BBA - II YEAR

DJB2C: FINANACIAL ACCOUNTING

SYLLABUS

UNIT – 1: Fundamentals of Book – keeping – Meaning – Systems of Book – keeping – Accountancy – Meaning – Accounting concepts and conventions – Recording Business Transactions – kinds of accounts – Journalism – Rules – Subsidiary books – Ledger postings – Trial Balance and Rectification of Errors – Bank Reconciliation Statement.

UNIT – II: Final accounts – Trading, Profit and Loss Accounts and Balance Sheet – Manufacturing Account – Adjusting entries – capital expenditure, Revenue expenditure and Deferred Revenue expenditure – meaning and distinction.

UNIT – III: Depreciation – Meaning, causes and need, Methods – Provision and reserves.

UNIT – IV: Accounts from incomplete records – Defects – Ascertainment of Profits – Conversion into Double entry.

UNIT – V: Accounts of Non – trading concerns – Receipts and payment accounts – Income and expenditure account and Balance Sheet.

Reference Books:

1. Advanced Accounts – M. C. Sukla and Grewal
2. Advanced Accounts – R. L. Gupta
3. Advanced Accounting – Arulanandham
4. Advanced Accounts – Jain and Narang
5. Advanced Accounts – R. S. N. Pillai

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UNIT-I

BOOK - KEEPING

INTRODUCTION:

Book - keeping is that branch of knowledge which tells us how to keep a record of financial transaction. People, who are earning and spending, must maintain a note or diary or register in which details of the transaction have been recorded. The fundamental idea behind this record is to show a correct position relating to incomes and expenditures. The need for keeping such records, in a clear and systematic manner, is the basis which gives rise to the subject book – keeping.

MEANING BOOK – KEEPING

Book - keeping includes recording of journal, posting in ledgers and balancing of accounts. All the records before the preparation of trial balance is the whole subject matter of book - keeping. It is important to note that only those transactions related to business are recorded which can be expressed in terms of money**.**

The work of book – keeping is usually entrusted to junior employees, who maintain various books of accounts journal, subsidiary books, ledgers etc. - can be called as book – keepers

BOOK – KEEPING - DEFINITION

R.N. Carter Says, "Book-Keeping is the science and art of correctly recording in books of account all those business transactions that result in the transfer of money or money's worth".

ACCOUNTING - DEFINITION

"Accounting is the art of recording, classifying and summarising in a significant manner and in terms of money, transactions and events which are of a financial character and interpreting the results thereof"

ORIGIN OF ACCOUNTING:

Accounting originated to meet the requirements of exchange of goods and commodities. The need for accounting grew in order to serve the transactions of the business–world. The origin of accounting cannot be exactly located. The value of money or the use of currency, that now we attach to the goods to-day, was unknown to the people of ancient times when barter system existed. Later, innovation of money facilitated to ease exchange of commodities. The credit transactions necessitated to maintain accounts, and accounting is as old as business itself**.**

MEANING OF ACCOUNTING

The modern system of accounting is based on what is known as the Double Entry principle. Accounting is a science because it has some definite objects to be fulfilled and is an art as it prescribes the process through which the object can be achieved

- Non-financial transactions cannot be recorded in accounting.
- Only transaction of financial nature is the subject-matter of accounting.
- Accounting is an art of recording transactions according to size, nature and type of business transactions, cash transactions, credit transaction, frequent transaction etc.**,**

DISTINCTION BETWEEN BOOK - KEEPING AND ACCOUNTING.

Book – keeping	Accounting
1. It is the basis of Accounting	**1.** It is the basis for Business Language.
2. Persons, do book –keeping, are called Book – keepers.	**2.** Persons, responsible for accounting, are called Accountants.
3. No Financial Statements can be prepared from book – keeping records.	**3.** Financial Statement can be prepared from the accounting records.
4. It has no branch.	**4.** It has many branches Cost Accounting, Management Accounting etc.
5. It is the recording phase.	**5.** It is the summarising phase.
6. A complete picture of financial condition of a business cannot be known.	**6.** A complete picture of the financial condition of a business unit can be known.
7. It need not require any special skill or knowledge.	**7.** It requires special skill and knowledge.
8. Personal judgement of the book - keeper is not required.	**8.** Personal judgement of the Accountant is essential.
9. It provides no information for taking managerial decisions.	**9.** It provides information for taking managerial decisions.
10. It does not guide in complying with any legal formality**.**	**10.** Legal formalities can be complied with the help of accounting records**.**

OBJECTS OF BOOK- KEEPING AND ACCOUNTING:

By systematic record of transactions, the following objects are fulfilled:

1. Accounting provides a permanent record of each transaction.
2. Entries related to incomes and expenditures of a concern facilitate to know the profit or loss for a given period.
3. Soundness of a firm can be accessed from the records of assets and liabilities on a particular date.
4. It enables to prepare a list of customer and suppliers to ascertain the amount to be received or paid.
5. Accounting as a method gives opportunities to review the business policies in the light of the past records.
6. Analysis of the accounting entries facilitates a good and proper control over expenses incurred so as to maximise the profits.
7. Amendment of business laws, provision of licences, assessment of taxes etc., are based on accounting records.
8. In the case of the companies to comply the provision of the Company Act d1956, it is necessary to maintain accounting records.
9. It provides the most vital information to the management for making and preparing budgets.
10. It provides the most effective way to the management for fixing up the objectives of the business.

FUNCTIONS OF ACCOUNTING:

Accounting has the following functions:

1. **Record keeping function:** The primary function of accounting relates to recording, classification and summary of financial transactions – journalisation, posting and preparation of final statements.
2. **Managerial function**: The day – to - day operations are compared with some pre-determined standard. The variations of actual operations with pre-determined standards and their analysis is possible with the help of accounting.

3. **Legal requirement function:** Auditing is compulsory in case of registered firms. Auditing is not possible without accounting. Thus accounting becomes compulsory to comply with legal requirements.
4. **Language of business:** Various transactions are communicated through accounting. There are many parties – owners, creditors, government employees etc., who are interested in knowing the results of the firm and this can be communicated only through accounting.

IMPORTANCE OF ACCOUNTING:

Accounting is the language employed to communicate financial information of a concern to such parties. Accounting is the discipline that provides information on which external and internal users of the information may base decisions that result in the allocation of economic resources in society**.**

INTERNAL USERS:

Internal users of accounting information are those persons or groups which are within the organisation. Following are such internal users**;**

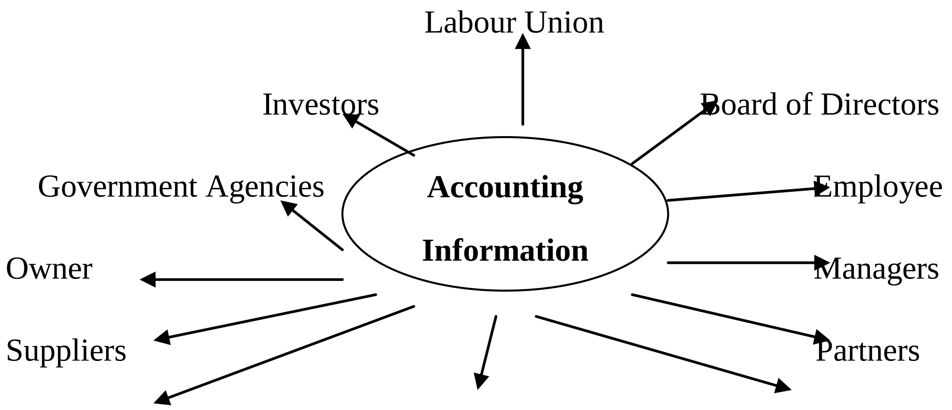
1. **Owner:** The owners provide funds or capital for the organisation. They possess curiosity in knowing whether the business is being conducted on sound lines or not and whether the capital is being employed properly or not. Owners, being businessmen, always keep an eye on the returns from the investment.
2. **Management:** The management of the business is greatly interested in knowing the position of the firm. The accounts are the basis; the management can study the merits and demerits of the business activity. Thus, the management is interested in financial accounting to find whether the business carried on is profitable or not. The financial accounting is the "eyes and ears of management and facilitates in drawing future course of action, further expansion etc."
3. **Employees:** Payment of bonus depends upon the size of profit earned by the firm. The demand for wage rise, bonus, better working conditions etc. Depend upon the profitability of the firm and in turn depends upon financial position.

EXTERNAL USERS:

External users are those groups or persons who are outside the organisation for whom accounting function is performed. Following are such external users

1. **Creditors:** It is usual that these groups are interested to know the financial soundness before granting credit. The progress and prosperity of the firm, to which credits are extended, are largely watched by creditors from the point of view of security and further credit.
2. **Investors:** The prospective investors, who want to invest their money in a firm, of course wish to see the progress and prosperity of the firm, before investing their amount, by going through the financial statement of the firm. This is to safeguard the investment.
3. **Government:** The state and central Governments are interested in the financial statement to know the earnings for the purpose of taxation.
4. **Consumer:** The establishment of a proper accounting control, which in turn will reduce the cost of production, in turn less price to be paid by the consumers. Research are also interested in accounting for interpretation.
5. **Research Scholars:** To make a study into the financial operations of a particular firm, the research scholar needs detailed accounting information relating to purchases, sales, Expenses, cost of materials used, current assets, current liabilities, fixed assets, long-term liabilities and share-holders funds which is available in the accounting records maintained by firm.
6. **Financial institutions:** The groups, who lend money need accounting information to analyse a company's profitability, liquidity and financial position before making a loan to the company. Further, they keep constant watch on the operating results and financial position of the business through accounting data.
7. **Regulatory agencies:** Various Government departments such as Company law department, Reserve Bank of India, Registrar of Companies etc. Require information to be filed with them under law. By examining this accounting information they ensure that concerned companies are following the rules and regulations.

USERS OF ACCOUNTING INFORMATION



Lenders Customers Researchers

ACCOUNTING PRINCIPLES:

The accounting principles are rules of action or a body of doctrine universally accepted while recording the business transactions. Adopting uniform principles in recording the transactions will ensure uniformity, clarity, and understanding. The accounting principles can be classified into two categories: 1. Accounting Concepts and 2. Accounting Conventions

ACCOUNTING PRINCIPLES

Accounting Concepts

1. Money measurements
2. Business Entity
3. Going Concern
4. Cost
5. Dual Aspect
6. Accounting Period
7. Matching
8. Realisation
9. Objectivity
10. Accrual

Accounting Conventions

1. Disclosure
2. Consistency
3. Conservatism
4. Materiality

ACCOUNTING CONCEPTS

1. Money Measurement Concepts: Only those transactions, which can be expressed in monetary terms, are recorded in accounting though their quantitative records may also be kept. All business transactions should be expressed only in money. Thus transaction, which cannot be expressed in money, will not be recorded in accounting books

2. **Business Entity concept:** Business is treated as separate from the proprietor. If business affairs and private affairs are mixed, the true picture of the business will not be available. Capital is thus a liability to the firm and the proprietor is the creditor of the business. The proprietor may draw amount out of the business and this reduces the liability of the firm.

Because of this concept, financial position of the business can be easily found out and earning capacity of the firm can be easily ascertained.

3. Going Concern Concept: This concept relates with the long life of the business. A business is intended to continue for an indefinitely long period. All firms that continue to operate on a profitable footing are treated as going concerns. In Balance Sheet market price of fixed assets are not considered. While preparing final accounts, record is made for outstanding expenses and pre-paid expenses with the assumption that the business will continue.

