languages and made payable according to the custom prevailing in the local markets are known as Hundies. The practical effect of hundies is the same as that of bills of exchange and promissory notes.

DIFFERENCE BETWEEN BILL OF EXCHANGE AND PROMISSORY NOTE

No.	Bills of Exchange	Promissory Note
1	In a bill of exchange, there is an order to pay	In a promissory note, there is a promise to pay

2	A bill of exchange requires to be accepted by the drawee	For a promissory notes no acceptance is necessary
3	There are three parties – The drawer, drawee and the payee	There are two parties – the maker and the payee
4	Its drawer is liable only when the drawee does not accept or pay the amount due	Its maker is primarily liable
5	In case of dishonor, a foreign bill must e protested if it is necessary accounting to law of the place where it is drawn.	In case of dishonor, protest is not necessary.

ADVANTAGES OF BILLS OF EXCHANGE

1. Since it is a written and signed acknowledgement of debt, it serves as a conclusive proof of indebtedness.
2. It fixes the that of payment.
3. It ensures prompt payment by a debtor.
4. The debtor enjoys the full period of credit, because he will not be called upon to pay the amount of the bill before the due date.
5. Even before the due date, the creditor of a bill can realize money by discounting it with a banker.
6. It can be transferred like the coin of the country since it is a negotiable instrument.
7. It enables the trader to get goods on credit basis. this increases the volume of trade.

TYPES OF BILLS OF EXCHANGE

1. Inland Bills

Inland bills are drawn and payable in the same country. For instance, if a merchant in Chennai draws a bill on merchant in Kolkatta, it becomes an inland bill.

2. Foreign Bills

Foreign bills are drawn in one country but payble in another country. For instance, if a merchant in Chennai draws a bill on a merchant in London, it becomes a foreign bill.

3. Time Bill

A bill which is payable at the expiry of a certain period after date or after sight, it called a time bill.

4. Demand Bill

A bill of exchange which is payable on demand is known as demand bill.

5. Order Bill

A bill of exchange which is expressed to payable to order is called an order bill. It should not contain words restricting any transfer. Example: Pay to Mr. R Seshadhri Only.

6. Bearer Bill

A bill of exchange which is expressed to payable to a bearer is called bearer bill. Example Pay to Mr. Seshadhri or bearer

7. Documentary Bill

A documentary bill is a bill of exchange drawn by the exporter on the importer which is accompanied by shipping documents to be handed over to the importer upon his acceptance or payment of the bill. The shipping documents are usually attached to documentary bill. A documentary bill may be either (a) D/A bill or (b) D/P bill.

TERMS USED IN BILLS TRANSACTIONS

1. The act of transferring a bill by a holder or drawer of the bill to another person is known as "endorsement of the bill".
2. The person who endorses the bill is called "endorser".

3. The person to whom the bill is endorsed is known as “endorsee”.

4. Date on which a bill becomes payable is called “due date” or “ Date of Maturity”.

5. When a bill is paid on the due date, it is said to be “honoured”.

6. Failure to pay the bill on the due date is “dishonor”.

The method of authenticating the fact of dishonor of a bill by a notary public is called “Noting”.

7. The fee payable to the notary public for evidencing the fact of dishonor of a bill is called “Noting Charges”.

8. To pay the bill before the date is “Retiring”.

9. When a bill is retired a small “Rebate” is allowed for the unexpired period of the bill.

10. It is “Renewal” when the acceptor approaches the drawer before the due date and requests him to cancel the original bill and draw on him a fresh bill for the amount sue plus interest.

ACCOUNTING TREATMENT

After knowing the meaning and nature of bills of exchange, let us study the accounting treatment of bill transactions.

Even though a bill of exchange may differ from a promissory note in certain aspects, both are treated alike for the purpose of accounting treatment. When bills and promissory notes are received, they are called as “Bills receivable” and when bills and promissory notes are accepted, they are called as “Bills Payable”. The accounting aspects of a bill of exchange are discussed below:

1. He can retain the bill till the maturity date and present it for payment with acceptor, the bill may be collected through a bank form the acceptor.

2. In order to meet his financial need he can discount the bill before the date of maturity with his banker.The banker charges interest for the amount given known as discount. The discount amount is deducted from the value of the bill and the balance amount is paid to

the drawer.

3. He can transfer his right upon the bill infavour of a creditor in payment of his amount. This method of transferring the bill in favour of a creditor is known as "endoresing the bill"

In all the above cases, the bill may honoured or dishonoured by the acceptor. Let us see the journal entries to be passed in the books of the drawer and the acceptor.

Entries for bill transactions

	In the books of drawer	**In the books of Acceptors**
1.	When a B/R is received Debit B/R a/c, because it is an asset Credit the personal a/c of the party, because he gives the bill	Debit the personal a/c of the drawer, because he receives the bill Credit B/P a/c, since the bill goes out
2.	When a B/R is duly honoured Debit cash a/c, since it comes in Credit B/R a/c, since it goes out	When a B/P is duly honoured Debit B/P a/c, since it comes in Credit Cash a/c, since it goes out
3.	When a B/R is dishonoured Debit the Acceptor‟s a/c since the amount is due from him. Credit B/R a/c, since it goes out	When a B/P is dishonoured Debit B/P a/c in order to cancel the original bill Credit the Drawer‟s a/c. Since we are Liable to pay the amount due to him
4.	When a B/R s discounted Debit cash a/c, since it comes in Debit Discount a/c, since it is a loss Credit B/R a/c, since it goes out	No entry is required
5.	When a B/R is endorsed to a person Debit the Received a/c	No entry is required

	Credit B/R a/c since it goes out	
6.	When discounted (or) endorsed bill is honoured No entry	When discounted or endorsed bill is honoured Debit Bills payable a/c because it comes in
		Credit cash a/c because it goes out
7.	When a discounted B/R is dishonoured Debit the Acceptor"s a/c since the amount is due from him. Credit Bank a/c, since we are liable to pay amount to the banker	When a discounted B/P is dishonoured Debit B/P a/c in order to cancel the original bill Credit the Drawer"s a/c, since we are liable to pay the amount due to him
8.	When an endorsed B/R isdishonoured Debit the Accepter"s a/c, since the amount is due from him. Credit endorsee"s a/c, since we are liable to pay the amount to endorse	When an endorsed B/P id dishonoured Debit B/P a/c in order to cancel the original bill Credit the Drawer"s a/c, since we are liable to pay the amount due to him
9.	When a B/R is noted by the drawer Debit the Accepter"s a/c, since the amount is due from him. Credit endorsee"s a/c, since we are liable to pay the amount to endorse	When a Bill is noted by the drawer Debit B/P a/c with the value of the bill to cancel the original bill. Debit Nothing charges a/c, since it is a loss to us Credit the Drawer"s a/c, because we are liable to pay him

10.	When a B/R is noted by the Banker Debit the Acceptor‟s a/c since the amount (inclusive of nothing charges) is due from him. Credit the Bank a/c with nothing charges	When a B/P is noted by the Banker Debit B/P a/c with the value of the bill to cancel the original bill. Debit Nothing charges a/c, since it is a loss to us Credit the Drawer‟s a/c, because we are liable to pay him
11.	When a B/R is noted by the endorse Debit the Acceptor‟s a/c since the amount is due from him (including nothing charges) Credit the endorsee‟s a/c with nothing charges. Credit B/R a/c, Since it goes out	When a B/P is noted by the endorse Debit B/P a/c with the value of the bill to cancel the original bill. Debit Nothing charges a/c, since it is a loss to us Credit the Drawer‟s a/c, because we are liable to pay him
12	When a B/R is renewed a) Debit the Acceptor‟s a/c since it denotes the amount due from him Credit the B/R a/c, for cancellation of the old bill b) Debit the Acceptor‟s for the interest receivable from him. Credit the interest receivable from him Credit the a/c since it is an income c) Debit B/R a/c with the amount of the new bill. Credit the Acceptor‟s a/c, since he gives the bill	When a B/P is renewed a) Debit B/P a/c for cancellation of the old bill Credit the drawer‟s a/c in order to show the amount which is payable to him b) Debit the interest a/c, since it is a loss Credit the Drawer‟s a/c, since it is payable to him. c) Debit the Drawer‟s a/c, since he is the receiver of the bill. Credit B/P a/c for the value of the new bill, since it goes out.

13	When a B/R is retired Debit Cash a/c, since cash comes in. Rebate a/c, since it is a loss to us. Credit B/R a/c, since it goes out.	When a B/P is retired Debit the Drawer‟s a/c, since he is the receiver of the bill. Credit B/P a/c for the value of the new bill, since it goes out.
14.	When a B/R is sent to Bank for collection Debit bills for collection a/c Credit the B/R a/c a) When it is actually collected	When a B/R is sent to Bank for collection No entry
	Debit Bank a/c Credit Bills for collection a/c	Debit B/P a/c, since it comes in Credit Cash a/c, since it goes out
	(or) b) When it is dishonoured Debit the Drawee‟s a/c Credit Bill for Collection a/c	Debit B/P a/c is order to cancel the original bill Credit the Drawer‟s a/c. Since we are liable to pay the amount due to him.

Now you know the entries for bills. Let us illustrate the above entries in the following examples.

Illustration: 1 When bill is drawn, accepted and honoured

On 1st Jan.2014 „A" drew a two months bill on „B" for Rs. 5,000 and the latter accepted the same. On the due date „B‟ met the bill. Show the Journal Entries.

Solution:

In the books of „A‟

Date	Particulars		Debit Rs.	Credit Rs.
01.01.2014	Bills receivable a/c To „B" a/c (being the entry for the receipt of the bill)	Dr.	5,000	 5,000
04.03.2014	Cash a/c To Bills receivable a/c (being the realization of the bill)	Dr.	5,000	 5,000

In the books of „B"

Date	Particulars		Debit Rs.	Credit Rs.
01.01.2014	A‟s a/c To Bills payable a/c (being the acceptance given to A)	Dr.	5,000	 5,000
04.03.2014	Bills payable a/c To cash a/c (being the entry for the honour of the bill)	Dr.	5,000	 5,000

Illustration: 2 When bill is drawn, accepted and dishonored

For goods supplied, „A" draws a bill on „B‟ for 2,000. „B" accepted the sale and returns it to „A". On the due date „B" refuses to honor the bill. Show journal entries.

Solution:

In the books of „A‟

Particulars		Debit Rs.	Credit Rs.
B‟s a/c To sales a/c (being the goods sold „B‟ on credit)	Dr.	2,000	2,000
Bills receivable a/c To B‟s a/c (being the bill received from B)	Dr.	2,000	2,000
B‟s a/c To Bills receivable a/c (being B refuse to honour the bill)	Dr.	2,000	2,000

In the books of „B‟

Particulars		Debit Rs.	Credit Rs.
Purchase a/c To A‟s a/c (being the acceptance given to X)	Dr.	2,000	2,000
A‟s a/c To Bills payable a/c (being the acceptance given to A)	Dr.	2,000	2,000
Bills Payable a/c To A‟s a/c (being the payment not made)	Dr.	2,000	2,000

Illustration: 3 When bill is dishonored and the Noting Charges paid

„N" owes „M" 1,000. „M" draws a two months bill for Rs.100 on „N" on01.07.2013 „N accept it and returns it to „M". On the due date „N" fails to honor his acceptance and „M" gets the bill noted by paying Rs. 50 as Noting charges. Show the journal entries.