4. Cost Concept: Under this concept fixed assets are recorded in the account books at the price at which they are acquired. The price paid to acquire the assets is termed as cost and this cost is the basis for all the subsequent accounting for the asset. But the asset is shown in balance sheet year after year, at cost price minus depreciation. This value is called book value.

5. Dual Aspect Concept: This concept signifies that every business transaction involves a two-folder aspect (a) the yielding of benefit & (b) the giving of the benefit. For an exchange of value, two parties are required a giver and a receiver. Technically speaking, "for every debit, there is a credit". "Double Entry book-keeping is a system of accounting by which receiving and giving aspects of each transaction are recorded at a time.

Total Assets = Total Liabilities

Total Assets = Capital + Outsiders' liabilities.

Capital = Total Assets – Outsiders' liabilities

6. Accounting Period Concept: Accounting is a continuous process. Every business wants to know the result of his investment. Accountants choose some shorter period to measure the result. Therefore, one year has been, generally, accepted as the accounting period. It may be 3 months, 6 months or 2 years also. Closing day of the accounting period is known as accounting date. At this date, accountant prepares income and position statements, shows the business operations, brings the changes of positions since the construction of last statements. One year accounting period is recognised by law and the taxation is assessed annually.

7. Matching concept: According to this concept, it is necessary to match the expenses incurred during the accounting period with the revenues recognised during the same period. Since profit is an excess of revenue over expenses, it becomes necessary to bring together all revenues and expenses pertaining to a particular period. In other word, expenses incurred in an accounting year should be matched with the revenues recognised in that year.

8. Realisation Concept: This concept revolves around the determination of the point of time when revenues are earned. A business firm invests money to purchase or manufacture goods for sale. To earn profit, sales have to be made. According to realisation concept, which is also known as the "revenue recognition concept" revenue is considered as being earned on the date on which it is realised i.e., the date on which good and services are transferred to customers either for cash or for credit.

9. **Objectivity Concept:** This concept implies that all accounting transactions should be evidenced and supported by business documents, i.e. invoice, vouchers etc. The evidence substantiating the business transactions should be objective, i.e. free from the bias of the accountant or others. These supporting documents form the basis for record of entries and of audit.

10. Accrual Concept: According to this concept the revenue is recognised on its realisation and not on its actual receipt. Similarly, the costs are recognised when they are incurred and not when payment is made. This assumption makes it necessary to give certain adjustments in the preparation of income statement regarding revenues and costs are recognised only when they are actually received or paid.

ACCOUNTING CONVENTIONS:

Conventions denote customs or traditions or usage which is in use since long. To be clear, these are nothing but unwritten laws. These conventions are also known as doctrine. Following are the important accounting conventions in use.

1. Convention of Disclosure: This convention requires that accounting statements should be honestly prepared and all significant information should be disclosed all material information. Here the emphasis is only on material information and not on immaterial information. Therefore, full disclosure is a very healthy convention, and is important.

2. Convention of Consistency: Rules and practices of accounting should be continuously observed and applied. In order to enable the management to draw conclusions about the operation of a company over a number of years, it is essential that the practices and methods of accounting remain unchanged from one period to another.

3. Convention of conservatism: "Anticipate no profit and provide for all possible losses" is the essence of this convention. Future is uncertain. Fluctuations and uncertainties are not uncommon. Conservatism refers to the policy of choosing the procedure that leads to understatement as against overstatement of resources and income. The consequences of an error of understatement are likely to be less serious than that of an error of overstatement. Following are the examples:

(a) The value of an asset should not be overestimated.

(b) The value of liability should not be underestimated

4. Convention of Materiality: American accounting association defines the term materiality as "An item should be regarded as material if there is reason to believe that knowledge of it would influence the decision of informed investor" it refers to the relative importance of an item or event. Materiality of an item depends on its amount and its nature. For instance, acquisition of items like fountain pen, stapler, pin cushion, punching machine etc.

Limitation of accounting:

Financial accounting suffers from the following limitations which have been responsible for the emergence of Cost and Management Accounting.

(i) Transactions of non-monetary nature do not place in accounting.

(ii) Cost concept found in accounting, price changes are not considered.

(iii) Acceptable alternatives are so broad that comparison are likely to be confusing or misleading

(iv) Accounting policies are framed by the Accountant. The figures of balance sheet are largely resulted by personal judgement of accountant.

(v) It does not provide information to analyse the losses due to various factors – idle plant and equipment, seasonal fluctuations in sales volume.

(vi) Financial accounting does not set up a proper system of controlling materials and supplies.

SYSTEMS OF BOOK KEEPING: There are two systems of book-keeping the Single Entry System and Double Entry System

1. Single Entry System: This single entry system is not really system because in some cases record may be one-sided, and in some other cases no record is maintained at all. It is more appropriate to call it an incomplete system of recording transactions. Double effect of every transaction is ignored and only the accounts relating to suppliers and customers and cash account are found. Thus, the system is incomplete inaccurate and unscientific system of recording business transactions.

2. Double Entry System: It refers to that system of book-keeping where each transaction is recorded inn both of its aspects, viz., (1) receiving of the benefit of the transaction and (2) giving away of the benefit of the transaction. For a complete record of transaction, it should present in both the accounts. If one account receives a benefit there must be another account to give the benefit. Normally, the receiver account is debited and the giver account is credited. The system under which both the debit and credit aspects are recorded is known as the principle of Double Entry System book-keeping.

Advantages of Double Entry System:

1. It presents a complete record of transaction.
2. Profit and loss account can easily be prepared.
3. It gives exact information regarding the amount due to and due by the firm at any time, because the system gives ready reference.
4. Arithmetical accuracy can be tested
5. It provides full particulars of various assets and liabilities of the business, so final financial position can be known by preparing Balance Sheet.
6. It prevents frauds and errors and makes their detection easier.
7. It has readymade information to be sent to Sales Tax and Income Tax authorities.

RECORDING OF FINANCIAL DATA

MEMORANDUM BOOK: Memorandum book, also called Waste Book or Rough Book, is kept by a businessman for noting down the transactions. When any transaction takes place, businessman immediately notes it down in the book. It helps in making records in the journal and ledger.

BUSINESS TRANSACTIONS: Business activities in a business are known as ‘event’ A transaction is a business event involving transfer of money or money’s worth. As soon as a business event occurs which can be measured and expressed in term of money and must be recorded in the books of accounts, it is called a ‘transaction’

JOURNAL: Journal is a book of 'primary entry' or 'original entry' Journal records all daily transactions of a business in the order in which they occur. Therefore, a 'journal' may be defined as a book containing chronological records of transactions. The journal is the Book of Prime Entry. It is otherwise known as the Book of Original Entry. These entries are the posted from the journal into the ledger. Ledger is known as the principal Book or the Main Book. The ledger is otherwise known as the Book of Final Entry.

Specimen of Journal

Date (1)		Particulars (2)	L.F. (3)	Dr. Amount (Rs.) (4)	Cr. Amount (Rs.) (5)
Year Month	Date	Name of Account to be Debited To name of Account to be credited (Narration)			

1. The date column is meant for recording the date of the transaction.
2. The second column is meant for recording the account to be debited and credited
3. The third column is meant for recording the page number of the ledger, where the entries are posted.
4. In this column, we write the amount to be debited against Dr.
5. In this column, we write the amount to be credited against Cr.
6. In the second column, within brackets, a brief explanation of the transaction is written, which is known as narration.

RULES OF JOURNALISING: The act of recording the transactions in journal is called journalising. This recording is made according to certain rules and these rules are called rules of journalising.

Types of Accounting

PERSONAL

(Ram's Account

Bank Account

IMPERSONAL

Real (property)

(Plant Account

Nominal(fictitious)

(Salary Account

Dubey's Account	machinery Account	Discount Account
Mohan's Account	Cash Account	Wages Account
	Goods Account)	Postage Account)

Rules for Debit and Credit:

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

Alternatively

Put the rules in another way:

Classes of account	Debit	Credit
Personal	The Receiver	The Giver
Real (property)	What comes in	What goes out
Nominal (Fictitious)	Expenses and Losses	Incomes and Gains

Illustration No.1: Journalise the following transactions

2005 Jan 21 Withdrew from Bank for personal use Rs. 1000

" 22 purchased goods and paid by cheque Rs. 2500

" 23 Purchased from Jeya Stores Rs. 2000

" 24 Sold goods to Baskar Rs. 1000

" 25 Paid Jeya stores amount due to them less 10% discount

" 26 Basker settled his account by giving Rs. 950

" 27 Paid 'Advertisement charges' to 'the Daily Thanthi' Rs. 600

" 28 Received cheque from Abi Rs. 1400

“ 29 The proprietor has brought in the business further cash Rs. 7000, Furniture worth Rs. 3000, stock worth Rs. 5000 and gave for business purpose Building worth Rs. 25,000

“ 30 Got a loan from Murali Rs. 5000

“ 31 Drawn from Bank for office use Rs. 2700

Solution:

Journal

Date	Particulars	L.F.	Debit (Rs)	Credit (Rs)
2005				
Jan 21	Drawings a/c. . . . . . . Dr.		1000	
	To Bank a/c			1000
	(being cash withdrawn from Bank for Personal expenses)			
Jan 22	Purchases a/c . . . . Dr.		2500	
	To Bank a/c			2500
	(Being purchases made by cheque)			
Jan 23	Purchases a/c . . . . Dr.		2000	
	TO Jeya stores a/c			2000
	(Being credit purchases made)			
Jan 24	Baskar a/c . . . . Dr.		1000	
	To Sales a/c			1000
	(Being credit sales made)			
Jan 25	Jeya Stores a/c . . . . Dr		2000	
	To Cash a/c			1800
	To Discount a/c			200
	(Being Jeya Stores a/c settled)			
Jan 26	Cash a/c . . . . Dr		950	
	Discount a/c . . . . . . Dr		50	
	To baskar a/c			1000
	(Being Basker settled his account)			
Jan 27	Advertisement a/c . . . . Dr		600	
	To cash a/c			600

	(Being advertisement charges paid)			
Jan 28	Cash a/c . . . . . . Dr		1400	
	To Abi a/c			1400
	(Being cheque received from Abi)			
Jan 29	Cash a/c . . . . Dr		7000	
	Furniture a/c . . . . Dr		3000	
	Stock a/c . . . . Dr		5000	
	Building a/c . . . . Dr		25000	
				40000
	To Capital a/c			
	(Being variance assets brought in to the business)			
Jan 30	Cash a/c . . . . Dr		5000	
	To Murali's Loan a/c			5000
	(Being loan got from murali)			
Jan 31	Cash a/c. .Dr		2700	
	To Bank a/c			2700
	(Being withdrawal from bank)			
	Total		59,200	59,200

ILLUSTRATION:2: Journalise the following transactions in the books of Glory.