Solution:

In the books of „M"

Date	Particulars	Debit Rs.	Credit Rs.
01.07.2013	Bills receivable a/c Dr.	1,000	
	To „N" a/c (being the bill received)		1,000
04.09.2013	N"s a/c Dr.	1,050	
	To Cash a/c		50
	To Bills receivable a/c (being the bill dishonored and noting charges paid)		1,000

In the books of „N"

Date	Particulars	Debit Rs.	Credit Rs.
01.07.2013	M"s a/c Dr.	1,000	
	To Bills payable a/c (being the bill accepted)		1,000
04.09.2013	Bills payable a/c Dr.	50	
	Noting Charges a/c Dr.	1,000	
	To M"s a/c		1,050
	(being the bill dishonored and noting		

	charges paid by the drawer)		

Illustration: 4 When bill is discounted and honored

Aurnsold goods to Raman on 5th February 2013 and draws a 3 months bill on Raman for Rs. 5,000 Aurn discounted the bill on 8th February at 10 percent per annum. At maturity the bill is honored. Journalise the transactions in the books of both the parties.

Note:

Remember that the date of maturity of the bill is 8th May 2013. The discount charge should be calculated for the period of 3 months, i.e., from 8th February to 8th May. Hence the discount is: 5,000×10/100×3/12=Rs. 125

Solution:

In the books of „Aurn"

Date	Particulars		Debit Rs.	Credit Rs.
Feb 5.	Raman a/c To sales a/c (being credit sales)	Dr.	5,000	5,000
Feb. 5	Bills receivable a/c To Raman a/c (being the acceptance received)	Dr.	5,000	5,000
Feb. 8	Bank a/c Discount a/c To Bills receivable (being the amount received on discounting the Bill)	Dr. Dr.	4,875 125	5,000

May 8	No entry		

In the books of „Raman"

Date	Particulars	Debit Rs.	Credit Rs.
Feb 5.	Purchase a/c Dr. To Aurn a/c (being credit purchase)	5,000	5,000

	Aurna/c Dr.	5,000	
Feb. 5	To Bills payable a/c (being the acceptance given)		5,000
	No entry		
	Bills payable Dr. To cash (being the cash paid for our acceptance)	5,000	5,000

Illustration: 5 When bill is discounted and dishonoured

On January 6, 2014 Ram sold goods to Mohan for Rs. 4,500. On the same data Ram drew a few months bill on Mohan which was duly accepted. The bill was discounted on Jan. 9 at 10%. At maturity the bill was dishonored and Ram had to pay the amount to the ban. Show journal entries

Solution:

Journal of Ram

Date	Particulars		Debit Rs.	Credit Rs.
2014 Jan. 6	Mohan a/c To sales a/c (being credit sales)	Dr.	4,500	4,500
Jan. 6	Bills Receivable a/c To Mohan a/c (being the acceptance received)	Dr.	4,500	4,500
Jan. 9	Bank a/c Discount a/c To Bills receivable a/c (being the amount received on discounting the bill)	Dr. Dr.	4,350 150	4,500
	Mohan To Bank a/c (being the amount paid on dishonor of	Dr.	4,500	4,500
April 9	Mohan‟s acceptance)			

Journal of Mohan

Date	Particulars	Debit Rs.	Credit Rs.

2014 Jan. 6	Purchase a/c Dr. To Ram a/c (being credit purchase)	4,500	4,500
Jan. 6	Ram a/c Dr. To Bills Payable a/c (being the acceptance given)	4,500	4,500
Jan. 9	No entry		
April 9	Bills payable a/c Dr. To Ram a/c (being the credit given to Ram on dishonout of our acceptance of Jan.6)	4,500	4,500

Note: Discount =4,500×10/100×4/12=150

Illustration: 6Bill is endorsed and honored

On 1st Jan., 2014, P sold goods to Q for Rs. 2,000 and drew a two month bill for the amount. P owed R a sum, of Rs. 2,000. P endorsed Q‟s acceptance to R. At maturity Q met his acceptance. Journalise the transaction in the books of P and Q. Solution:

Journal of „P‟

Date	Particulars	Debit Rs.	Credit Rs.
2004 Jan. 1	Q a/c Dr. To Sales a/c (being credit sales)	2,000	2,000

”	Bills receivable Dr. To Q a/c (being the acceptance received)	2,000	 2,000
” March 4	R a/c Dr. To Bills Receivable a/c (being the transfer of Q‟s acceptance in favour of R)	2,000	 2,000
	No entry		

Note: On maturity, P will not pass any entry because Q will the pay the amount to R.

Journal of „Q‟

Date	Particulars	Debit Rs.	Credit Rs.
2004 Jan. 1	 Purchase a/c Dr. To P a/c (being credit purchase)	 2,000	 2,000
”	P a/c Dr. To Bills Payable a/c (being the acceptance received)	2,000	 2,000
”	No entry		

March 4	Bills payable Dr. To Cash a/c (being the cash paid on maturity of our acceptance)	2,000	2,000

X sold goods to Y on 3rd October 2003 for Rs. 4,000. X drew a three month bill on Y for the amount. X endorsed the bill in favour of Z. At maturity the bill was dishonored. Journalise the transactions in the books of X and Y.

Solution:

Journal of „X‟

Date	Particulars	Debit Rs.	Credit Rs.
2013 Oct. 3	Y a/c Dr.	4,000	
	To Sales a/c (being credit sales)		4,000
Oct. 3	Bills receivable a/c Dr. To Y a/c (being the acceptance received)	4,000	4,000
Oct. 3	Z a/c Dr. To Bills Receivable a/c (being the transfer of Y‟s acceptance in favour of Z)	4,000	4,000

2014 Jan. 6	Y a/c Dr. To Z a/c (being the credit to Z on dishonorof Y"s acceptance)	4,000	 4,000

Journal of „Z"

Date	Particulars	Debit Rs.	Credit Rs.
2013 Oct. 3	Purchase a/c Dr. To P a/c (being credit purchases)	4,000	 4,000
Oct. 3	X a/c Dr. To Bills Payable a/c	4,000	 4,000
	(being the acceptance received)		
	No Entry		
	Bills payable a/c Dr. To X a/c (being dishonour of our acceptance dated Oct. 3)	4,000	 4,000

Illustration: 8 On retiring the bill

On 1st June.2013, „A" drew a bill for Rs. 300 on „B", payable after 3 months. Before the due date „B" retired the bill for which a rebate of Rs. 5 was given. Show necessary journal entries.

Solution:

In the books of „X"

Date	Particulars		Debit Rs.	Credit Rs.
01.06.2013	Bills receivable a/c	Dr.	300	
	To „Y" a/c			300
	(being the entry for the receipt of the bill)			
”	Cash a/c	Dr.	295	
	Rebate a/c	Dr.	5	
	To Bills receivable a/c			300
	(being the entry for the realization of the bill before the due date)			

In the books of „Y"

Date	Particulars		Debit Rs.	Credit Rs.
01.06.2003	X"s a/c	Dr.	300	
	To Bills payable a/c (being the acceptance given to X)			300
”	Bills payable a/c	Dr	300	
	To cash a/c			295
	To rebate	.		

	a/c (being the entry for the retirement of the bill) bill)		5

Illustration: 9. Renewal of the Bill

Before due date of the bill for Rs. 500, B, the acceptor, approaches A, the drawer, and pays Rs. 200 in cash and requests A to draw another bill for Rs. 315. Show the journal entries.

Solution:

Journal of „A"

	Particulars	Debit Rs.	Credit Rs.
a)	B"s a/c Dr. To B/R a/c (being cancellation of the original bill)	500	500
b)	B"s a/c Dr. To interest a/c (being the interest due)	15	15
c)	B"s a/c B/R Dr. a/c Dr. To B a/c (being cash and 2^{nd} bill received)	200 315	515

Journal of „B"

	Particulars	Debit Rs.	Credit Rs.

a)	Bills payable a/c Dr. To A a/c (being the cancellation of the bill)	500	500
b)	Interest a/c Dr. To A a/c (being the interest due)	15	15
c)	A"s a/c Dr. To cash a/c To bills payable a/c (being cash and new acceptance given)	515	200 315

INSOLVENCY OF ACCEPTOR

Insolvency of a person means that he is unable to pay his liabilities. When the acceptor of a bill of exchange or marker of a promissory note becomes bankrupt or insolvent and unable to pay the amount of the bill on due date, the instrument should be treated as dishonoured and necessary entries have to be passed in this regard in the books of the parties concerned. It is also usual to find that a partial payment which is expressed as so many paise in the Rupee, e.g., 5 paise in the Rupee, in full satisfaction of the claims of the creditors. To determine how much is received in cash, it becomes necessary to prepare the insolvent"s personal account. After posting the entry for the amount received from the insolvent"s estate, the balance still owing by him which represents irrecoverable debt has to be written off as bad debt. By writing off the balance as bad debt the insolvent"s account is closed.

Illustration 10

Rahul purchased goods from Goul for Rs. 4,000 on 1st March, 2014, the same day he gave a promissory note for the amount payable after two months. On 4th March, this was discounted by Goul with his baners at the rate of 6% per annum. The promissory note was dishonoredon the due date and that the baners have incurred noting charges of Rs. 20. When approached by Rahul, Goul agreed to receive a sum of Rs. 1,060 in cash and two promissory notes – one at two months for Rs. 1,000 and the other at 3 months for Rs. 2,000 in full settlement from him. The first promissory note which has been endorsed to Trisul was duly honoured at maturity. The second note was dishonoured due to Rahul‟s insolvency. Gokul could recoveronly 40 paise in the Rupee as first and final dividend from the estate of Rahul. Show journal entries and ledger accounts in the books of Gokul and Rahul.