2005 Jan 1 Started business with cash Rs.9000

Jan 2 Purchases goods for cash Rs.2100

Jan 3 Sold goods for cash Rs.700

Jan 4 Deposited into Canara Bank Rs.3000

Jan 5 Cash received from Rajan Rs.400

Jan 6 Cash paid to Ananda Traders Rs.1000

Jan 7 Paid salary Rs.300

Jan 8 Paid Rent Rs.400

Jan 9 Received commisssion Rs.200

Jan10 Withdrew from Canara Bank Rs.1200

Solution:

Journal

Date	**Particulars**	**L.F**	**Debit**	**Credit**
2005				
Jan 1	Cash a/c Dr		9,000	
	To Capital a/c			9,000
	(Being the business started)			
Jan 2	Purchases a/c Dr		2,100	
	To Cash a/c			2,100
	(Being purchases made)			
Jan 3	Cash a/c Dr		700	
	To Sales a/c			700
	(Being sales made)			
Jan 4	Canara Bank a/c Dr		3,000	
	To Cash a/c			3,000
	(Being cash paid into bank)			
Jan 5	Cash a/c Dr		400	
	To Rajan a/c			400
	(Being cash received from Rajan)			
Jan 6	Ananda Traders a/c Dr		1,000	
	To Cash a/c			1,000
	(Being salary paid)			
Jan 7	Salary a/c Dr		300	
	To Cash a/c			300
	(Being salary paid)			
Jan 8	Rent a/c Dr		400	
	To Cash a/c			400
	(Being rent paid)			
Jan 9	Cash a/c Dr		200	
	To Commission a/c			200
	(Being commission received)			
Jan 10	Cash a/c Dr		1,200	
	To Canara Bank a/c			1,200
	(Being cash withdrawn from bank)			

Illustration No:3: Journalise the following transaction:

2005 Jan 11 Purchased goods for Rs.1500

Jan 12 Purchased goods from Jeyam Stores Rs.900

Jan 13 Sold goods for Rs. 1000

Jan 14 Sold goods to Raju Rs.250

Jan 15 Bought Furniture for cash Rs.2000

Jan 16 Bought Furniture from JFA furniture Mart Rs.800

Jan 17 Goods returned to Jeyam Stores Rs.200

Jan 18 Raju returned goods worth Rs.100

Jan 19 Drew for private use Rs.500

Jan 20 Electric charges amounted Rs.120

Solution: **Journals**

Date	Particulars	L.F	Debit	Credit
2005 Jan 11	Purchases a/c Dr To Cash a/c (Being purchases made)		1,500	1,500
Jan 12	Purchases a/c Dr To Jeyam Stores a/c (Being credit purchases made)		900	900
Jan 13	Cash a/c Dr To Sales a/c (Being sales made)		1,100	1,100
Jan 14	Raju a/c Dr To Cash a/c (Being credit sales made)		250	250
Jan 15	Furniture a/c Dr To Cash a/c (Being furniture purchased)		2,000	2,000
Jan 16	Furniture a/c Dr To JFA Furniture Mart a/c (Being purchases return to Jeyam Stores)		800	800

Jan 17	Jeyam Stores a/c Dr		200	
	To Returns Outwards a/c			200
	(Being purchases return to Jeyam Stores)			
Jan 18	Returns Inward a/c Dr		100	
	To Raju a/c			100
	(Being sales return from Raju)			
Jan 19	Drawings a/c Dr		500	
	To Cash a/c			500
	(Being cash withdrawn for personal use)			
Jan 20	Electric charges a/c Dr		120	
	To cash a/c			120
	(Being electric charges paid)			
	Total		7,470	7,470

Illustration: 4: Pass necessary journal entries for the following transaction in the books of Rajan

2009

May 11 Rs.2,000 was stolen from the office

May 18 Given on charity cash Rs.400; Goods Rs.800 and a fan Rs.1,000

May 20 Received cash from Raj bad debts written of last year Rs.1,800

May 24 Goods worth Rs.1,500 stolen by an employee

May 26 Installation charges Rs.600

May 27 Goods worth Rs.800 destroyed by fire

May 30 Goods worth Rs.500 distributed as sample

Solution:

JOURNAL

DATE	PARTICULARS	L/F	DEBIT	CREDIT

2009 May 11	Loss by theft a/c Dr To Cash a/c (Being cash stolen from the office)		1,000	 1,000
May 18	Charity a/c Dr To Cash a/c To Goods a/c To Fan a/c (Being the cash, goods and fan given as charity)		2,200	 400 800 1,000
May 20	Cash a/c Dr To Bad debts received a/c (Being the amount received from Raj part of the bad debts)		1,800	 1,800
May 24	Loss by theft a/c Dr To Purchases a/c (Being loss of goods by theft)		1,500	 1,500
May 26	Installation charges a/c Dr To Cash a/c (Being installation charges paid)		600	 600
May 27	Loss by fire a/c Dr To Purchases a/c (Being goods lost by fire)		800	 800
May 30	Free samples a/c Dr To Purchases a/c (Being goods distributed as sample)		500	 500

LEDGER

As we know that first, all business transaction are recorded in the journal, separately and date-wise. The transactions relating to persons, assets, expenses and income are journalised chronologically i.e. date-wise. But, one cannot find similar transaction at one place in the journal. Therefore, to have a consolidated view, we have to prepare different accounts in the ledger. No transaction gets into the ledger unless it appears first in the journal. The source of information for the ledger is the journal. Thus, journal is subsidiary to the ledger and the ledger is the principal or main book of account.

The method of writing from journal to the ledger is called posting or ledger posting. Ledger contains accounts. Accounts are generally kept in a book called ledger. It contains accounts related to business transactions. Ledger is a register, having a number of pages, which are numbered consecutively. One page in the ledger is usually allotted to one account. An index to various accounts in the ledger is given at the beginning of the ledger for easy reference.

Specimen of Ledger

Dr. **Cr**.

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

PROCESS OF LEDGER POSTING

The following procedures are followed for posting:

First part of the other account:

1. Location in the ledger, the first Account named in the journal
2. Write the date of the transaction, in the date column, in debit-side of that account
3. Enter in the debit-side of the ledger, in particulars column, the name of the Account credited with prefix "To"
4. Write in folio column on the debit-side of the account, the page number of journal from which the entry is being posted.
5. Enter the amount, on the debit column of the ledger as per journal.
6. Similarly, write the ledger page number in the folio column of the journal.

Second part of the other Account:

1. Locate in the ledger, the second Account named in the journal.
2. Write the date of the transaction, in the date column on credit side of that account.
3. Enter in the credit-side of the ledger, in particulars column, the name of the Account debited with prefix "By"
4. Write in the folio column of the ledger, the page number of the journal from which the entry is being posted.
5. Enter the amount on the credit side of the ledger as per the journal.
6. Similarly, write the ledger page number in the folio column of the journal.

Example: Record the following transaction and post them into ledgers:

On 1st Dec. 2004, Ram started business with a capital of Rs. 50,000.

Journal

Date	Particulars	L.F.	Debit Rs.	Credit Rs.
2004 Dec.1	Cash A/C Dr. To Capital A/C (Being business started)		50,000	50,000

Ledger Posting

Cash Account

Dr. Cr.

Date	Particulars	JF	Amount Rs.		Date	Particulars	JF	Amount Rs.
2004 Dec.1	To Capital A/C	1	50,000					

Ram's Capital Account

Dr. **Cr.**

Date	Particulars	JF	Amount Rs.		Date	Particulars	JF	Amount Rs.
					2004 Dec.1	By cash A/C	1	50,000

ILLUSRATION: 1: Journalise the following transactions and prepare ledger accounts.

2005 Feb 1 Sold goods for cash Rs.130

Feb 2 Purchased goods Rs. 400

Feb 3 Purchased goods from Kumar Rs.3000

Feb 4 Sold goods to Prabu Rs. 2000

Feb 5 Received cash from Prabu Rs.1200

Feb 6 Paid to Kumar Rs. 1000

Feb 7 Paid salary Rs.700

Solution: **Journals**

Date	Particulars		L.F.	Debit Rs.	Credit Rs.
005 Feb 1	Cash a/c	Dr.		1,300	
	To Sales a/c				1,300
	(Being sales made)				
Feb 2	Purchases a/c	Dr.		400	
	To cash a/c				400
	(Being purchases made)				
Feb 3	Purchases a/c	Dr.		3000	
	To Kumar a/c				3000
	(Being credit purchase made)				
Feb 4	Prabu a/c	Dr.		2000	
	To sales a/c				2,000
	(Being credit sales made)				
Feb 5	Cash a/c	Dr.		1200	
	To prabu a/c				1200
	(Being cash received from prabu)				
Feb 6	Kumar a/c	Dr.		1000	
	To cash a/c				1000
	(Being cash paid to kumar)				
Feb 7	Salary a/c	Dr.		700	
	To cash a/c				700
	(Being salary paid)				
	Total			**9,600**	**9,600**

Ledger:

Cash Account

Dr **Cr**

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

2005				**2005**			
Feb 1	To Sales a/c		1,300	Feb 2	By Cash a/c		400
Feb 5	To Prabu a/c		1,200	Feb 6	By Kumar a/c		1,000
				Feb 7	By Salary a/c		700
				Feb 28	By Balance c/d		400
			2,500				2,500
Mar1	To Balance b/d		400				

Sales Account

Dr **Cr**

Date	**Particulars**	**J.F**	**Amount**	**Date**	**Particulars**	**J.F**	**Amount**
2005				**2005**			
Feb 28	To Balance c/d		3,300	Feb1	By Cash a/c		1,300
				Feb 4	By Prabu a/c		2,000
			3,300				3,300
				Mar 1	By Balance b/d		3,300

Purchase Account

Dr **Cr**

Date	**Particulars**	**J.F**	**Amount**	**Date**	**Particulars**	**J.F**	**Amount**
2005				**2005**			
Feb 2	To Cash a/c		400				
	To Kumar a/c		3,000	Feb 28	By Balance c/d		3,400
			3,400				3,400
Mar 1	To Balance b/d		3,400				

Kumar Account

Dr Cr

Date	**Particulars**	**J.F**	**Amount**	**Date**	**Particulars**	**J.F**	**Amount**
2005				**2005**			
Feb 6	To Cash a/c		1,000	Feb 3	By purchase a/c		3,000
Feb 28	To Balance c/d		2,000				
			3,000				3,000
				Mar1	By Balance b/d		2,000

Prabu Account

Dr **Cr**

Date	Particulars	J.F	Amount	Date	Particulars	J.F	Amount
2005				**2005**			
Feb 4	To Sales a/c		2,000	Feb 5	By cash a/c		1,200
				Feb28	By Balance c/d		800
			2,000				2,000
Mar 1	To Balance b/d		800				

Salary Account

Dr **Cr**

Date	Particulars	J.F	Amount	Date	Particulars	J.F	Amount
2005				**2005**			
Feb 7	To Cash a/c		700	Feb 28	By Balance c/d		700
			700				700
Mar1	To Balance b/d		700				

TRIAL BALANCE

Books of accounts of a firm are closed at the end of the year, but they may be closed at any time according to the requirements of the proprietor. Whenever books are closed, balances are found out in various accounts and then, these balances are recorded in a statement which has four columns, viz., particulars, L.F., Debit Balance and Credit Balance and this statement is called TRIAL BALANCE. Thus, Trial Balance is a statement in which the debit and credit balances of all accounts are recorded with a view to ascertain the arithmetical accuracy of the books of accounts. The only condition is that accounts must be balanced in order to draw a Trial Balance is not a part of journal or ledger. It is only a list or statement.

OBJECT

1. A Trial Balance provides a good check on the accuracy of the work done in preparing the ledger accounts. When the total of the debit balances agrees with the total of credit

balances, it is quite a good proof that the ledger accounts have been correctly written up.

2. The balance of all the accounts at one place and thus facilitates the preparing of trading account and profit and loss Account, which is the result of the business; and the Balance Sheet to ascertain the financial position of the firm
3. The balance of any account can be easily and conveniently known by a trial balance.
4. It serves as a summary of what is contained in the ledger.

METHOD OF PREPARING TRIAL BALANCE

A trial balance refers to a list of the ledger balances, as on a particular date. It can be prepared in the following manners.

1. **The Total method:** According to this method, debit total and credit total of each account of ledger are recorded in the trial balance.
2. **The Balance Method:** According to this method, only the balances of the accounts either debit or credit, as the case may be, are recorded against their respective account. The second method is the most common and is considered to be better, because a trial balance prepared according to this method supplies ready figures for final accounts.

Advantages of Drawing up Trial Balance

1. It summarises the result of all transactions during a period.
2. It proves the arithmetical accuracy of accounting entries in the ledger.
3. It supplies in one place ready reference of all the balances of all the ledger accounts.
4. If any error is found, it can easily be rectified.
5. It is a basis, on which the final accounts of a firm can be prepared.

ILLUSTRATION: 2

From the following list of balance, prepare a trial balance.

	Rs		Rs
Capital Account	1,00,000	Opening stock account	15,000
Debtors Account	20,000	Creditors Account	20,000

Fixed Assets Account	92,000	Purchase Account	70,000
Sales Account	1,10,000	Return inward Account	2,000
Return outward Account	1,000	Wages and salaries Account	30,000
Bills payable Account	8,000	Bills receivable Account	15,000
Bank overdraft Account	11,000	Rent Account	6,000

SOLUTION

TRAIL BALANCE

SL.No	Heads of Accounts	L.,F	Debit Balance(Rs)	Creadit Balance(Rs)
1.	Capital Account		__	1,00,000
2.	Debtors Account		20,000	__
3.	Fixed Assets Account		92,000	__
4.	Sales Account		__	1,10,000
5.	Returns outward Account		__	1,000
6.	Bills payable Accounts		__	8000
7.	Bank overdraft Account		__	11,000
8.	Opening stock Account		15,000	__
9.	Creditors Account		__	20,000
10.	Purchase Account		70,000	__
11.	Return inward Account		2,000	__
12.	Wages and salaries Account		30,000	__
13.	Bills receivable Account		15,000	__
14.	Rent Account		6,000	__
	Total		2,50,000	2,50,000

ERRORS AND THEIR RECTIFICATION

Classification of errors;

Errors can be classified into the following:

1. Errors of omission

2. Errors of commission

3. Errors of principle

4. Errors of wrong posting

5. Compensation

ERRORS

Affect the Trial Balance (A)

Do not affect the Trial Balance (B)

(A) The following errors affect the Trial Balance

(1) Wrong totalling of subsidiary books

(2) Posting of the wrong amount

(3) Errors of partial omission

(4) Errors of partial omission

(5) Wrong balancing of ledger account

(6) Posting twice to a ledger

(7) Omission of any accounts from the Trial Balance, etc.,

(B) The following errors do not affect the Trial Balance

(1) Errors of principle

(2) Errors of omission

(3) Posting to wrong Account

(4) Errors of recording in subsidiary books

(5) Compensating errors.

Rectification of errors classification of errors:

1. Trial balance will not disclose the following errors: The Trial Balance is not absolute proof of the accuracy of ledger accounts. It is a proof of the accuracy of ledger accounts/ it is a proof only of the arithmetical accuracy of the postings. The total of debits may be equal to the total of credits yet still there may be errors. Such errors are not disclosed by a trial balance; and they are;

(a) Errors of Principle: An error of principle is an error which violates the fundamentals of book- keeping.

(b) **Errors of omission:** If a transaction is completely omitted, there will be no effect on the Trial Balance. For instance, if a credit purchase is omitted to be recorded in the Purchase Day Book, then it will be omitted to be posted both in the purchase account and the Supplier's account.

(c) Posting to Wrong Account: Posting an item to wrong account, but on the correct side. For instance if a purchase of Rs.200 from Ramu has been credited to Raman, instead of Ramu and this error will not affect the agreement of trial Balance. Thus, Trial Balance will not detect such an error.

(d) Error of amounts in original Book: If an invoice for Rs.632 is entered in Sales Book as Rs.623, the Trial Balance will come but in fact there out correctly, since the debit and credit have been recorded as Rs.623. The arithmetical accuracy is there, is an error.

(e) Compensating Error: If one account in the ledger is debited with Rs.500 less and another account in the ledger is credited Rs.500 less, these errors cancel themselves. That is, one error is neutralised by similar error on the opposite side.

2. A Trial Balance will disclose the following errors: If the Trial Balance does not agree, there must have been some error or errors somewhere in our working. The following are some of the errors, which cause the Trial Balance to disagree, in brief:

(a) Wrong Totalling of Subsidiary Books: If the total of any subsidiary book is wrongly cast, it would cause a disagreement in the Trial Balance. For instance, Sales Book has been under cast by Rs100.

(b) Posting of the Wrong Account: If a wrong amount is posted in one of the two accounts, the Trial Balance disagrees. For instance sales made to Ram for Rs. 570, wrongly debited to Ram's account with Rs.750, instead of Rs.570. Ram's account has been over debited by Rs.180. Thus, the debit side of the Trial Balance will exceed by Rs.180, i.e., 750 – 570= 180.

(c) **Posting an Amount on the wrong side of the Account**: For instance, a credit sales made to a customer for Rs.500 has been credited to the customer account, instead of debit. As a result of this error, the credit side of the Trial Balance will exceed by Rs.1,000 (double the amount of the error) because there are two credits one in sales account and another in Personal Account and no debit for the transaction.

(d) Posting twice to a ledger: For instance, salary of Rs.500 paid has been debited to salary account twice by mistake. This will cause disagreement of trial Balance in debit side by excess of Rs.500/-

Apart from the above, the following are some of the common errors, by which Trial Balance totals disagree.

(e) Omission of an Account from the Trial Balance (cash, Bank etc.)

(f) Wrong additions or balancing of ledger accounts.

(g) Balance of account written to the wrong side of the Trial Balance.

(h) Errors made in preparing the list of Debtors and Creditors.

(i) Errors made in carrying forward the total from one page to another page.

(j) There may be some items to which double entry is incomplete.

(k) Wrong totals of the Trial Balance**.**

How to Locate Errors;

1. Re-total the debit and credit columns of the Trial Balance. Find out the amount of different by the two columns, divided by 2 and see similar amount appears in the trial balance.

2. See that cash balance and Bank balance are properly listed in the Trial Balance.

3. If still the difference exists, divide the difference by 9. If the difference is evenly divisible by 9, the error is likely to occur from the transposition or transplacement of figures.

Disarrangement of figures is transposition and Transplacement means the digits of the numbers are moved to the left or right.

	Transposition		Transplacement	
If	6418		67.180	
is written as	4618		6.718	
	-----------		------------	
Difference is	1800		60.462	
A complete division	1800	= 200	60.462	= 6.718
	----------		-------------	
Is possible, thus,	9		9	

If such a difference exists, search the figures, where such errors might have been made.

4. Confirm that the opening balances have been correctly brought forward in the current year, from the previous year.

5. Recheck the amounts listed in the trial Balance and confirm that all the ledger balances have been copies down.

6. Check the total in the lists of Sunday Debtors and Sundry Creditors.

7. Re -compute the Account balances.

8. Check the casting and carry forward of all subsidiary books.

9. Verify the postings of individual items from the subsidiary books.

10. After making complete checking of journal, ledger and subsidiary books, if the errors cannot he located, then transfer the difference to a Suspense Account and when the mistake is found out the Suspense Account is closed.

Rectification of one sided errors:

Illustration: 3

Rectify the following errors:

1) Purchase Book is overcast by Rs.300

2) Sales Book is under cast by Rs.200

3) Purchase Return Book has been over cast Rs.75

4) Sales return book has been under cast by Rs.30

Solution:

Rectification:

1) Credit, Purchase a/c with Rs.300

2) Credit, Sales a/c with Rs.200

3) Debit, Purchase returns a/c with Rs.75

4) Debit, Sales returns a/c with Rs.30

Rectification of two sided errors:

Illustration: 4

Rectifying the following error:

1) Purchase of machinery for Rs.5000 has been passed through Purchase Book.
2) A credit purchase of Rs.2000 from raja &Co was omitted to be passed through the invoice book.
3) Goods returned by Rani &Co Rs.700 posted to vani & Co a/c.
4) Rent paid Rs.450 proprietors house was debited to rent a/c
5) A credit purchase from Jeyam Stores has been passed through the sales Day Book Rs.2000

Solution:

Rectification Journal Entries

S. No	Particulars	Debit	Credit
1.	Machinery a/c Dr	5000	
	To purchases a/c		5000
2.	Purchase a/c Dr	2000	
	To Raja & Co a/c		2000
3.	Vani & Co a/c Dr	200	
	To Rani & Co a/c		200
4.	Drawings a/c Dr	450	
	To Rent a/c		450
5.	Sales a/c Dr	2000	
	Purchase a/c Dr	2000	
	To Jeyam Stores a/c		4000

Both one sided and two sided errors:

Illustration: 5

Rectify the following errors:

1) Sales Book under cast by Rs.4000
2) Machinery purchased for Rs.6000 passed through purchase Book.
3) Sales to Ram for Rs.1100 debited to his account as Rs.1010
4) Repairs to building Rs.1440 debited to building account.

Solution:

Rectification Entries

S. No	Particulars	Debit	Credit
1.	Credit, Sales Book with Rs.4000		
2.	Machinery Dr	6000	
	To purchase a/c		6000
3.	**Debit ,** Ram a/c with Rs.90	200	
4.	Repairs a/c Dr	1440	
	To Buildings a/c		1440

Illustration: 6

Rectify the following error

1) Old Goods sold to Danaraj for Rs.6300 is wrongly debited to Danaraj pillai account Rs.3600
2) Goods purchased from Mohan Rs.15000 is wrongly debited to his account.
3) Total discount column in the debit side of the cash book wrongly cash short Rs.40

4) Salaries paid to Manager Rs.5000 is debited his personal account.

Solution:

S. No	Particulars	Debit	Credit
1.	**Debit,** Danaraj a/c with Rs.6300		
	Credit, Danaraj pillai a/c with Rs.3600		
2.	**Credit,** Mohan a/c by Rs.30,000		
3.	**Debit,** Discount allowed a/c with Rs.40		
4.	Salaries a/c Dr	5000	
	To Manager a/c		5000

Bank Reconciliation Statement:

Whenever a businessman deposit money into bank **or** withdraws from the bank, he records the same in (the bank column of) his cash book .Correspondingly, the bank records the same transaction in a pass Book opened by the banker in the businessman's name. Thus, the balance as shown by the businessman's Cash Book and the balance shown by the Bank Pass Book should agree. Of course, if in the cash book the bank accounts show a debit balance, in the Pass Book, it would be credit balance and Wise-versa. However, on account of various reasons the Pass Book and Cash Book balance rarely agree.

Causes for Difference between Pass Book and Cash Book

1) Cheques deposited (paid) into bank but not collected and credited in the pass book.
2) Cheque issued but not yet presented for payment.
3) Interest on investment, dividends, bills etc. Collected by the bank.
4) Amounts paid into bank directly by a customer.
5) Bank charges, interest on overdraft etc. Debited in the pass book only.
6) Insurance premium, subscription, rent etc. Paid by the bank on behalf of businessmen.
7) Cheques paid in, but dishonoured.
8) Errors in the cash book or pass book.

Bank Reconciliation Statement

The Bank Reconciliation Statement is a statement prepared by the (businessmen) customer of a bank to reconcile the balance as shown by his Cash book with that of the Pass Book.

The basic purposes of preparing the Bank Reconciliation Statement is ascertain the causes of difference between the two balances and to make necessary corrections.