Solution:

Journal of Gokul (Drawer)

Date	Particulars		Debit Rs.	Credit Rs.
2014 March 1	Rahul a/c	Dr.	4,000	
	To Sales a/c			4,000
	(being the sale of goods on credit to Rahul)			
March 1	Bills Receivable a/c	Dr.	4,000	
	To Rahul			4,000
	(being Receipt of promissory note from Rahul)			
March 4	Bank a/c	Dr.	3,960	
	Discount a/c	Dr.	40	
	To Bills receivable a/c			4,000
	(being Amount received on discounting the bill)			

May 4	Rahul a/c Dr. To Bank a/c (being the bill is dishonoured and noting charges paid by the Bankers)	4,020	4,020
May 4	Rahul a/c Dr. To interest a/c (being Amount of interest receivable	40	40
	from Rahul)		
May 4	Cash a/c Dr. Bills receivable a/c Dr. To Rahul a/c (being Receipt of cash and two promissory notes one at months for Rs. 1,000 and the other at 3 months for Rs. 2,000 from Rahul)	1,060 3,000	4,060
May 4	Trishul a/c Dr. To Bills Receivable a/c (being the bill dishonoured to Trishul)	1,000	1,000
July 7	No entry		
Aug. 7	Rahul a/c Dr. To Bills Receivable a/c (being the bill dishonoured this day)	2,000	2,000

Aug. 7	Cash a/cDr Bad debts a/c Dr To Rahul a/c (being receipt of first and final dividend of 40 paise in the Rupee from the estate of Rahul)	800 1,200	2,000

Journal of Rahul (Acceptor)

Date	Particulars		Debit Rs.	Credit Rs.
2014 March 1	Purchase a/c To Gokul a/c (The purchase of goods from Gokul)	Dr.	4,000	4,000
March 1	Gokul a/c To Bills payable a/c (Our promissory note given to Gokul)	Dr.	4,000	4,000
	No entry			
May 4	Bills payable a/c Noting Charges a/c To Gokul a/c (The bill dishonoured this day)	Dr. Dr.	4,000 200	4,200
May 4	Gokul a/c To Cash a/c To Bills Payable a/c (payment of cash	Dr.	4,060	1060 3000

	and issue of two promissory notes – one at months for Rs. 1,000 and the other at 3 months for Rs. 2,000 to Gokul)		
May 4	No entry		
July 7	Bills payable a/c Dr. To Cash a/c (The bill met at maturity)	1,000	1,000
Aug. 7	Bills Payable a/c Dr. To Gokul a/c (the bill dishonoured this day)	2,000	2,000
Aug. 7	Gokul a/c Dr. To Cash a/c To Deficiency a/c (Payment of 40 paise in the Tupee as first and final dividend to Gokul)	2,000	800 1,200

Ledger in the boos of Gokul Rahul a/c

Date	Particulars	Amount Rs.	Date	Particulars	Amount Rs.
2014			2014		
Mar. 1	To sales a/c	4,000	Mar 1	By bills receivable a/c	4,000
May 4	To bank a/c	4,00	May 4	By cash a/c	1,060
May 4	To interest a/c	40	May 4	By bills receivable a/c	3,000
Aug. 7	To bills receivable a/c	2,000	Aug. 7		800
			Aug. 7		1,200
		10,060			10,060

books of Rahul Gokul a/c

Date	Particulars	Amount Rs.	Date	Particulars	Amount Rs.
2014			2014		
Mar. 1	To bills payable a/c	4,000	Mar 1	By purchase a/c	4,000
May 4	To cash a/c	1,060	May 4	By bills payable a/c	4,000
May 4	To bills payable a/c	3,000	May 4	By noting charges	20
Aug. 7	To cash a/c	800	Aug. 7	By interest	40
Aug. 7	To deficiency a/c	1,200	Aug. 7	By bills payable	2000
		10,060			10,060

Theory Questions

1) Define Bills of Exchange and bring out the features of it.

2) Differentiate Bills of exchange from promissory note

3) What is accommodation bill?

4) Explain the term "Noting Charges"

5) Give the specimen Journal entries for the renewal of the bill.

6) What are the advantages of Bills of Exchange?

7) Distinguish between Trade Bill and Accommodation bill.

8) What are days of Grace?

9) What do you mean by discounting of bills, endorsement of bills and retirement of bills?

Exercise

On 1st Jan 2015, Anand supplied goods to Ashok of the value of Rs. 9,000 and settled the account by means of three bills of Rs. 3000 each, due after two, three and four months respectively. A week later, Anand discounted the first bill at the discount of Rs. 60. The other two bills were held till maturity. On the due date the first two bills are duly met. On the maturity of the third bill, however, Ashok arranged to retire the bill by paying Rs. 1000 cash and giving Anand a fresh bill for four months to cover the balance together with 1% p.a. Anand discounted it for Rs. 2,000. Pass the necessary Journal entries in the books of Anand and Ashok.

1) Senthil sold goods at the value of Rs. 4000 to Kesavan, taking a bill at 3 months therefore. Senthil discounted the bill at 10% p.a. with his bank. On maturity the bill was returned by the ban dishonoured with Rs. 10 as noting charges. Kesavan paid Rs. 1,000 and the noting charges and gave another bill at 3 months for Rs. 3000 and 10% interest but before maturity he had become bankrupt and ultimately paid to his creditors 80 paise in the rupee. Pass Journal entries in the books of Senthil.

2) Mohan purchased goods from Shanmugam for Rs. 4,000 on 1.1.2014. Mohan accepted three months bill for the amount due. At it is due date the bill is dishnonour nothing charged are paid by Shanmugam Rs. 15. Give journal entires in the books of Shanmugam.

3) On 1st August 2000 X sold goods is Rs. 500 to Y and draw a three months bill on

Y. Y accepted the bill and return if to X. On due date, Y unable to meet the bill and approached X to renew the bill for two months with interest 6% p.a. X agreed for this on the due date the second bill was honoured pass journal entries in the books of two parties

UNIT -IV

ACCOUNTING FROM INCOMPLETE RECORDS-SINGLE ENTRY SYSTEM

INTRODUCTION:

Modern financial accounting is based on double entry system. under double entry system, both the aspect of a transaction (debit and credit) are recorded. As a result, all personal. Realand nominal accounts are opened. But this method requires more time, efforts and money. Hence small sole proprietor and partnership firms do not follow strict rules of double entry system. They maintain only cash book and personal accounts. No other accounts or records are maintained. This method of accounting known as **single entry system.**

Single entry system is a system of accounting, which does not follow the double entry principles. Under this system, accounts relating to debtors and creditors are maintained.

DEFINITION:

Kohler defines single entry system as "a system of book keeping which as a rule only records of cash and personal accounts are maintained, it is always incomplete double entry varying with circumstances"

FEATURES OF SINGLE ENTRY SYSTEM:

(i) Maintenance of personal accounts

(ii) Maintenance of cashbook

(iii) Dependence on original vouchers

(iv) It does not follow strict double entry principles

(v) The system may differ from firm to firm and therefore, no uniformity.

(vi) The system suitable in case of small firms, partnership firm. Hence, it is not suitablefor corporates

Merits

(ii) It is simple method of accounting

(iii) It is economical

(iv) It is suitable for small enterprises
It is possible to record transactions quickly

Demerits:

1. Arithmetical accuracy cannot be checked
2. Nominal accounts are not maintained
3. It does not record of all assets and liability
4. Financial position of business cannot be judged
5. True profit cannot be ascertained
6. It is not suitable for limited companies
7. It is not acceptable to income tax authorities

Difference between single Entry system and double entry

SI. NO.	Basis of Difference	Double Entry System	Single Entry System
1.	Recording of Transactions	Both aspects of all transactions are recorded.	In some cases, both aspects, in some others a single aspect or no aspect is recorded.
2.	Accounts Maintained	All personal, real and nominal accounts are maintained	Only personal accounts and cash account are opened.
3.	Trial Balance	Trial Balance can be prepared	Trial Balance cannot be prepared

4.	Ascertaining profit or loss	Accurate profit or loss can be found , through trading and profit and loss A/c.	Profit or loss cannot be found normally, in the absence of Trading and Profit and loss A/c.
5.	Revealing Financial Position:	Reliable Financial Position can be found through Balance Sheet.	Balance Sheet cannot be prepared . So, Financial position is difficult to ascertain.
6.	Acceptable Evidence	In case of disputes, accounting records can be produced in courts of law.	The Accounting records are not acceptable as evidence.
7.	Acceptability	Acceptable for Income tax and other tax purposes, for raising of bank loans etc.	Not acceptable for taxation, claims, raising of loan etc.,
8.	Utility	Suitable for any type of business of any size.	It can be followed by small business men who can be exercise personal control over the business.
9.	Internal check	Internal check is possible	Internal check is not possible

Types of Single Entry System

1. **Pure Single Entry System**: In this method, only the personal accounts are maintained and there is no information present, concerning the sales and purchases, cash in hand, and bank balance.

2. **Simple Single Entry System**: In a simple single entry system, cash book is maintained along with the personal accounts and these are maintained as per double entry system of bookkeeping. Cash received or paid, from/to business debtors or creditors are merely written on the bills issued or received.

3. **Quasi Single Entry System**: In this system, subsidiary books such as sales book, purchases book, bills receivable book and bills payable book are maintained in

addition to cash book and personal accounts.

Statement of Affairs

Statement of affairs (SOA) is also identified as a record of financial position of a particular business entity at a given time. The key purpose of SOA is to afford relevant information for the interested parties such as shareholders, customers, employees, competitor, etc. Rather than exhibiting book values of the assets and liabilities, SOA considers the amount at whichthe organization can recover after selling off their assets and settling their outside obligations.

Difference between Statement of Affaires and balance sheet

Basis of Difference	**Balance Sheet**	**Statement of affairs**
1.Objectives	Main objective of making balance sheet is to show the financial position of any organization.	Main objective of making statement of affairs to find the opening and closing capital in single entry system and in the liquidation of company, to find surplus or deficiency on the basis ofestimated value of assets and liabilities of company.
2. System of Book Keeping	It follows double entry system of book keeping	It follows the single entry system of bookkeeping.
3. Arithmetical Correctness	When balance sheet's both side are matched, it means, itshows also the arithmetical correctness.	It does not prove the arithmetical correctness because it is prepared just information of accounting record. It is not prepared on the basis

	Because it is prepared from trial balance and trial balance is prepared from the balance of ledger accounts.	of trial balance.
4. .Actual and Estimated	All assets and liabilities are shown on the actual value.	All assets and liabilities are shown on the basis of estimation.
5. Finding of Mistake	If we forget to show any asset or liability, our balance sheet will not match. With this, we can find the mistake.	Because all the assets and liabilities are shown on our past estimation, so, if we forget any asset or liability, we can not find from statement of affair because due to wrong estimation, we can show less or more value of asset
6. Proof in Court	Court accepts balance sheets proof of valid information.	Court does not accept it as proof of financial position of organization because there is chance of wrong estimation of assets and liabilities

Difference between profit and loss account and Statement of profit or loss

Profit and loss account	**Statement of profit and loss**
1.It is an account **It is prepared under double entry**	It is a statement **It is prepared under single entry**
It is starts with gross profit or loss	It is starts with closing capital

It shows the exact profit or loss	**It does not show the exact profit or loss**
It takes into account purchases, sales, returns and all expenses and income from ascertaining profit or loss	It takes into account closing and opening capitals for ascertaining profit or loss
It is prepared from ledger account balances only	**It is prepared partly from ledger account balances and partly from estimates, physical verification and memory**
It gives the reason for earning profit or incurring loss	It does not give the reasons for g profit or incurring loss

Computation of profit

The profit or loss in case of a business maintaining accounts according to single entrysystem can be computed by two methods namely, statement of affairs method and conversionmethod.

Statement of affairs method or net worth method

According to this method, the profit or loss made by the business is computed by comparing the capital of the business on two different dates. The following procedure is followed

(a) A statement of affairs at the beginning of the year is prepared to ascertain capital atthe beginning.