Type 1 (Cash Book to Pass Book)

Illustration: 1

From the following particulars prepare a Bank Reconciliation statement as on 31.12.1999.

1) Balance as per Cash Book Rs.5877
2) Cheques issued but not presented for payment Rs.2013
3) Cheques deposited but not cleared up to 31.12.1999 Rs. 1419
4) Wrongly debit in the Pass Book Rs.225

Solution:

Bank Reconciliation Statement as on 31.12.1999

Particulars		**Amount Rs.**
Balance as per Cash Book		5877
Add		
Cheques issued but not presented for payment	2013	2013
		7890
Less		
Cheques deposited but not cleared	1419	
Wrong debit in the Pass Book	225	1644
Balance as per Pass book		6246

Illustration: 2

1) Bank balance as per cash book Rs.200
2) Cheque deposited but not collected Rs.1500
3) Cheque issued but not presented for payment Rs.2500
4) Bank charges debited in the pass book Rs.200
5) Interest entered in the pass book only Rs.100

Prepare Bank Reconciliation Statement

Solution:

Bank Reconciliation Statement

Particulars	Amount	Rs.
As Balance per Cash Book		200
Add		
Cheque issued but not presented for payment	2500	
Interest allowed	100	2600
		2800
Less		
Cheque deposited but not collected	1500	
Bank charges debited in the pass book	200	1700
Balance as per pass book		1100

Type 2 (Pass Book to Cash Book)

Illustration: 3

From the details prepare Bank Reconciliation Statement as on 31 December 1997.

1) Bank balance as per pass book Rs.9250
2) Cheque deposited in to bank but not collected Rs.1500
3) Cheque issued but not presented for payment Rs.2000
4) Bank charges debited in the pass book Rs

Solution:

Bank Reconciliation statement as on 31.12.1999

Particulars		Amount Rs
Balance as per pass book		9250
Add		
Cheque deposited but not collected	1500	
Bank charges debited in the pass book	10	1510
		10760
Less		
Cheque issued but not presented for payment	2000	2000

Balance as per pass book		8760

Type 3 (Cash Book OD Pass Book)

Illustration: 4

The bank overdraft of Mohan on 31.12.1999 was Rs.4500 as per cash book. From the following particulars prepare a bank reconciliation statement.

1) Unpresented cheques Rs.1500
2) Uncleared cheques Rs.850
3) Bank interest debited in the pass book only Rs.250
4) Cheques of Anand dishonoured Rs.250
5) Cheque issued to Sathya entered in the cash Column of cash book Rs.150

Solution:

Bank Reconciliation Statement of Mohan on 31.12.1999

Particulars		**Amount Rs.**
Over draft as per cash book		4500
Add		
Uncleared cheques	850	
Bank interest debited in the pass book	250	
Cheques of Anand dishonoured	250	
Cheque issued entered in the cash column	150	1500
		6000
Less	1500	1500
Unpresented cheques		
Overdraft as per pass book		4500

Type 4 (Pass Book OD to Cash Book)

Illustration: 5

From the following particulars, prepare a Bank Reconciliation Statement showing the balance as per cash book on December 31,1998.

1) The bank pass book showed on overdraft of Rs.19200.
2) Out of cheques of Rs.9200 paid on December 29, Rs.4200 appear to have been credited in the pass book only on January 1999.

3) Cheques issued in December 1998 amounting in all to Rs.15000,of which Rs.6000v worth cash been cashed in the same month, a cheque of Rs.5000 has been cashed on January 3, 1999 and the result have not been presented at all.
4) Bankers have given a wrong credit to same other account instead of cheque paid into his account Rs.1200.
5) The pass book shows a credit of Rs. 1200 as interest collected from securities.

Solution:

Bank Reconciliation Statement as on 31.12.1998

Particulars		**Amount Rs**
Overdraft as per Pass Book		19,200
Add		
Cheque issued but not cashed on 31.12.1998		
(5000+4000)	9000	
Interest collected from the securities entered in the passbook	1200	10,200
		29,400
Less		
Cheques paid in but not credited on 31.12.1998	4200	
Cheques paid in but credited to some other account	1200	
		5400
Overdraft as per cash book		24,000s

UNIT-II

TRADING ACCOUNT

Trading account is prepared mainly to know the profitability of 'goods' bought or manufactured and sold by the businessmen. The difference between the selling price and cost price of the goods is the gross result

	Rs
Opening stock	-
Add: Purchases less returns	-
Add: Direct Expenses	-
	-
Less: Closing Stock	-
Cost of goods sold	-

INDIVIDUAL ITEMS POSTED TO THE DEBIT OF TRADING ACCOUNT

Opening stock

This is the stock of goods in hand. This figure is available from Trial Balance. Generally, when Trading Account is prepared, stock is taken on the last day of the trading period, by actual counting and fixing value. A firm, which is started newly, has no opening stock. Opening stock consists of raw materials, work-in-progress and finished goods.

A Profoma of a Trading Account is given below:

Name of the Firm

Trading Account

For the year ended on 31st December……

Dr **Cr**

		Rs				Rs
To Opening Stock	-	-		By sales less Returns	-	-
To Purchases Less Returns	-	-		By Closing Stock	-	-
To Wages	-	-				
To carriage	-	-				
To Freight	-	-				
To Dock Charges	-	-				
To Excise Duty	-	-				
To Octroi	-	-				
To Import Duty	-	-				
To Fuel, Power etc.	-	-				
To Stores consumed	-	-				
To Royalty (Production basis)	-	-				
To Manufacturing Expenses	-	-				
To Profit and Loss A/c (Balancing figure) (Gross Profit transferred)	-	-				

Opening Stock is always debited to Trading Account.

Purchases: Traders generally purchase goods on cash or on credit. The purchases are debited to the Trading Account after deducting Purchase returns, if any. The Deductions are shown in the inner column and net purchases are shown in outer column**.**

Direct Expenses: Direct expenses are those expenses which have been incurred to bring the goods or making the goods ready for sale. All such expenses are debited to Trading Account. A few examples are given below.

Wages /Direct Wages/production Wages: Wages paid to workers, who are directly engaged in the production, are direct expenses. Workers may be employed to manufacture merchandise or make it more saleable. Similar types of items are debited to Trading Account.

Carriage/Freight/Carriage Inward: These items fall under direct expenses. These are transportation expenses met for bringing the goods purchased to the business place. Whether such expenses are paid or outstanding does not matter; if they have incurred must be debited to Trading Account.

Import Duty/Customs Duty: In case of goods imported from abroad, import duty, customs duty or dock charges etc., have to paid. Since these are related to purchase of goods for resale purposes, these expenses are shown in the debit side of the Trading Account.

Fuel/Power/Lighting etc.,: Machines are used in the production process with the help of coal or electricity. Such charges are direct and are debited to Trading Account.

Packing Charges: Sometimes, it is necessary to pack the goods in a special type of packages in order to protect the goods or attract the customers. In these circumstances, the cost of the packaging is a direct expense and is debited to Trading Account. At the same time, the ordinary packing of goods at the time of sales are not direct these expenses are debited to Profit and Loss Account.

INDIVIDUAL ITEMS CREDITED TO TRADING ACCOUNT

Sales: Both cash and credit sales of goods are included under this item. From this figure, Sales Returns, if any, should be deducted in the column and net sales amount shown in the outer column. Sales of assets are not credited to Trading Account.

Closing Stock: The Closing Stock is credited to the Trading Account. It is nothing but unsold stocks. The closing stock is valued at Cost Price or Market price whichever is less. Closing Stock is shown in Balance Sheet.

In the credit side of the Trading Account, sales, closing stock etc. are shown

ADVANTAGES OF TRADING ACCOUNT

1. The result of trading can be known separately.
2. The various items of trading account of different periods can be compared.
3. The adjustment in the selling price can be made by knowing the percentage of gross profit on net sales.
4. Over-stocking/under-stocking can be known in order to act wisely.
5. If gross loss is disclosed, the business can be closed immediately because the loss will further increase when the indirect expenses are added to it.
6. The progress can be studied on the basis of gross Profit ratio, year after year.

TRADING ACCOUNT EQUATION

Trading account is prepared for calculating gross profit or gross loss. Gross profit or gross loss is the difference between the 'cost of goods sold' and 'sales'.

Gross Profit = Sales – Cost of goods and sold

(Or) Gross Profit + Cost of goods sold = Sales

PROFIT AND LOSS ACCOUNT

By preparing the trading account, it is possible to find out the gross profit or gross loss made during the given period. The next step is the preparation of the Profit and Loss Account to ascertain net profit earned or net loss suffered during a given period of time. The balance of Trading Account is brought down to Profit and Loss account. Then, the Profit and Loss Account is credited with other and the balance with all indirect expenses.

The following items are debited in the Profit and Loss Account:

1. Administrative expenses/Management expenses: Office salaries, Office Rent, Office Lighting, Printing, Stationary, Telephone Rent, Directors' fees, Auditor's fee, Legal Expenses, Postage, Insurance, Repairs, Interest and other similar expenses connected with the office.

2. Financial expenses: Interest on loan, Discount Allowed, Interest on Capital, Bad Debts, Bank Expenses, Discount on Bills etc.

3. Sales Expenses: Salesmen Salaries, Travelling Expenses, Advertising, Selling Commission, Brokerage, Free Samples, Trade Expenses etc.

4. Distribution expenses: Carriage out, Warehouse expenses, Warehouse Insurance, Warehouse rent, Delivery Van Expenses, packing expenses etc.

5. Depreciation of assets, various provisions etc.

A proforma of a Profit and Loss Account is given below:

Profit and Loss Account

For the year ended 31st December

Dr. Cr.

	Rs			Rs
To Gross Loss b/d			By Gross Profit b/d	
To **Management Expenses**:			By Interest Received	
Office Salaries			By Discount Received	
Rent of office building			By Commission Received	
Office Lighting			By Income from Investment	
Office, Rent, Rates and Taxes			By Apprenticeship Premium	

Printing and Stationery			By Rent from Tenants	
Telephone Charges			By Reserve for Discount on Creditors	
Postage			By Interest on Renewal of Bills	
Legal Expenses			By Miscellaneous Income	
Audit Fees			By Net Loss, transferred to Capital Account	
Insurance				
General expenses etc.				
To **Selling Expenses**:				
Travelling Expenses				
Advertising				
Bad Debts				
Selling Commission				
Brokerage				
Free samples				
To **Distribution Expenses**:				
Carriage Out				
Warehouse Rent				
Warehouse Insurance				
Delivery Van Expenses				
Packing Expenses				
To **Depreciation** :				
Depreciation of Assets				
Maintenance Expenses				
To **Finance Expenses:**				
Discount Allowed				
Interest on Loan				
Interest on Capital				
Discount on Bills				
Loss by Fire				
To Net Profit, transferred to capital Account				

ADVANTAGES OF PROFIT AND LOSS ACCOUNT

1. Various expenses can be effectively controlled by comparing various expenses, year after year.
2. The net result-profit or loss, revealed by the Profit and Loss Account is an index by which progress can be measured.
3. Profitability is the basis and helps in planning future course of action.

ILLUSTRATION: 1

From the following figures, prepare Profit and Loss Account Madanlal, as it would appear at the one year ended on 30th June.

	Rs		Rs
Salaries and Wages	3,000	Advertising	1,000
Commission paid	200	Discount Allowed	1,800
Postage & Telegram	150	Rent Received	1,700
Insurance	300	Interest on Investment	1,500
Interest paid	400	Bad Debts	900
Carriage out	500	Brokerage paid	95

The gross profit was 45% of sales, which amounted to Rs 65,000.

SOLUTION

Profit and Loss Account of Madanlal
For the year ended on 30th June…

Dr. **Cr.**

	Rs			Rs
To Salaries A/c	3,000		By Gross Profit 45% of Rs 65,000	29,250
To Commission A/c	200		By Rent Received A/c	1,700
To Postage & Telegrams A/c	150		By Interest Investment A/c	1,500
To Insurance A/c	300			
To Interest A/c	400			
To Carriage Out A/c	500			
To Advertising A/c	1,000			
To Discount Allowed A/c	1,800			
To Bad Debts A/c	900			
To Brokerage A/c	95			
To Capital A/c (net profit Transferred)	24,105			
	32,450			32,450

Difference between Trading and Profit and Loss Account

Trading Account	Profit and Loss Account
1. The first section of revenue account is known as Trading Account.	1. The second section of revenue account is known as the Profit and

2. It is prepared to known only the result of trading. 3. It deals with purchasing and manufacturing costs of goods. 4. Balance of this account is transferred to Profit and Loss Account.	Loss Account. 2. It is prepared to know the ultimate result of the business. 3. It deals with administration, selling, distribution expenses etc. 4. Balance of this account is transferred to Capital Account.

MANUFACTURING ACCOUNT

A businessman purchases finished goods for resale whereas a manufacturer buys raw materials, converts them into finished goods, by incurring certain expenses, and then sells them. Thus, Trading Account is splited into two-Manufacturing Account and Trading Account.

Manufacturing account is the employed to show the cost of manufacture or production. On the debit side, opening stock of raw materials, work-in-process, purchases of raw materials, carriage, manufacturing expenses and all other expenses relating to factory are entered.

On the credit side, closing stock of raw materials, work-in-process is shown and the balance, representing the cost of production of finished goods, is transferred to Trading Account. If one wants to know the cost of manufacturing, then an Account-Manufacturing Account-will have to prepared. The following example illustrates it.

ILLUSTRATION: 2

From the following particulars prepare Manufacturing Account and Trading and Profit and Loss Account.

	Rs		Rs
Purchases of Raw Materials	13,195	Interest on Bank Loan	600
Returns Inward	70	Stock: 1st Jan. 2004	
Stock on 31st Dec. 2004		Raw materials	400
Raw Materials	1,210	Work-in-progress	300

Work -in-progress	1,000	Finished Goods	410
Finished goods	1,370	Sales	19,500
Productive wages	2,000	Returns Outward	85
Factory Expenses	1,840	Carriage Outward	105
Office Expenses	300	Carriage Inward	100
Salaries	600	Discount Allowed	10
Distributing Expenses	100	Sale of Scrap	20
Selling Expenses	700	Depreciation of Machinery	500
Purchase Expenses	600	Repairing to Machinery	100
Export Duty	300	Depreciation of office furniture	40
Import Duty	200		

SOLUTION

Manufacturing Account

For the year ended on 31st December 2004

Dr **Cr**

		Rs		Rs
To Work-in-progress		300	By Sale of Scrap	20
To Materials Consumed			By Work-in-progress	1,000
Opening Stock	400		By Cost of Finished goods, transferred to Trading Account	16,920
To Purchases: 13,195				
Less: Returns 85	**13110**			
	13,510			
Less: Closing Stock	**1,210**	**12,300**		
To wages		2,000		
To Factory Expenses		1,840		
To Purchases Expenses		600		
To Import Duty		200		
To Carriage Inward		100		
To Depreciation of Machinery		500		
To Repairs to Machinery		100		
		17,940		17,940

Trading & Profit and Loss Account

For the year ended on 31st December 2004

Dr **Cr**

	Rs			Rs
To opening Stock A/c	410	By Sales A/c	19,500	
To Manufacturing A/c	16,920	**Less**: Returns	70	19,430
To Gross Profit c/d	3,470	By Closing Stock		1,370
	20,800			**20,800**
To Office Expenses A/c	300	By Gross Profit b/d		3,470
To Salaries	600			
To Distributing Expenses A/c	100			
To Selling Expenses A/c	700			
To Export Duty A/c	300			
To Carriage Outward A/c	105			
To Discount Allowed A/c	10			
To Interest on Loan A/c	600			
To Depreciation on Furniture A/c	40			
To Net Profit, transferred to Capital Account	715			
	3,470			**3,470**

Balance sheet

Trial balance consists of all Accounts-Personal, Real and Nominal. From the trial Balance, nominal accounts are transferred to Trading or Profit and Loss Account and the remaining balances are taken to Balance sheet.

Balance sheet is also known as s statement of Assets and Liabilities. Balance sheet is the last and the most important link in the chained Final Accounts and Statements. It describes the financial position of a business in a systematic standard form. It is a mirror of a business. When the assets exceed the liabilities, one can conclude that the business is sound and solvent. The function of the Balance Sheet is to show the true picture the business on a particular date.

Difference between a Trial Balance and a Balance Sheet

Balance Sheet	Trial Balance
1. Balance sheet columns are headed by Liabilities and Assets.	1. Trial balance columns are headed by Dr. and Cr.
2. It is a statement showing closing balances of Personal and Real Accounts.	2. It is codified summary of all ledger balances-Personal, Real and Nominal accounts.
3. It is the last step in final accounts.	3. It is the first step in the final accounts.
4. It contains only closing stock.	4. It contains opening stock.
5. In reveals the true the financial position of a firm.	5. It establishes the arithmetical accuracy of the accounting work.
6. It is prepared after the preparation of revenue accounts.	6. It is prepared before the preparation of revenue accounts.
7. Stock taking is essential for the preparation of Balance Sheet.	7. Stock taking is not necessary for a Trial Balance.
8. The arrangement of assets and liabilities are made in order of liquidity or performance.	8. There is no order as to the arrangement of ledger balance in a Trial Balance.
9. To complete the accounting circle. Balance Sheet is essential.	9. To complete the accounting circle. Trial Balance is not necessarily prepared.
10. It gives a clear picture of the trend of the firm.	10. It will not give any guidance to understand the trend of the firm.

Form of Balance sheet: It has two sides-left hand side (liabilities) and right hand side (assets). It is not an account. It is a statement. 'To' and 'By' should not be used in the Balance Sheet. The left hand side contains the credit balances of all personal accounts while right hand side contains debit balances of real and personal accounts. The two sides of the Balance Sheet must always agree.

Function of a Balance Sheet

1. A Balance Sheet exhibits the true financial position of a firm at a particular date.
2. Financial position can be ascertained clearly with the help of Balance Sheet.
3. It provides valuable information to the management for taking better decision through ratio analysis.
4. Balance Sheet helps in knowing past and present position of an enterprise. It may be called the horoscope of the concern.
5. It is a mirror of a business.

Limitations of Balance Sheet

1. It is prepared on a historical cost basis. Changes in prices are not considered.
2. Historical Cost of Balance Sheet does not convey fruitful information.
3. Different assets are valued according to different rules.
4. It is measured in terms of money or money's worth. That is, only those assets are recorded in it which can be expressed in money.
5. Balance Sheet has some fictitious assets, which have no market values. Such items are unnecessarily inflate the total value of assets.

CLASSIFICATION OF ASSETS AND LIABILITIES

ASSETS

Assets are the properties possessed by an undertaking. Assets are what the business owns, i.e., its property and possessions such as Cash, Book-debts, Debtors, Stock, Land, Building etc. The classification is done as follows:

1. Fixed Assets: Fixed Assets are durable in nature, acquired and held permanently in the business and are used for the purpose of earning profits. For instance, Plant and Machinery, Land, Buildings, Furniture, Fixture etc. Fixed assets may be tangible or intangible.

2. Current Assets: Current assets or Floating assets are in the form of cash or that can be converted into cash within a short period of time. Cash in hand, Cash at Bank, Debtors, Bills Receivable, Investment etc. are the examples.

1. **Fictitious Assets:** These are not real assets and are fictitious in nature. These are unwritten losses or non-recoupable costs. For instance, underwriting commission. Brokerage, Discount on Issue of Shares or Debentures, heavy advertisement expenses, etc.
2. **Wasting Assets:** Generally speaking assets that lose value through wear and tear or constant use, for instance, mines, quarries etc. Coal existing in coal mines, and if the coal has been taken out, fresh coal cannot be created, therefore mine is treated as wasting assets.

3. Liquid Assets

Liquid assets are those assets, which can be readily converted into cash. Liquidity does not mean mere convertibility. It means convertibility without any appreciable loss of value. For instance, Cash, Cash at Bank, Stocks, Bills receivable etc.

LIABILITIES

Liabilities are the amounts which a business has to pay. They are generally classified according to the period for which they are contracted.

1. Fixed liabilities: All long period liabilities are treated as fixed liabilities whether they are payable to the proprietor or to the outsiders. For instance, Debentures, mortgages, long term loans etc.

2. Current Liabilities: These are to be redeemed in the near future, usually within a year. That is all short period liabilities which are payable within one year are termed as current liabilities. Trade Creditors, Bank loans, Bills Payable etc. are examples of current liabilities.

3. Contingent Liabilities: The liabilities which are not the liabilities of the firm on the date of the Balance Sheet but may become liabilities in future on happening of an uncertain event are all called contingent liabilities.

Balance Sheet (Liquidity Order)

Liabilities	Rs		Assets	Rs
Current Liabilities			**Liquid Assets**	
Bills Payable			Cash in hand	
Sundry Creditors			Cash at hand	
Bank Overdraft			**Floating Assets**	
Long Term Liabilities			Sundry Debtors	
Loan from Bank			Investments	
Debentures			Bills Receivable	
Fixed Liabilities			Stock in trade	
Capital			Prepaid Expenses	
			Fixed Assets	
			Plant and Machinery	
			Buildings	
			Furniture & Fixtures	
			Land	
			Fictitious Assets	
			Advertisement	
			Miscellaneous Expenses	
			Profit & Loss	
			Intangible Assets	
			Goodwill	
			Patents	
			Copyright	

Balance Sheet (Order of performance)

Liabilities	Rs		Assets	Rs
Fixed Liabilities			Intangible Assets	
Long Term Liabilities			Fictitious Assets	
Current Liabilities			Fixed Assets	
			Floating Assets	
			Liquid Assets	

ILLUSTRATION: 3

From the following particulars, prepare a Balance Sheet as on 31st December 2004

Capital	--	40,000
Drawings	4,400	--
Creditors and Debtors	6,400	4,200
Cash in hand	360	--
Cash at bank	7.200	--
Furniture	3.700	--
Plant	10,000	--
Net Profit	--	1,600
General Reserve	--	1,000
Closing Stock	14,800	--
	46,800	46,800

SOLUTION

Balance Sheet As on 31st December 2004
(Liquidity order)

Liabilities		Rs	Assets	Rs
Sundry Creditors	Rs	4,200	Cash in hand	360
General Reserve		1,000	Cash at Bank	7,200
Capital:	40,000		Sundry debtors	6,400
Add: Profit	1,660		Stock	14,800
			Furniture	3,700
	41,660		Plant	10,000
Less: Drawings	4,400	37,260		
		42,460		42,460

Balance Sheet As on 31st December 2004

(In order of Performance)

Liabilities		Rs	Assets	Rs
Capital:	40,000		Plant	10,000
Add: Profit	1,660		Furniture	3,700
			Stock	14,800
	41,660		Sundry Debtors	6,400
Less: Drawings	4,400	37,460	Cash at bank	7,200
General Reserve		4,200	Cash in hand	300
Sundry creditors		1000		
		42,460		**42,460**

FINAL ACCOUNTS WITH ADJUSTMENTS

In order to make the final accounts give a true picture of the business (true profit/loss) various adjustments must be taken into account. All items which need to be brought into account at the time of preparing final accounts are called "Journal entries passed to effect the required adjustments. Journal entries passed to effect the required adjustments are called **"adjustment entries**

ADJUSTING ENTRIES

(1) Every adjusting entry affects both Profit and Loss Account and Balance Sheet.
(2) It does not directly affect cash.
(3) It is recorded at the end of the accounting period.
(4) There is a change in income or expenses.