(b) Closing statement of affairs is prepared to ascertain capital at the end

(c) Profit is ascertained by

Capital at the end	Xxx
Add: drawings	Xx

Xxxx

Less further capital introduced Xx

Profit made during the year Xxx

Illustration : 1

A keeps his books by single entry system. His position on 1st Jan 2011 was as follows:

Cash at bank	Rs 5000	Machinery and plant –	Rs 6500
Cash in hand	Rs 1000	Bills receivable	Rs 2600
Stock	Rs 7000	creditors	Rs 2500
Sundry debtors	Rs 8400	Bills payable –	Rs 4000

On 31st Dec 2011 his position was as under

Cash at bank	Rs 4300	Machinery and plant	Rs 6500
Cash in hand	Rs 1700	Bills receivable	Rs 3200
Stock	Rs 9000	Creditors	Rs 160
Sundry debtors	Rs 6000	Bills payable –	Rs 3200

During the year a introduced further capital of Rs 2000, and his drawings were Rs. 800 permonth

Depreciate machinery and plant by 5% and create a reserve for bad and doubtful debts at 5%.from the above information prepare a statement showing the profit and loss made by him for the year ended 31st Dec 2011

Solution

Statement of affairs as *on 1st Jan 2011*

Liabilities	Rs	Assets	Rs
Creditors	2500	Bank	5000
Bills payable	4000	Cash in hand	1000
Capital(balance)	24000	Stock	7000
		Debtors	8400
		Machinery	6500
		Bills receivable	2600
	30500		30500

Statement of affairs *as on 31 dec 2011*

Liabilities	Rs	Assets	Rs
Creditors	1600	Bank	4300
Bills payable	3200	Cash in hand	1700
Capital(balance)	25275	Stock	9000
		Debtors (6000 5%)	5700
		Machinery (6500 5%)	6175
		Bills receivable	3200

	30075		30075

Statement of profit for the *year ended 31st Dec2011*

Capital as on 31/12/2011	25275
Add: drawings (800*2)	9600
	34875
Less further capital introduced	2000
	32875
Less capital as on 1/1/2011	24000
Profit made during the year	887

Illustration 2

Sri C Sharma commenced business on 1-jan-2003 with a capital of Rs 25000: Rs 20000 brought in cash and the balance in the form of machinery. On 1st October 2003 he introducedRs 10000 in the business for which Rs 6000 were borrowed from his wife during the year. Hewithdraw at the rate of Rs 500 a month his position on 31st Dec 2003 was as follows

ASSETS

Stock of goods Rs 12500: sundry debtors Rs 10500: machinery Rs 6000: cash at bankRs 3000: cash in hand Rs 500: bills receivable: Rs 3800 and furniture Rs 10000

LIABILITIES

Sundry creditors Rs 8500: loan from wife Rs 6000: bills payable Rs 1500Ascertain his profit for the year ended 31 Dec 2003

STATEMENT OF AFFAIRSAs at 31 12 2003

liabilities	`	Asset	`
Sundry creditors Loan from wife Bills payable Capital(balancing figure)	8500 6000 1500 30300	Stock Sundry debtors Machinery Cash at bank Cash in hand Bills receivable Furniture	12500 10500 6000 3000 500 3800 10000
	46300		46300

Statement of profit or loss for the year 31/12/2003

Capital at the end 32/12/2003	30300
Add drawings during the year	6000
	36300
Less additional capital introduced	4000
	32300
Less capital at the beginning	25000
Profit earned during the year	7000

Illustration 3

Sri Shankar keeps his books on single entry and following info is disclosed from his records

	31 12 2002(Rs)	31 12 2003(Rs)
Balance at bank	(Cr)2500	5500
Sundry debtors	14000	21000

Furniture	29000	27500
Stock in trade	15000	20000
Investments	6000	6000
Cash in hand	200	500
Sundry creditors	25000	29000
Bills payable	1000	600
Loan from tea pankaj	…………	4000

Sri V Shankar transferred Rs 300 per month from the business to his private bank account by way of drawings. In addition, he withdraws Rs 6000 for his daughter's marriage and Rs 500 for charitable purpose. He also withdraws goods worth Rs 2500 for domestic purpose. In august 2003 he had received a lottery price of Rs 6000 of which he invested Rs 3000 in to the business. He sold some private property for Rs 8000 and processed were utilized for the business. He wants his furniture to be depreciated at 10% per annum and a reserve for doubtful debts be created at 6%.he had not paid 2 months' salary to his accountant at the rateof 400 per month and 2 months' rent of the shop was unpaid amounting to Rs 500.interest earned but not received by him was Rs 2100. Prepare a statement of profit and loss for the year ending 31-12-2003.

Solution

To calculate the opening capital, the statement of affairs as at 31-dec-2002 is prepared thus:

Statement of affairs as at 31-12-2002

Liabilities	Rs	Assets	Rs
Bank overdraft	2500	Sundry debtors	14000
Sundry creditors	25000	Furniture	29000

Bills payable	1000	Stock in trade	15000
Capital (bal.fig)	35700	Investment	6000
		Cash in hand	200
	64200		64200

Similarly, a statement of affairs at Dec 31, 2003 will show the closing capital, thus:

Statement of affairs as at 31 12 2003

Liabilities	`	Assets	`
Sundry creditors	29000	Cash at bank	5500
Bills payable	600	Sundry debtors	21000
Loan from T pankaj	4000	Furniture	27500
Capital (B/F)	46900	Stock in trade	20000
		Investment	6000
		Cash in hand	500
	80500		80500

Then arrive at the profit or loss made by him. During the year a statement of profit or loss is prepared, thus:

Capital at the end (31/12/2003)		46900
Add drawings during the period		12600
		59500
Less additional capital introduced		11000
		48500

Less capital at the beginning		35700
Profit subject to adjustment		12800
Less depreciation on furniture	2750	
10% reserve for doubtful debts	1260	
6% outstanding salary	800	
Outstanding rent	500	5310
		7490
Add interest earned but not received		2100
Net profit transferred to capital		9590

CONVERSION METHOD

Conversion of single entry in to double entry involves the complete process of journalizing, posting, balancing and preparation of trial balance. Then final accounts are to beprepared .if any information is missing, it should be ascertained by preparing the relevant accounts before preparation of final accounts

Following steps are taken

1) Prepare statement of accounts in the beginning so as to ascertain capital in the beginning

2) Prepare cashbooks, cashbook reveals missing figure cash or bank balance at the beginning or at the end as the case may be. Sometimes cashbook reveals the amountof sundry expenses or drawings or cash purchases(if credit side is shorter than debit) or cash sales or sundry incomes or capital introduced(if debit side is shorter than credit side)

3) Then prepare I(1)total debtors account (2) total creditors account,(3) bills receivableaccount

(4) bills payable account(these accounts help in finding out credit sales, credit purchases,debtors or credit balances

4) After preparing these accounts, calculate total sales by adding credit sales and cash sales total purchases by adding cash purchases and credit purchases

5) Information relating to nominal accounts can be ascertained from the cashbook. Real accounts and amounts outstanding are given by way of information. These accounts can be completed

6) After these it will be possible to prepare final accounts in the usual manner

Specimen

TOTAL DEBTORS ACCOUNT

	Rs		Rs
Opening balance of creditors	Xxx	Cash received from debtors	Xxx
Credit sales	Xxx	Bills receivable received	Xxx
Bills receivable dishonored	Xxx	Discount allowed	Xxx
		Allowances claimed Return inwards	Xxx
		Bad debts	Xxx
		Transfer to/from creditors Closing	Xxx
		balance of debtors	Xxx
			Xxx
	xxx		Xxx

TOTAL CREDITORS ACCOUNT

	Rs		Rs
Cash paid to creditors	Xxx	Opening balances of	Xxx
Bills payable accepted	Xxx	creditorsCredit purchases	Xxx
Discount received	Xxx	Bills payable dishonored	Xxx
Allowances received	Xxx		
Return outwards	Xxx		
Transfer to/ from debtors	Xxx		
Closing balance of creditors	Xxx		
			Xxxx
	xxxx		

BILLS RECIEVABLE ACCOUNT

	Rs		Rs
Opening balance	Xxx	Cash (realization of bill)	Xxx
Sundry debtors (B/R received)	Xxx	Sundry debtors (bill returned dishonored)	Xxx
		Closing balance	Xxx
	xxxx		Xxx

BILLS PAYABLE ACCOUNTS

	Rs		Rs
Cash paid	Xxx	Opening	Xxx
(on account of bills		balance Sundry	Xxx

payable)Sundry creditors (B/P dishonored) Closing balance	Xxx Xxx xxxx	creditors (bills accepted)	 Xxxx

Illustration 4

Ascertain credit sales and purchases from the following figures

Debtors	`	creditors	`
Opening balances	10800	opening balances	5900
Cash received	36850	cash paid	24800
Discount allowed	2000	discount received	450
Bad debts written off	450	returns	540
Returns	800	bills payable issued	2860
Bills receivable received	8400	closing balances	6200
Bills receivable dishonored	600		
Closing balance	8700		

Solution

Total debtors account

	Rs		Rs
Balance b/d	10800	Cash	3685

			0
Bills receivable (dishonored)	600	Discount allowed	2000
Credit sales(balancing figure)	45800	Bad debts	450
		Returns	800
		Bills receivable	8400
		Balance c/d	8700
	57200		5720 0

Total creditors accounts

	Rs		Rs
Cash	24800	Balance b/d	5900
Discount received	450	Credit purchases	
Returns	540	(balancing figure)	2895 0
Bills payable	2860		
Balance c/d	6200		
	34850		3485 0

Illustration 5

From the following particulars extracted from the books of a trader kept under the single entry system you are asked to find out the figure for credit sales and credit purchasesby preparing the total debtors account and total creditors account show also the bill receivable account and bills payable account.

Balance, 1st Jan 2011	`
Total debtors	18700
Total creditors	8500
Bills receivable	1400
Bills payable	900
Cash received from customers	46500
Cash paid to creditors	24720
Discount allowed to customers	1450
Discount received from suppliers	950
Bad debts written off	850
Returns to suppliers’	435
Returns from customers	945
Cash received against bills receivable	4660
Cash paid against bills payable	2230
Bad debts previously written off, now received	450
Bills receivable dishonored	500
Balance 31st December, 2011	
Total debtors	17800
Total creditors	9400
Bills receivable	350
Bills payable	1050

Solution:

Bills Receivable Account

	`		`
Balance b/d	1400	Cash	4660
Sundry debtors	4110	Sundry debtors	500
(balancing figure)		(bills dishonored)	350
	5510	Balance c/d	5510
Balance b/d	350		

Bills payable account

	Rs		Rs
Cash	2230	Balance b/d	900
Balance c/d	1050	Sundry creditors	2380
		(balancing figure)	
	3280		3280
		Balance b/d	
			1050

Total debtors account

	Rs		Rs
Balance b/d	18700	Cash	46500
Bills receivable	500	Discount	1450
(dishonored)		Bad debts	850
Sales credit	52455	Returns	945
(balancing figure		Bills receivable	4110

		Balance c/d	17800
	71655		71655

Total creditors account

Particulars	`Amount	Particulars	`Amount
Cash	24720	Balance c/d	8500
Discount	950	Purchases credit	29385
Returns	435	(balancing figure)	
Bills payable	2380		
Balance c/d	9400		
	37885		37885
		Balance b/d	940

Illustration 6

From the following data ascertain total sales

Balance of debtors on 1-1-2011	Rs24000
Sales returns	10000
Cash received from customers	90000
Discount allowed t them	6000
B/R received	34000

Bad debts	3000
B/R dishonored	7000
Balance of debtors as on 31-12-2011	20000
Cash sales	50000

Total debtors account

	Rs		Rs
Balance b/d	24000	Cash	90000
B/R(dishonored)	7000	Discount	6000
Sales(credit balancing figure)	132000	B/R	34000
		Bad debts	3000
		Sales returns	10000
		Balance c/d	20000
	163000		163000

Total Sales=132000+50000=182000

Illustration 7

From the following, ascertain total purchases:

`

Balances of creditors on 1 1 2011	14000
Cash paid to creditors	10000
B/P given	10000
Discount allowed by them	500
Return outward	3000
Creditors as on 31 12 2011	25000
Cash purchases	10000

Solution

Total creditors account

	Rs		Rs
Cash	10000	Balance b/d	14000
B/P	10000	Purchases(credit balances)	34500
Discount	500		
Returns	3000		
Balance b/d	25000		
	48500		48500

Total purchases= 34500+10000=44500

Illustration 8

A commenced as a business as a cloth merchant on 1-1-2011 with a capital of rs10000.on the same date he purchased furniture and fitting for cash 3000

From the following particulars obtained from his books kept by single entry, you are required prepare trading and profit and loss account for the year ending 31st December 2011 and a balance sheet on that date:

Sales (inclusive of cash Rs 7000)	17000
Purchases (inclusive of cash Rs 4000)	15000
A's drawings	1200
Salary to staff	2000
Bad debts written off	500
Business expenses	700

A took cloth worth Rs 500 from the shop for private use and paid Rs 200 to his son, but omitted to record these transactions in his books on 31st December 2011.his sundry debtors were Rs 5200.and sundry creditors Rs 3600.stock in hand on 31st Dec 2011 was Rs 6500.

A's trading & profit and loss account for the year ending 31st Dec 2011

Particulars		`	Particulars	`
Purchases	15000		Sales	17000
Less drawings	500	14500	Closing stock	6500
Gross profit c/d		9000		
		23500		23500
Salaries		2000		
Bad debts		500	Gross profit b/d	9000
Business expense		7000		
Net profit		5800		
		9000		9000

A's balance sheet as on 31 December 2011

		Rs		Rs
Sundry creditors		3600	Cash	2800
Capital	10000		Sundry debtors	5200
Less drawings	1900		Closing stock	6500
			Furniture	3000
81000				
Add net profit	5800			
		13900		
		17500		
				17500

Working notes:

Sundry debtors account

			Rs
Sales credit	10000	Cash (balancing figure)	4300
		Bad debt	500
		Balance c/d	5200
	10000		10000

Sundry creditors account

	Rs		Rs
cash (balancing figure)	7400	Purchases – credit	11000
balance c/d	3600		
	11000		11000

Cash account

	Rs		Rs
Capital	10000	Furniture	3000
Sales	7000	Purchases	4000
Debtors	4300	Drawings(1200+200)	1400
		Salaries	2000
		Business expenses	700
		Creditors	7400
		Balance c/d(balance)	2800

	21300		21300

Illustration 9

Sunil keeps his books on single entry system. From the following information provided by him prepare a trading and profit and loss account for the year ended 31st December 2011 and a balance sheet on that date

Particular	31 12 2010	31 12 2011
Furniture	10000	12000
Stock	6000	3000
Sundry debtors	12000	13000
Prepaid expenses	………	500
Sundry creditors	5000	………
Outstanding expenses	1400	2200
Cash	2400	800

Receipts and payment account during the year was as follows

Received from debtors	40500
Paid to creditors	19000
Carriage inwards	4500
Drawings	10000
Sundry expenses	12500
Furniture purchased	2000

Other information

There were considerable amount of cash sales. Credit purchases during the year amounted to Rs 24000.create a provision of 10% on debtors for doubtful debts.

Receipts	`	**Payment**	`
Balance b/d	2400	Creditors	19000
Debtors	40500	Carriage inwards	4500
Sales (b/f)	5900	Drawings	10000
		Sundry expenses	12500
		Furniture	2000
		Balance c/d	800
	48800		48800
Balance b/d	800		

Total Debtors Account

	`		`
balance b/d	12000	Cash	40500
sales (b/f)	41500	Balance b/d	13000
	53500		53500
Balance b/d	13000		

Total Creditors Account

	`		`
Cash	19000	Balance b/d	5000
Balance c/d	10000	purchases	24000
	29000		29000
		Balance B/d	10000

Balancesheet as on 31/12/2010

Liabilities	`	Assets	`
Outstanding expenses	1400	Cash	2400
Sundry creditors	5000	Debtors	12000

Capital (b/f)	24000	Furniture	10000
		Stock	6000
	30400		30400

Trading and profit and loss *account*

For the year ended31st December 2011

Particulars	`	Particulars	`
Opening stock	6000.	Sales:	
Purchases	2400	Cash 5900	
Carriage inwards	4500	Credit 41500	47400
Gross profit	15900	Closing stock	3000
	50400		50400
Sundry expenses 12500		G/P B/d	15900
Less prepaid 500			
Less outstanding(2010) 1400			
Add o/s 2011 2200	12800		
Provision for	1300		
ddNet profit	18000		
	15900		15900

Balance sheet as on 31/12/2011

Liabilities	`	Assets		`
Sundry creditors	10000	Furniture		12000
Outstanding expense	2200	Stock		3000
Capital		Debtors	13000	
2400		Less provision	1300	11700
0		Prepaid expenses		500
Add net profit 1800		cash		800

……..	15800		
25800	28000		28000
Less drawings 10000			

Illustration 10

From the following data, ascertain total sales

Balances of debtors on 1/1/2011	24000	Sales return	10000
Cash received from debtors	90000	Discount allowed to them	6000
BR received	34000	Bad debts	3000
BR dishonoured	7000	Balance of debtors on 31/12/2011	20000
Cash sales	50000		

Solution

Total Debtors A/c

To balance b/d	24000	By cash	90000
,, B/R (dishonored)	7000	,, Discount	6000
,, credit sales (Bal. fig.)	132000	,, B/R	34000
		,, Bad debts	3000
		,, sales returns	10000
		,, balance c/d	20000
	163000		163000

Total sales = 132000+50000 = 182000

Self –Balancing Ledgers

As a business unit grows in size, it becomes necessary to open a large number of accountsof the customers and suppliers in addition to the other nominal and real accounts in the Ledger. If all these accounts are to be kept in a single Ledger, locating the error, if any, becomes difficult and time-consuming. The system of self balancing has been devised to make the task of locating the errors easy and prompt, so that the preparation of the trial balance need not be delayed unduly.

Section System of Balancing Vs. Self-Balancing

A stage it is to be understood that there are two systems of balancing; they are (1) Sectional system of balancing, and (2) Self-balancing. In a small business unit where in all the differenttypes of accounts such as personal accounts, real accounts and nominal accounts are maintained. When the business unit grows in size, maintaining all the accounts in one ledger will make the ledger unwieldy and the job of preparing the trial balance more difficult. It is for such a situation that the system of sectional balancing is designed.

The sectional system of balancing is very simple. Instead of one General Ledger for all accounts, the different ledger, viz., Debtors Ledger (Sold Ledger or Sales Ledger), Creditors Ledger (Bought Ledger or Purchase Ledger) and General Ledger (Nominal Ledger) are maintained. The accounts of all credit customers (i.e., debtors) are taken out of the General Ledger and placed in the Debtors Ledger. In the place of the individual debtors accounts so taken out, an account known as 'Total Debtors Account' showing, in total, all the transactions with the credit customers is prepared in the General Ledger, similarly, the accounts of the creditors are taken out of the General Ledger and put in the Creditors Ledger. In the place of all the creditors accounts so taken out, a 'Total Creditors Account' is prepared in the General Ledger. These two total accounts and the remaining accounts will from the General Ledger. Thus a firm will have three Ledgers:

General Ledger: Containing all the usual accounts except those relating to debtors andcreditors but containing instead of a Total Debtors Account and a Total Creditors Account.

Debtors Ledger: Containing accounts of individual debtors only. Creditors Ledger:Containing accounts of individual creditors only.

The total accounts in the General Ledger are posted in totals, where as the individuals' accounts in the Debtors or Creditors Ledger are posted with the individual transactions and, therefore, the total of the balances of individual customers or creditors should be equal to the balance shown by the Total Debtors Account or the Total Creditors Account respectively. If this is so, the Debtors Ledger and Creditors Ledger can be taken as correct. For the purpose of preparing Total Accounts, an analysis of the individual transactions concerned with the individual debtors or creditors should be made and the total figures ascertained. It is with these total figures the Total Accounts are constructed.

Total Debtors Account: The Total Debtors Account is a substitute account prepared in the Nominal Ledger for the accounts of the individual customers, but with total figures. A proforma of a Total Debtors Account is shown below:

In the Nominal LedgerTotal Debtors Account

		Rs.			Rs.
Jan. 1	To Balance b/d	-	Dec.31	By Cash received from Drs.	-
	To Credit Sales	-		By Bills Receivable received	-
	To Bills receivable dishonoured	-		By Sales Return	-
	To Sundry charge debited to			By Allowance to customers	-
	Customers	-		By Bad Debts w/off	-
				By Balance c/d	-
		-			-

The balace shown by the Total Debtors Account on any date should agree with the total ofthe debit in Debtors Ledger, at that date. If not, there is some mistake either in the Total Debtors Account or the individual accounts.

Total Creditors Account: It is nothing but a summary of the individual creditors accounts prepared in the General Ledger. A proforma of the Total Creditors Account is given below:

In the Nominal Ledger Total Creditors Account

		Rs.			Rs.
Dec 31	To Cash paid	-	Jan. 1	By Balance b/d	-
	To Bills payable accepted	-	Dec.31	By Credit Purchase	-
	To Purchase Return	-		By Bills Payable dishonored	-
	To Discount Received	-			
	To Balance c/d	-			
		-			-

The Credit Balance of the Total Creditors Account on any date should agree with the

total of the credit balance in the individual creditors accounts as found in the Creditors Ledger. If so it may be concluded that there is no mistake in the total creditors account or in the individual creditors accounts.

Illustration 3

From the following information prepare (1) Total Debtors 'Account and (2) Total Creditors' Account.

Rs.