WHEN ADJUSTMENT ENTRY IS PASSED, IT AFFECTS MINIMUM TWO ACCOUNTS

1. **TRADING AND PROFIT AND LOSS ACCOUNT (or)**
2. **TRADING ACCOUNT AND BALANCE SHEET (or)**
3. **PROFIT AND LOSS ACCOUNT AND BALANCE SHEET**

Some of the common items that need adjustment to be made at the end of accounting period are discussed and are as follow:

1. Closing Stock: Generally, the firm takes out a list of all stocks, remaining unsold along with their value. The stock is always valued at cost or market price whichever is lower.

1. Closing stock is shown on the Credit side of Trading Account.
2. Closing Stock is shown on the Asset Side of Balance Sheet.

2. Outstanding Expenses: Such expenses, which are due for payment in given accounting year but the payment will be made in future accounting year, i.e., payment of such items is postponed, are Outstanding or unpaid expenses.

* Outstanding Expenses debited to Profit and Loss account.

* Outstanding Salary is a liability and shown in Balance sheet (liability)

3. **Unexpired or Prepaid Expenses:** When we have paid any expense and its benefit is to be availed in future, it is termed as unexpired or prepaid expenses.

* The amount of prepaid expenses is deducted in the Profit and Loss A/c from the expense.

* The amount will appear in the Asset side of Balance Sheet.

4. Accrued Income: Accrued income is an amount earned but not actually received during the accounting period or till the date of preparation of Final Accounts for the period concerned.

* It is credited to the Profit & Loss Account

* It is shown in the asset side of the Balance Sheet.

5. Income Received in Advance (Income received but not Earned): When income is received in advance, for the work not done yet, the trader is liable. That is such income though received is not the income for the current trading period, but services will be rendered in the next year.

* The unearned income is deducted from Rent Received Account.

* The deducted amount is shown in the liability side of the Balance sheet.

6. Depreciation: The asset may lose its value due to its constant use or due to its non-use (merely by passage of time).

* Depreciation is shown on the debit side of Profit & Loss Account.
* The amount of depreciation is deducted from the concerned asset, in the asset side of the Balance sheet.

7. Additional Bad debts: The customers to whom we sell goods we sell goods on credit become our Debtors and they are liable to pay their dues.

Bad Debts are debited to Profit and Loss Account.

Sundry Debtors are reduced Bad Debts in the Balance Sheet.

8. Provision for Doubtful Debts: A Doubtful Debt may or may not recoverable. A Doubtful Debt is only and expected loss. An expected loss need not be treated as a loss before it actually occurs.

*It is debited in the Profit & Loss Account.

*It is shown as a deduction from Debtors, in the Balance sheet.

9. Provision for Discount on Debtors: If the debtors of the current period settle their accounts promptly in the succeeding period, discount will have to be allowed by us.

* It is shown on the debit side of Profit and Loss Account.

* It is shown as deduction from Debtors in Balance Sheet. But remember the amount of Provision is calculated only after deducting the amount of additional Bad Debts.

10. Interest on capital:

Debited to Profit and Loss Account

Credited to Capital Account

11. Interest on Drawings: When the Proprietor withdraws money from the business for personal use, it is treated as a temporary loan to the Proprietor by the business. Business charges interest on such drawings: The adjustment entry is

* It is credited to the Profit & Loss Account.
* It is added to the Drawings and then deducted from Capital, in Balance Sheet (liability side)

12. Provision for Discount on Creditors: Sound business firms settle their accounts with the Creditors at the proper and scheduled time.

* Credit the amount in Profit and Loss Account

* In balance Sheet (liability side) it is shown as a deduction from Sundry Creditors.

13. Creation of various Reserves: A portion of the new profit is kept aside by most of the firms as a Provision for unforeseen contingencies. They are charged to Profit and Loss Account.

*It is debited to the Profit and Loss Account

*It is shown in the Liability side of the Balance Sheet.

14. Deferred Revenue Expenditure: There may be heavy expenditure on Research Projects, Advertisement, Sales Campaign, etc.

*A portion of such expenditure is debited to Profit and Loss A/c

*The balance of such expenditure is shown in the Asset side of Balance Sheet.

15. Commission Payable as a Percentage on Net Profit: The commission payable is taken to the debit side of the Profit and Loss and credited to the concerned officer.

16. Accidental Loss: The amount of Stock Destroyed Account is debited and Trading Account is credited. If the amount of Stock Destroyed or Stock destroyed or Stock Damaged Account is not recoverable, the amount may be transferred to Profit and Loss Account.

ILLUSTRATION: 4

The following are the balances extracted from the books of Thiru.Patel as on 31.3.2000. Prepare profit and loss account for the year ended 31 Dec. 2000 and a Balance sheet as on that date.

	Rs	**Rs**
Capital	-	1,00,000
Opening Stock	20,000	-
Machinery	40,000	-
Purchases	70,000	-
Purchases returns	-	1,000
Sales	-	90,000

Sales returns	1,000	-
Wages	2,000	-
Salaries	5,000	-
Office rent	2,000	-
Insurance	1,000	-
Sundry Debtors	50,000	-
Sundry Creditors	-	29,000
Cash	4,000	-
Bank Balance	25,000	-

Adjustment:

i) Closing stock is Valued at Rs 20,000
ii) Outstanding Salaries Rs 1000
iii) Prepaid Insurance Rs 500
iv) Bad Debts Rs 1000
v) Provide 10% depreciation on machinery

SOLUTION

Trading and Profit & Loss Account of Thiru. Patel
For the period ended 31 March 2000

Dr **Cr**

Particulars	Rs	Particulars	Rs

To opening Stock		20,000	By sales	90,000	
To Purchases	70,000		**Less:** Returns	1,000	**89,000**
Less: Returns	1,000	**69,000**	By closing stock		20,000
To Wages		2,000			
To Gross profit		**18,000**			
		1,09,000			1,09,000
To Salaries	5,000		By Gross profit		**18,000**
Add: Outstanding	1,000	**6,000**			
To Office rent		2,000			
To Insurance	1,000				
Less: Prepaid	500	**500**			
To Bad Debts		1000			
To Depreciation on Machinery 10%		4,000			
To Net profit……………		4,500			
		18,000			**18,000**

Balance Sheet of Thiru. Patel as on 31 March 2000

Liabilities		**Rs**	**Assets**		**Rs**
Capital	1,00,000		Machinery	40,000	
Add: Net profit	4,500	**1,04,500**	**Less:** Depreciation(10%)	4,000	**36,000**
Sundry Creditors		29,000	Sundry debtors	50,000	
Outstanding Salary		1,000	**Less**: Bad debts	1,000	**49,000**
			Cash		4,000
			Bank Balance		25,000
			Closing stock		20,000
			Prepaid Insurance		500
		1,34,500			**1,34,500**

ILLUSTRATION: 5

The following ledger balances were extracted from the books of Madhumathi. You are required to prepare trading and profit and loss and balance sheet as on 31st March 2000.

Capital	10,000	Returns inwards	300
Drawings	2,000	Returns outwards	580
Purchases	20,800	Carriage inwards	400

Stock (1.4.1995)	6,900	Wages	325
Sales	27,500	Salaries	900
Creditors	8,100	Interest	480
Rent	1,000	Carriage outwards	700
Discount (Dr)	270	Insurance	900
Furniture and fixtures	900	Bank Loan	3,800
Machinery	5,000	Cash in hand	575
Travelling expenses	650		
Bad debts	120		
Debtors	7,500		

Adjustments:

i) Closing stock was valued at Rs 8900

ii) Insurance prepaid Rs 250

iii) Outstanding expenses: Salaries Rs 100; Rent Rs 200

iv) Interest on Bank Loan Rs 150

v) Depreciate machinery and furniture by 10% each

vi) Provide for doubtful debts at 5% on Debtors.

Solution:

Trading and profit & Loss account of Madhumathi

For the period ended 31March 2000

Dr **Cr**

Particulars		Rs	**Particulars**		Rs
To Opening Stock		6,900	By sales	27,500	
To Purchases	20,800		**Less:** returns	300	**27,200**
Less: returns	580	**20,220**			
			" Closing Stock		8,900
To Carriage inwards		400			

" Wages	325		
" Gross Profit……..	8,225		
	36,100		36,100
To Rent 1,000		By Gross profit	8,255
Add outstanding 200	1,200	" Discount	270
" General expenses	650		
" Bad debts 120			
Add provision for			
Doubtful debts 375	495		
" Salaries 900			
Add outstanding 100	1,000		
" Carriage outwards	700		
" Insurance 900			
Less prepaid 250	650		
" **Depreciation:**			
Machinery 10%	500		
Furniture 10%	90		
" Net profit…………..	**2,760**		
	8,525		8,525

Balance sheet of Madhumathi as on 31 march 2000

Liabilities	**Rs**	**Assets**	**Rs**
Capital 10,000		Furniture & fixtures 900	
Add: net profit 2,760		**Less** : Depreciation 90	810
12,760		Machinery 5,000	
		Less: Depreciation 500	4,500
Less: Drawings 2,000	10,760		
Sundry Creditors	8,100	Debtors 7,500	
Bank Loan	3,000	**Less**: provision for	
		Doubtful debts 375	7,125
Outstanding expenses:		Cash in hand	575
Salary 100		Prepaid insurance	250
Rent 200		Closing stock	8900
Interest on loan 150	450		
	22,160		22,160

ILLUSTRATION: 6

From the following balances extracted from the books of S. khan on 31st December 2005. Prepare Trading and Profit & Loss account.

TRADING ACCOUNT

Debit	Rs	Credit	Rs
Opening stock	10,600	Returns out wards	150
Salaries and wages	2,200	Sales discount Received	25,200
Carriage	200	Capital	400
Commission on	300	Creditors	7,000
purchase	12,000	Loan	830
Purchases	440		1,400
Returns Inwards	580		
Trade expenses	200		
Rent	2,600		
Plant	460		
Repairs to plant	200		
Cash in hand	1,000		
Cash at bank	3,000		
Debtors	500		
Income Tax	700		
Drawings			

Stock remaining unsold on 31-12-2005 Rs. 3000

SOLUTION:

TRADING AND PROFIT & LOSS a/c

For the year ended 31-12-2005.

Dr.

Cr.

To opening Stock	10,600	By Sales 22,400	
To Purchase a/c 12,000		**Less:** Return 440	24,760
Less: Returns		Inwards	
Out wards 150	11,850	By closing stock	3,000
To Carriage a/c	200		
To Commission on	300		
Purchases a/c			
To Gross Profit c/d	4,810		
	27,760		27,760
To Salaries & Wages	2,200	By Gross Profit b/d	4,810
To Rent	200	By Discount Received	400

To Trade expenses	580		
To Repairs and plant	460		
To Net profit transferred to capital a/c	1,770		
	5,210		5,210

ILLUSTRATION 7

From the following Trial Balance prepare a Trading and Profit and Loss a/c for the year ending 31sst March 2006.