Jan 1, 1998: Balance of Sundry Debtors

32,000

Balance of Sundry Creditors

37,000June 30, 1998:

Credit Purchase

9,000

Credit Sales		19,600
Cash Sales		1,500
Cash Purchase		1,000
Paid to Creditors		19,750
	Discount allowed by them	650
	Cash received from debtors	15,600
	Discount allowed to them	400
	Bills payable accepted	3,000
	Bills receivable received	6,000
	Returns Inward	1,750
	Returns Outward	1,200
	Rebate allowed to debtors	550
	Rebate allowed to creditors	300
	Provision for doubtful debts	320
	Bad debts	900
	Bills receivable dishonored	750
	Bad debts previously written off now recovered	500

In the Nominal LedgerTotal Debtors Account

1998		Rs.	1998		Rs.
Jan. 1	To Balance b/d	32,000	June 30	By Cash received	15,600
June 30	To Sales (Credit)	19,600	,,	By Discount allowed	400
June 30	To B/R Dishonoured	750	,,	By B/R received	6,000
			,,	By Returns Inward	1,750
			,,	By Rebate allowed	550
			,,	By Bad debts	900
			,,	By Balance c/d	27,150
		52350			52,350
July 1	To Balance b/d	27,150			

Total Creditor's Account

1998		Rs.	1998		Rs.
June 30	To Cash paid	19,750	Jan.1	By Balance b/d	37,000
‘’	To Discount received	650	June 30	By Purchase (Cr.)	9,000
‘’	To B/P accepted	3,000			
‘’	To Returns outward	1,200			
‘’	To Rebate received	300			
‘’	To Balance c/d	21,100			
		46,000			46,000
			July 1	By Balance c/d	21,000

Note: Cash Sales, Cash Purchases, Provision for Bad Debts and Bad Debts recovered will not appear in the Total Debtors Account since the Debtors or Creditors accounts are not affected by them.

Illustration 4

From the following particulars as extracted from the books of Dochan & Co., who keep a Debtors 'Ledger Creditors' Ledger and a General Ledger on the Self-balancing system, show how the various adjustment accounts will appear in each of the ledgers.

Drs. Balance (1.1.98)	45,750
Crs. Balance(1.1.98)	54,900
Transactions for the month of January	
Credit Purchases	20,500
Credit Sales	22,700
Returns inwards	400
Return outwards	600
Cash received from customers	25,500
Bad debts written off	2,500
Sundry charges debited to customers	345
Discount received from Creditors	670
Discount allowed to customers	450
Cash paid to Creditors	30,700
Acceptances received from Debtors	8,500
Creditors bills accepted	12,000
B/R returned dishonoured	1,200
B/P dishonoured	3,000
Allowances from creditors	275

Solution:

In the General Ledger

Debtor's Ledger Adjustment A/c

1998		Rs.	1998		Rs.
Jan.1	To Balance b/d	45,750	Jan. 31	By General Ledger	
Jan. 31	To General Ledger			By Adjustment A/c	
	To Adjustment A/c			By Sales returns	400
	To Credit Sales	22,700		By Cash received	25,500
	To Sundry Charges	345		By Bad Debts	2,500
	To B/R dishonoured	1,200		By Discount allowed	450
				By B/R received	8,500
				By Balance c/d	32,645
		69,995			69,995
Feb.1	To Balance b/d	32,645			

Creditors Ledger Adjustment Account

1998		Rs.	1998		Rs.
Jan. 31	To General Ledger		Jan.1	By Balance b/d	54,900
	To Adjustment Account			By General Ledger	
	To Purchases Return	600		By Adjustment A/c	
	To Cash paid	30,700		By Credit Purchases	20,500
	To Discount Received	670		By B/P dishonoured	3,000
	To B/P accepted	12,000			
	To Allowance received	275			
	To Balance c/d	34,155			
		78,400			78,400
					34,155

In the Debtors Ledger General Ledger

Adjustment Account

1998		Rs.	1998		Rs.
Jan.31	Drs. Ledger		Jan.1	By Balance c/d	45,750
	Adjustment Account:		Jan.31	By Drs. Ledger Adjustment	
	To Sales returns	400		Account:	
	To Cash	25,500		By Credit Sales	22,700
	receivedTo Bad	2,500		By Sundry charges	345
	Debts	450		By B/R dishonoured	1,200
	To Discount Allowed	8,500			
	To B/R received	32,645			
	To Balance c/d	69,995			69,995
			Feb.1	By Balance b/d	32,645

In the Creditors Ledger General Ledger Adjustment A/c

1998		Rs.	1998		Rs.
Jan.1	To Balance b/d	54,900	Jan. 31	By Crs. Ledger	
Jan.31	Crs. Ledger Adjustment			Adjustment Account:	
	To Credit Purchases	20,500		By Purchase returns	600
	To B/P dishonoured	3,000		By Cash paid	30,700
				By Discount Received	670
				By B/P accepted	12,000
				By Allowance received	275
				By Balance c/d	34,155
		78,400			78,400
Feb.1	To Balance b/d	34,155			

****

FIRE INSURANCE CLAIMS

INTRODUCTION:

Fire, in the business premises of any firem, can damage a number of assets like stock , buildings, furniture , fixtures, machinery etc. In addition, the normal working of a firm is affected for a number of days or months, resulting in loss of sales and loss of profits.

It is very difficult for a business to replace all the destroyed assets and normalize its working without affecting its working capital position and cash position. During such difficult times, external help is like a boon to the business.

All prudent business firms insure their stock and also other assets against the risk of fire . They take appropriate Insurance Policy from a recognized company by paying required premium. This enables the business to lodge claim against insurance company and receive sufficient funds to replace the lost assets.

Insurance companies investigate any claim made through experienced assessors. They evaluate the causes for fire and the actual loss through the damage. Based on the assessors report, insurance company settles the claim made against it for loss due to fire.

Types of Fire Insurance policies

There are two major types of policies issued by insurance companies - loss of stock policies and loss of profits or consequential loss policies.

Loss of Stock Claims

Business units who have insured their godown or store against the risk of loss of stock by fire are eligible to lodge loss of stock claims when a fire causes loss of their stock.

Salvage: Fire may destroy some items of stock completely. Some other portion of stock may be damaged and some items of stock may not be affected at all.

The damaged stock and undamaged stock are separately valued and are called salvage Value or Stock Salvaged.

When claim is lodged for loss of stock , stock salvaged is subtracted from stock on the date of fire and claim is made for the balance amount.

(A) Steps to Computation of claim to be lodged for loss of stock

- Calculation of Gross Profit Ratio
- Calculation of Stock on the Date of Fire
- Calculation of Loss of stock
- Calculation of Amount of Claim

CALCULATION OF GROSS PROFIT RATIO

Dr Trading A/ c for the year ended Cr

Particulars	(Rs.)	Particulars	(Rs.)
To Opening Stock	XXX	By Sales A/ c	XXX
To Purchase A/ c	XXX	By Closing Stock	XXX
To Direct Expenses A/ c	XXX		
To Gross Profit (Bal. Fig.)	XXX		
	XXX		XXX

Gross Profit Ratio = Gross Profit / Net Sales X 100 = _ _ %

CALCULATION OF STOCK ON THE DATE OF FIRE

Dr Memorandum Trading A/ c for the year ended Cr

Particulars	(Rs.)	Particulars	(Rs.)
To Opening Stock	XXX	By Sales A/ c	XXX
To Purchase A/ c	XXX	By Stock on the date of Fire	XXX
To Direct Expenses A/ c	XXX	(Bal. Fig.)	
To Gross Profit	XXX		
	XXX		XXX

CALCULATION OF LOSS OF STOCK

Stock on the Date of Fire	XXX
Less : Salvage Value	XXX
Loss of Stock	XXX

CALCULATION OF AMOUNT OF CLAIM

Total Loss : If the goods are totally destroyed

- Fully insured - Amount of Claim will be equal to Loss of Stock
- Under insurance - Amount of Claim will be equal to Amount of Policy

Calculation of Amount of Claim – Partial Loss

1. Without Average Clause

Amount of Claim = Lower of Actual loss or sum assured

2. With Average Clause

Amount of Claim = Amount of Policy / Stock on the Date of Fire X Loss of Stock

Note : Average Clause is applicable only when insured value is less then stock on the date of fire.

Illustration : 01

Mr. A Prepares accounts on 30th Sept each year, but on 31st Dec, 2021 fire destroyed the greater part of his stock. Following information was available

Particulars	Rs.
Stock as on 1.10.2021	29,700
Purchases from 1.10.2021 to 31.12.2021	75,000
Wages from 1/ 10.2021 to 31.12.2021	33,000
Sales from 1.10.2021 to 31.12.2021	1,40,000

The rate of G.P is 33.33% on Cost. Stock to the value of Rs. 3,000 was salvaged and Insurance policy was for Rs. 25,000 subject to Average Clause.

Additional Information:

1. Stock at the beginning was calculated at 10% less than the cost.

2. A Plant was installed by the firm's own workers. Wages Paid Rs. 3000 was included in wages.

3. Purchases included purchase of Plant for Rs. 5,000

You are required to calculate the claim for the loss of stock

Calculation of Gross Profit Ratio:

The Question has provided that the gross profit rate is 33.33% on cost i.e 1/ 3rd on cost, which means 1/ 4th on sales, which means that gross profit is 25% on sales

Calculation of Stock on the Date of Fire:

Memorandum Trading A/ c for the year ended Cr

Particulars	(Rs.)		Particulars	(Rs.)
To Opening Stock 3 (29,700 x 100/ 90)		33,000	By Sales A/ c	1,40,000
To Purchases	75,000		By Stock on the date of Fire	30,500
Less : Cost of Plant	(5,000)	70,000	(Bal. Fig.)	
To Wages	33,000			
Less : Wages for Plant	(500)	32,500		
To Gross Profit (1,40,000 x 25%)		35,000		
		1,70,500		1,70,500

Calculation of Loss of Stock:

Stock on the Date of Fire	30,500
Less : Salvage Value	(3,000)
Loss of Stock	2 7,500

Calculation of Amount of Claim:

Amount of Claim = Amount of Policy/ Stock on the Date of Fire X Loss of Stock

= 25,000 / 30,500 X 27,500

Amount of Claim = 22,541

LOSS OF PROFIT

- When the Fire occurs, apart from the direct loss on account of stock or other assets destroyed, there is also a consequential loss.
- Consequential loss is the Loss of Profit suffered, which the business would have earned otherwise, because, for sometime, the business is disorganized or has to be discontinued
- Also the standing expenses of the business like rent, salaries etc continue.

IMPORTANT TERMS :

Some important terms in computation of loss of profits claims are briefly explained below:

1. Indemnity Period: This is the period for which insurance policy is taken against the risk of fire. The insurance policy is always taken for a period of one year. Indemnity period refers to the length of period which may be affected by fire . During the indemnity period , normal working is not expected.

2. Affected Period :This is the period for which normal working is affected because of fire.

3. Turnovers :

a) Affected Period Turnover : This is the actual sales made during the period in which work is affected by fire.

b) Standard Turnover: This is the sales during the same months as the affected period, in the previous year.

c) Accounting year Turnover : This is the sales in the last accounting year for which accounts were prepared.

d) Annual Turnover : This is the sales during the twelve months exactly before fire.

e) Saved Turnover : This is the sales achieved due to spending additional amounts during the affected period. This may be less than or equal to affected period turnover.

4. Standing Charges: These are the fixed expenses which have to be paid whether work is carried on or not, like salaries , rent , directors, fees, postage etc.

5. Insured Standing Charges: Fixed expenses which are mentioned in the policy taken by the insured firm.

6. Uninsured Standing Charges: These are the fixed expenses which are not mentioned in the insurance policy, but still incurred by the insured firm.

7. Short Sales: This is the difference between standard turnover and affected period turnover.

8. Saving in standing charges: Due to fire , some fixed costs need not be paid. The total of such costs is called ‘ Saving in standing charges’.

9. Special Circumstances Clause : If any increasing or decreasing trend is observed in sales, adjustment has to be made. The increasing or decreasing trend as a percentage should be found. Then the standard turnover and annual turnover should be increased or decreased, proportionate to the trend.

FORMAT FOR COMPUTATION OF CLAIMS FOR LOSS OF PROFITS:

Step : 1 Claim for reduction in turn over:

	Rs.
Standard Turnover	XXX
Add: Increase for trend	
Or	XXX
Less: Decrease for trend	XXX
	XXX
Less: Affected period turn over	XXX
Short Sales	

$$\text{Gross profit ratio} = \frac{\text{Net profit + Insured standing charges}}{\text{Accounting year Turnover}} \times 100$$

Claim for Reduction in Turnover = Short Sales x Gross profit ratio

Step : 2 Claim for increased cost of working:

Lowest of the following three items can be claimed for increased cost of working.

Step : 3 Total claim for loss of profits:

Claim for Reduction in Turnover (as per Step 1) = xxxAdd: Claim for increased cost of working (as

xxx

Less : Saving in standing charges xxx

Total claim for loss of profit xxx

Step : 4 Application of average clause:

If the policy amount is less than gross profit on annual turnover, average clause applies.

	Rs.
Annual Turnover Add: Increase for trend Or Less: Decrease for trend Adjusted annual turnover	XXX XXX XXX

$$\text{Claim to be made} = \text{Total claim} \times \frac{\text{Policy Amount}}{\textbf{Gross profit on adjusted annual turnover}}$$

ROYALTIES

Introduction

The owner of an asset (e.g. mines, quarries, patent, copyright, etc), as a business arrangement, may allow other party (lessee, licencee, publisher, etc) the right to use that asset against some consideration. Such consideration is calculated with reference to the quantity produced or sold. This payment to the owner by the user of the asset is termed as **Royalty**.

We can therefore say that the royalty is the amount of consideration paid by a party to the owner of the asset in return for the right to use that asset.

For example, when a publisher publishes a book, he makes a payment to the author which is based on the number of copies sold known as royalty.

The following are some of cases where one party paid to another in the form of Royalty:

1. where the owner of a mine allows another the right to extract minerals from land;
2. where right such as patents or copyrights are licensed in favour of another;
3. where an author, artist or designer gives exclusive rights to another to copy the work.

Common terms Used in Connection with Accounting for Royalty :

1. Minimum Rent / Dead Rent

A contract is entered into between the landlord and the lessee for payment of royalty, usually calculated upon the quantum of production or sale at a certain stipulated rate.

So, if there is little or no production or sale, the landlord would receive little or no royalty at all, thus affects the monetary interest of the landlord as well as the lessee. It is normally not acceptable to the owner, since sale or production mostly depends on the capacity of the person to whom the rights have been given. To avoid such a situation, the landlord and the lessee agreed upon a minimum periodical amount that the landlord will receive from the lessee, even if the actual royalty as calculated on the basis of actual production or sale is less than such minimum amount.

This assured and mutually agreed periodical minimum amount is known as **"Minimum Rent".**

Example: Suppose royalty per ton of production is ` 10 and the minimum (annual) rent is ` 4, 00,000. Now, the actual production is 35,000 tons, then actual royalty would become ` 3, 50,000. In this case the minimum rent of ` 4, 00,000 will have to be paid by the lessee. On the other hand, if the actual production is 46,000 tons, then the actual royalty would become ` 4, 60,000. In this case ` 4, 60,000 will have to be paid by the lessee.

Thus, as there is a stipulation for minimum rent, then either the minimum rent or the actual royalty whichever is more shall have to be paid by the lessee.

The minimum rent is also called dead rent, certain rent, fixed rent, etc.

2. Short workings/Redeemable Dead Rent

Short workings are the amount by which the minimum rent exceeds the actual royalty. It is the difference between Actual Rent and Minimum Rent.
In the above example, the short workings is ` 50,000 (` 4, 00,000 – ` 3, 50,000). Where there is

short workings in any period the lessee is liable to pay the minimum rent and, in effect, short workings becomes the part of the minimum rent and not represented by the use of rights.

The question of short workings will arise only when there is a stipulation for minimum rent in the agreement.

3. Excess working

It refers to the amount by which the actual royalty exceeds the minimum rent. In the above example, the excess workings is ` 60,000 (` 4, 60,000 – ` 4, 00,000) if the production is 46,000 tons.

4. Ground Rent/Surface Rent

It refers to the fixed yearly or half-yearly rent payable by the lessee to the landlord in addition to the minimum rent.

5. Recoupment of Short workings

Generally the royalty agreement contains a provision for carrying forward of short workings with a view to adjust it in the future. In the subsequent years, such short working is adjusted against the surplus royalty. This process of adjustment is called recoupment of short workings. The right of recoupment of short workings enables the lessee to recover the excess payment, made in the earlier years to meet the condition of payment of minimum rent. A time is usually agreed upon the number of years for which such short workings can be recouped. This time limit for recoupment of short workings may be fixed or fluctuating. If the short workings cannot be recouped within the specified time, they lapse and are charged to Profit and Loss Account in the year when that specified time limit for recoupment ends.

(i) Fixed right:

When the lessee can recoup short workings within a certain period from the date of the lease it is known as fixed right. For example, short workings can be recouped within three years from the date of the lease. So, after three years from the date of the lease the short workings cannot be recouped.

(ii) Fluctuating right:

In this type of agreement, lessee can recoup short workings of any year during the next following year(s). For example, short workings can be recouped in the year subsequent to the year of short workings.

6. Strike and Lockout, etc.:

If agreement so provides, the minimum rent may be proportionately reduced in the event of strike and/ or lockout. So special entry is required for the same except the adjustment of minimum rent for that particular year.

Accounting Entries in the Books of the Lessee/Licensee/Publisher etc.

1. **Where a minimum rent exists with right to recoup short workings**

(a) Where the actual royalty is less than the minimum rent

(i)	Royalties (payable) Account	Dr.	[Actual royalties for the period]
	Short workings Account	Dr.	[Minimum rent - Actual royalties]

To Landlord Account [Minimum rent]

(ii) Landlord Account Dr. [Minimum rent]

To Bank Account [Net amount paid]
To Income Tax Payable Account [Tax deducted at source]

(iii) Manufacturing / Profit & Loss Account Dr. [Transfer]
To Royalties (payable) Account [Actual royalties for the period]

If the user is a manufacturer and royalties are calculated on the basis of production, the actual royalties are debited to Manufacturing Account. Where royalties are calculated on the basis of sales, they are debited to Profit and Loss Account.

In case of a limited company, which does not prepare Manufacturing Account separately, the actual royalties are debited to Profit and Loss Account and they are shown in production or manufacturing section of the Profit and Loss Account.

Treatment of Short workings

As per agreed terms, short workings can be recouped in the year when the actual royalty is more than the Minimum rent. Any short workings, which cannot be recouped within the specified period becomes irrecoverable and it should be charged to Profit and Loss Account in the year in which the period ends.

However, the recoupable short workings should be carried forward and they are shown in the Balance Sheet as a Current Asset.

The relationship between Minimum rent, Actual Royalty and Royalty payable are in below
: Minimum rent = Actual Royalty + Short workings.

(b) Where the actual royalty is more than the minimum rent:

(i) Royalties (payable) Account Dr.
To Landlord Account [Actual royalties for the period]

(ii) Landlord Account Dr.
To Short workings Account
(Short workings, if any, recouped)

Landlord Account Dr.
To Bank Account to
Income Tax Payable Account

(iii) Profit & Loss Account Dr.
To Short workings Account

(Short workings, which cannot be recouped)

(iv) Manufacturing / Profit & Loss Account Dr.

To Royalties (payable) Account

Important Points to note :

1. When the royalty agreement does not contain a clause for minimum rent, the question of short workings and its recoupment does not arise.
2. The landlord is always entitled to get either the minimum rent or the actual royalty whichever is higher subject to any adjustment for short workings recouped.

Illustration 1.

The Bihar Coal Co. Ltd. holds a lease of coal mines for a period of twelve years, commencing from 1st April 2006.According to the lease, the company is to pay ` 7.50 as royalty per ton with a minimum rent of ` 150,000 per year. Short workings can; however, be recovered out of the royalty in excess of the minimum rent of the next two years only. For the year of a strike the minimum rent is to be reduced to 60%. The output in tons for the 6 years ending31st March, 2012 is as under:

2006-07:10,000; 2007-08:12,000; 2008-09:25,000; 2009-10: 20,000; 2010-11: 50,000; and 2011-12: 15,000 (strike).

Write up the necessary Ledger Accounts in the books of Bihar Coal Co. Ltd.

In the books of Bihar Coal Co. Ltd. Statement showing Royalty Payable

									Fig in (`)
Year	**Output (Tons)**	**Actual Royalties**	**Min. Rent**	**Excess Short Workings**	**Short workings**				**Amount**
					Occurred	**Recouped**	**Written offer lapsed**	**C/F**	**Payable**
2006-07	10,000	75,000	150,000	0	75,000	0	0	75,000	150,000
2007-08	12,000	90,000	150,000	0	60,000	0	0	135,000	150,000
2008-09	25,000	187,500	150,000	37,500	0	37,500	37,500	60,000	150,000
2009-10	20,000	150,000	150,000	0	0	0	60,000	0	150,000
2010-11	50,000	375,000	150,000	225,000	0	0	0	0	375,000
2011-12	15,000	112,500	90,000	22,500	0	0	0	0	112,500

Royalties Account

Date	Particulars	Amount (`)	Date	Particulars	Amount (`)
31.03.07	To Landlord A/c	75,000	31.03.07	By Profit & Loss A/c	75,000
31.03.08	To Landlord A/c	90,000	31.03.08	By Profit & Loss A/c	90,000
31.03.09	To Landlord A/c	187,500	31.03.09	By Profit & Loss A/c	187,500
31.03.10	To Landlord A/c	150,000	31.03.10	By Profit & Loss A/c	150,000
31.03.11	To Landlord A/c	375,000	31.03.11	By Profit & Loss A/c	375,000
31.03.12	To Landlord A/c	112,500	31.03.12	By Profit & Loss A/c	112,500

Landlord Account

Date	Particulars	Amount (`)	Date	Particulars	Amount (`)
31.03.07	To Bank A/c	150,00 0	31.03.07	By Royalties A/c By Short workings A/c	75,000 75,000
31.03.08	To Bank A/c	150,000	31.03.08	By Royalties A/c	150,000
		150,00 0		By Short workings A/c	90,000 60,000
31.03.09	To Bank A/c	150,000	31.03.09	By Royalties A/c	150,000
	To Short workings A/c	150,000 37,500			187,500
		187,500			187,500
31.03.10	To Bank A/c	150,000	31.03.10	By Royalties A/c	150,000
		150,000			150,000
31.03.11	To Bank A/c	375,000	31.03.11	By Royalties A/c	375,000
		375,000			375,000
31.03.12	To Bank A/c	112,500	31.03.12	By Royalties A/c	112,500
		112,500			112,500

Short workings Account

Date	Particulars	Amount (`)	Date	Particulars	Amount (`)
31.03.07	To Landlord A/c	75,000	31.03.07	By Balance c/d	75,000
		75,000			75,000
1.4.07 31.03.08	To Balance b/d To Landlord A/c	75,000 60,000	31.03.08	By Balance c/d	135,000

		135,000			135,000
1.4.08	To Balance b/d	135,000	31.03.09	By Landlord A/c By Profit & Loss A/by Balance c/d	37,500 37,500 60,000
		135,000			135,000
1.4.09	To Balance b/d	60,000	31.03.10	By Profit & Loss A/c	60,000
		60,000			60,000

A. Ltd. obtain from B.S. Ltd. a lease of some coal-bearing land, the terms being a royalty of ` 15 per ton of coal raised subject to a minimum rent of ` 75,000 p.a. with a right of recoupment of short-working over the first four years of the lease. From the following details, show (i) Short-working Account, (ii) Royalty Account and (iii) B.S. Ltd. Account in the books of A. Ltd.

Year	Sales (Tons) `	Closing Stock (Tons) `
2009	2,000	300
2010	3,500	400
2011	4,800	600
2012	5,600	500
2013	8,000	800

Solution:

Workings:

[Coal raised i.e., Production = Sales + Closing Stock – Opening Stock.]

Year	Sales	+ Closing Stock	-	Opening Stock	=	Net Production
2009	2,000	+ 300	-	Nil	=	2,300
2010	3,500	+ 400	-	300	=	3,600
2011	4,800	+ 600	-	400	=	5,000
2012	5,600	+ 500	-	600	=	5,500
2013	8,000	+ 800	-	500	=	8,300

In the books of A. Ltd.

Memorandum Royalty Statement

Year	Quantity	Rate `	Royalty `	Minimum Rent `	Short working `	Recoupment `	Short working carried forward `	Short working Transferred to P&L A/c or lapsed `	Payment to Landlord `
2009	2,300	15	34,500	75,000	40,500	---	40,500	---	75,000
2010	3,600	15	54,000	75,000	21,000	---	61,500	---	75,000
2011	5,000	15	75,000	75,000	---	---	61,500	---	75,000
2012	5,500	15	82,500	75,000	---	7,500	---	54,000	75,000
2013	8,300	15	1,24,500	75,000	---	---	---	---	1,24,500

B. S. Ltd. (Landlord) Account

Date	Particulars	Amount `	Date	Particulars	Amount `
2009	To Bank A/c	75,000	2009	By Royalty A/c	34,500
				” Short-working A/c	40,500
		75,000			75,000
2010	To Bank A/c	75,000	2010	By Royalty A/c	54,000
				” Short-working A/c	21,000
		75,000			75,000
2011	To Bank A/c	75,000	2011	By Royalty A/c	75,000
		75,000			75,000
2012	To Bank A/c	75,000	2012	By Royalty A/c	82,500
	To Short-Working A/c	7,500			
		82,500			82,500
2013	To Bank A/c	1,24,500	2013	By Royalty A/c	1,24,500
		1,24,500			1,24,500

Short-Working Account

Date	Particulars	Amount `	Date	Particulars	Amount `
2009	To B. S. Ltd. A/c (Landlord)	40,500	2009	By Balance c/d	40,500
		40,500			40,500
2010	To Balance b/d	40,500	2010	By Balance c/d	61,500
	" B. S. Ltd. A/c (Landlord)	21,000			
		61,500			61,500
2011	To Balance b/d	61,500	2011	By Balance c/d	61,500
		61,500			61,500
2012	To Balance b/d	61,500	2012	By B. S Ltd. (Landlord) A/c	7,500
				" Profit and Loss A/c	54,000
		61,500			61,500

Royalty Account

Date	Particulars	Amount `	Date	Particulars	Amount `
2009	To B. S. Ltd. A/c	34,500	2009	By Profit & Loss A/c	34,500
2010	To B. S. Ltd. A/c	54,000	2010	By Profit & Loss A/c	54,000
2011	To B. S. Ltd. A/c	75,000	2011	By Profit & Loss A/c	75,000
2012	To B. S. Ltd. A/c	82,500	2012	By Profit & Loss A/c	82,500
2013	To B. S. Ltd. A/c	1,24,500	2013	By Profit & Loss A/c	1,24,500

Accounting Entries in the Books of the Landlord / Lessor

1. ***Where a minimum rent exists with right to recoup short workings***

(a) Where the actual royalty is less than the minimum rent:

(i)	Lessee Account	Dr.	[Minimum rent]
	To Royalty Receivable Account		[Actual Royalties for the period]
	To Royalty Suspense Account/		[Short fall in Royalties]
	Or Short workings Allowable A/c		
(ii)	Bank Account	Dr.	[Net amount paid]
	Tax Deducted at	Dr.	[Tax deducted at source][Minimum rent]
	source To		
	Lessee Account		
(iii)	Royalties Receivable Account	Dr.	
	To Profit & Loss Account		[Transfer]

Where the actual royalty is more than the minimum rent:

(ii)Royalty Suspense Account/ Dr.

Or Short workings Allowable A/c To

Lessee Account

[Recoupment of Short workings, if any]

(iii)	Bank Account	Dr.	[Net amount paid]
	Tax Deducted at source	Dr.	[Tax deducted at source]
	To Lessee Account		

(iv) Royalties (Receivable) Account Dr.

To Profit & Loss Account [Transfer]

v) Royalty Suspense Account/ Dr.

Or Short workings Allowable A/c

To Profit and Loss Account

[Short workings, which can not be recouped]

Illustration 3.

For the same figures as given in illustration 1, prepare necessary accounts in the books of Landlord.

Solution :

In the books of Landlord

***Dr.*Royalty Receivable Account**

Date	Particulars	Amount (`)	Date	Particulars	Amount (`)
31.03.07	To Profit & Loss A/c	75,000	31.03.07	By Bihar Coal Co.Ltd	75,000
31.03.08	To Profit & Loss A/c	90,000	31.03.08	By Bihar Coal Co. Ltd	90,000
31.03.09	To Profit & Loss A/c	1,87,500	31.03.09	By Bihar Coal Co. Ltd	1,87,500
31.03.10	To Profit & Loss A/c	1,50,000	31.03.10	By Bihar Coal Co. Ltd	1,50,000
31.03.11	To Profit & Loss A/c	3,75,000	31.03.11	By Bihar Coal Co. Ltd	3,75,000
31.03.12	To Profit & Loss A/c	1,12,500	31.03.12	By Bihar Coal Co. Ltd	1,12,500

Dr. **Bihar Coal Co. Ltd. (Lessee) Account**

Date	Particulars	Amount (`)	Date	Particulars	Amount (`)
31.03.07	To Royalties Receivable A/c	75,000	31.03.07	By Bank A/c	150,000
	To Shortworkings Susp.A/c	75,000			
		150,000			150,000
31.03.08	To Royalties Receivable A/c	90,000	31.03.08	By Bank A/c	150,000
	To Shortworkings Susp.A/c	60,000			

		150,000			150,000
31.03.09	To Royalties Receivable A/c	187,500	31.03.09	By Bank A/c	150,000
				By Shortworkings Susp.A/c	37,500
		1,87,500			1,87,500
31.03.10	To Royalties Receivable A/c	150,000	31.03.10	By Bank A/c	150,000
		150,000			150,000
31.03.11	To Royalties Receivable A/c	375,000	31.03.11	By Bank A/c	375,000
		375,000			375,000
31.03.12	To Royalties Receivable A/c	112,500	31.03.12	By Bank A/c	112,500
		112,500			112,500

Shortworkings Suspense Account

Date	Particulars	Amount (`)	Date	Particulars	Amount (`)
31.03.07	To Balance c/d	75,000	31.03.07	By Bihar Coal Co. Ltd	75,000
			1.4.07	By Balance b/d	75,000
31.03.08	To Balance c/d	1,35,000	31.03.08	By Bihar Coal Co. Ltd	60,000
		1,35,000			1,35,000
31.03.09	To Bihar Coal Co. LtdTo Profit & Loss A/c To Balance c/d	37,000 37,500 60,000	1.4.08	By Balance b/d	135,000
		1,35,500			1,35,500
31.03.10	To Profit & Loss A/c	60,000	1.04.09	By Balance b/d	60,000
		60,000			60,000

Illustration 5.

A fire occurred in the office premises of lessee in the evening of 31.3.2012 destroying most of the books and records. From the documents saved, the following information is gathered:

Short-working recovered :

2009-10 ` 4,000 (towards short-workings which arose in 2006-07)

2010-11 ` 8,000 (including ` 1,000 for short-working 2007-08)

2011-12 ` 2,000

Short-working lapsed :

2008-09 ` 3,000

2009-10 ` 3,600

2011-12 ` 2,000

A sum of ` 50,000 was paid to the landlord in 2008-09. The agreement of Royalty contains a clause of Minimum Rent payable for fixed amount and recoupment of short-workings within 3 years following the year in which Short-workings arise.

Information as regards payments to landlord subsequent to the year 2008-09 is not readily available.

Show the Short – working Account and the Royalty Account in the books of lessee.

Solution:

Working Notes:

Analysis of payments

Year	**Minimum Rent** `	**Royalty** `	**Actual Payment** `	**Short working** `			
				Occurred	**Recouped**	**Lapsed**	**Carried Forward**
2007-08	-	-	-	-	-	-	11,600
2008-09	50,000	39,000	50,000	11,000	-	3,000	19,600**(C)**
2009-10	50,000	54,000	50,000	-	4,000	3,600	12,000**(B)**
2010-11	50,000	58,000	50,000	-	8,000	-	4,000**(A)**
2011-12	50,000	52,000	50,000	-	2,000	2,000	-

Analysis of Royalty Payable:

		`	`
Royalty in 2008-09	Minimum Rent – Shortworking	50,000 - 11,000	39,000
Royalty in 2009-10	Minimum Rent + Recoupment	50,000 + 4,000	54,000
Royalty in 2010-11	Minimum Rent + Recoupment	50,000 + 8,000	58,000
Royalty in 2011-12	Minimum Rent + Recoupment	50,000 + 2,000	52,000

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