Stock 1sr April	5,000	Rent, Rates and Taxes	800
Wages	3,000		
Discount allowed	200	Salaries	2,,000
Bad debts	500	Purchases	10,000
Repairs	300	Office expenses	2,500
Depreciation	1,000	Interest received	600
		Sales	17,000

On 31st March, 2006 the stock was valued at Rs, 10,000

SOLLUTION:

TRADING AND PROFIT & LOSS a/c

For the year ended 31-3-2006

Dr Cr

To opening Stock	5,000	By Sales	17,000
To Purchases	10,000	By Closing Stock	10,000
To Wages	3,000		
To Gross Profit c/d	9,000		
	27,000		27,000
		By Gross Profit b/d	9,000
		By Interest received	600
To Salaries	2,000		
To Rent, Rates and Taxes	800		
To Office expense	2,500		
To Repairs	300		
To Depreciation	1,000		
To Bad debts	500		
To Discount allowed	200		
To Net profit transferred	2,300		
	9,600		9,600

ILLUSTRATION 8

Pick out items relating to the Trading Account and construct a Trading Account for the year ending 31st March 2006.

2005		
April	Stock of goods	2,000
2006		
March 31	Purchases 7,000; Wages (Productive) 1,500; Office Lighting 250	
	Freight on goods bought 750; Marine Inwards on Purchases 250	
	Duty on goods imported 400; Salaries to clerks 1,200	
	Wages to office & shop assistants 300; Motive power 120	
	Carriage Inwards 75; Sales 15,000; Stock 3,000;	
	Packing materials 200; Returns Inwards 400; Returns Outward 300	

Solution:

TRADING ACCOUNT

For year ended 31st March 2006

Dr. **Cr.**

To opening Stock	2,000	By Sales 15,000	
To Purchases 7,000		**Less**: Returns	
Less: Returns		Inwards 400	
Outwards 300			14,600
	6,700		
To Freight on purchases	750	By Closing Stock	3,000
To Marine Insurance	250		
On purchases	400		
To Carriage Inwards	75		
To Motive power	120		
To Wages (Productive)	1,500		
To Packing materials	200		
To Gross profit c/d	5,605		
	17,600		17,600

ILLUSTRATION: 9

Kumar's books show the following balances on 31`st Dec.2005

Opening Stock	28,000	Sales	13,600
Purchases	73,000	Purchases	2,000
Wages	25,000		
Freight Inwards	3,000		
Sales Returns	4,500		
Fuel and Power	11,000		
Direct expenses	2,000		

Stock on 31st December, 2005 was valued at Rs. 25,800. Wages for month of December, 2005 totalling Rs 2,300, have still to be paid. A customer returned goods worth Rs. 600 on December 31st these have not been included on stock and no entry has yet been passed. Prepare the Trading Account.

Solution:

TRADING ACCOUNT OF Mr. KUMAR

For the year ended December 31, 2205.

Dr. **Cr**

To opening stock	28,000	By Sales 1,38,600	
		Less: Return 5,100	
To Purchases 73,000		(4500+600)	
Less: Returns 2,000	71,000		1,33,500
To wages 25,000		By Closing Stock	26,400
Add: Unpaid 2,300	27,300	(25800+600)	
	3,000		
To freight inwards	11,000		
To fuel & power	2,000		
To Direct Expenses	17,600		
To Gross profit c/d			
	1,59,900		1,59,900

CAPITAL AND REVENUE EXPENDITURE:

In these final accounts all the revenue items are included in the Revenue Account i.e Trading and Profit and Loss Account and all capital items are included in the Balance Sheet. Charging a capital items into an expense account or charging a revenue item to an asset account, then the Revenue Accounts and Balance Sheet will be inaccurate and misleading

Capital expenditure:

Capital expenditure is that expenditure is that expenditure which results in the acquisition of permanent asset or fixed asset which is used continuously in the business for the purpose of earning revenue. Any amount spent on the asset which will result in the increasing the production or reducing the cost of production may also be treated as Capital expenditure

Revenue expenditure

Revenue expenditure is that expenditure which is not capital expenditure. It is an expenditure charged against operation; a term used to contrast with the capital expenditure. Revenue expenditure is incurred in the current period or in one period of account. The benefit Revenue expenditure is utilised in that period itself

Deferred Revenue expenditure and capital expenditure

A large sum of revenue expenditure incurred in some cases, the benefit of such expenditure may extend to a number of years. Such expenditure is called Deferred Revenue expenditure. Hence this expenditure is not charged straightly to profit and loss account, but a portion of it is charged every year to profit and loss account for the prescribed number of years. The amounts which remain unchanged at the end of any particular year is Deferred Revenue expenditure and capital expenditure, which is put as an asset in the balance sheet.

Items of Deferred Revenue expenditure

1. Preliminary expenses, brokerage on Shares, cost of issue of debentures

2. Underwriting commission

3. Heavy advertisement expenses, Research and Development expenses

4. Exceptional Repairs, Special types of losses

UNIT-III

DEPRECIATION AND RESERVES

Definition of Depreciation

"Depreciation may be defined as permanent decrease in the value of an asset through wear and tear in the use or the passage of time."

"The primary meaning of the word depreciation is loss of value through wear and the tear or some other from material deterioration. The secondary sense of depreciation is the operation of adjusting the book values of assets. As the machines or other get old, it is the practice of the Accountant to reduce their values in the book of accounts and it is usual to call this as depreciation."

CAUSES OF DEPRECIATION

1. W**ear and Tear:** An asset is constantly used for production, the asset wears out. More and more use of an asset, the greater would be the wear and tear.

2. Lapse of Time: The certain assets like leasehold property, patents, copy-right etc., That are acquired for a particular period. After the expiry of the period, there are rendered useless.

3. Obsolescence: Appearance of new and improved machines result in discarding of old machines. Thus new invention, change in fashions and taste, market condition, Government policies etc, are the causes discard the value of an asset.

4. Exhaustion: Some assets are of wasting nature .For instance quarries, mines, oil-well etc,. It is the reductions in the value of natural deposit are resources have been extracted year after the year.

5. Non –use: Machines which are idly lying, becomes less and less useful with the passage of time. Certain type of machines exposed to weather conditions, may have more depreciation from not using it than from its use.

6. Maintenance: A good maintenance of machine will naturally increase its life. When there is no maintenance, there is more depreciated value.

7. Market Trend: The market price may fluctuate in case of certain asset, for instance, investment in gilt- edged securities. When the price goes down, the concerned asset may depreciate its value. In certain case, accident causes diminution in the value of assets.

NEED FOR DEPRECIATION

Depreciation is provided for the assets with a view to achieve the following results:

1. **To ascertain the true working result:** Asset is an important tool in earning revenues. Huge amounts are spending for acquisitions of assets which are worn out in the process of earn income. Depreciation should be debited to profit and loss account before profit is ascertained.

2. To ascertain true value of asset: The function of the balance sheet is to show the true and correct view of the state of affairs of a business. If no depreciation charged and when assets are shown at the original cost year after year, Balance sheet will not disclose the correct state of affairs of a business.

3. To retain funds for replacement: Asset use in the business needs replacement after the expiry of their service. It is always not possible to determine the useful life of asset. But, in certain cases, machine often becomes, obsolete long before it wears out because of rapid changes in tastes and technology. It is a permanent loss in value of the asset.

4. To reduce tax liability: Depreciation is the tax deductible expenses. The owner of a business may avail himself of this benefit by charging depreciation to his profit and reducing to his tax liability

5. To present true position: Financial position can be studied from the balance sheet. Depreciation must be deducted from the asset and then at such reduced value may be shown in the balance sheet. If depreciation is not for, the profit of the company is overstated, in turn, it is distributed among the shareholder.

Methods of Depreciation

The various fixed assets differ from each other in their nature and therefore no single method of providing depreciation can be applied to all types of assets. The following are the various methods of providing depreciation.

1. Fixed instalment method

2. Diminishing balance method
3. Annuity method
4. Depreciation fund method
5. Insurance policy method
6. Depreciation reserve and repairs fund method
7. Revaluation method
8. Machine hour rate method
9. Depletion method
10. Kilo meter method
11. Sum of years digit method

1. Fixed Instalment method or Equal Instalment method or Straight Line method or Fixed percentage on Original cost method

In this method a fixed or equal amount of depreciation written off as depreciation at the end of each year, during the life time of the asset.

(a) When the asset has no residual value:

$$\text{Each year's depreciation} = \frac{\text{Original cost}}{\text{Estimated life of asset in years}}$$

(b)When the asset has residual value:

$$\text{Each year's depreciation} = \frac{\text{Original Cost of Asset-Estimated Scrap value}}{\text{Estimated life of asset in years}}$$

Illustration: 1. Find out the rate of depreciation under straight line method

Cost of price = Rs 5000; Scrap value = Rs 500; Estimated life = 10 years

SOLUTION:

$$\text{Depreciation} = \frac{\text{Original cost of asset –Scrap value}}{\text{Estimated life of asset}}$$

=5000-500/10

=4500/10

=Rs.450

Rate of depreciation = 450/5000 X100

= 9%

Illustration: 2

Find out the amount of Depreciation

Cost price Rs.4,000; Estimated life 6 Years ; Scrap value Rs. 2,000

Solution:

$$\text{Depreciation} = \frac{\text{Original cost of asset – scrap value}}{\text{Estimated life of asset}}$$

$$\text{Depreciation} = \frac{14,000 – 2,000}{6}$$

= Rs. 2,000

Illustration: 3

Teetee Ltd purchased certain machinery at a cost of Rs. 20,000 on 1st January 2001. They decided to write off depreciation @ 20% p.a, according to straight line method? Prepare the Machinery Account and Depreciation Account for the year 2001 to 2004.

SOLUTION

Machinery a/c

Dr **Cr**

Date	**Particulars**	**Amount**	**Date**	**Particulars**	**Amount**

2001			**2001**		
Jan1	To cash-(purchase)		Dec 31	By Depreciation	4,000
		20,000	Dec 31	By Balance c/d	16,000
		20,000			**20,000**
2002			**2002**		
Jan 1	To balance b/d	16,000	Dec 31	By Depreciation	4,000
		16,000	Dec 31	By balance c/d	12,000
					16,000
2003			**2003**		
Jan 1	To balance b/d	12,000	Dec 31	By depreciation	4000
			Dec 31	By balance c/d	8000
		12,000			**12,000**
2004			**2004**		
Jan 1	To balance b/d	8,000	Dec 31	By depreciation	4,000
			Dec 31	Balance c/d	4,000
		8,000			**8,000**
2005	To balance b/d	4,000			

Depreciation Account

Dr **Cr**

Date	**Particulars**	**Amount**	**Date**	**Particulars**	**Amount**
2001			**2001**		
Dec 31	To machinery	4,000	Dec 31	By profit & loss a/c	4,000
2002			**2002**		
Dec 31	To machinery	4,000	Dec 31	By profit & loss a/c	4,000
2003			**2003**		
Dec 31	To machinery	4,000	Dec 31	By profit & loss a/c	4,000
2004			**2004**		
Dec 31	To machinery	4,000	Dec 31	By profit & loss a/c	4,000

Illustration: 4

A company whose accounting year is calendar year, purchased on 1^{st} April 2003, machinery costing Rs. 30,000. It purchased another machine on 1^{st} October 2003, costing Rs. 20,000and on 1st July 2004, costing Rs. 10,000. On 1st Jan. 2005, one-third of the machinery which was installed on 1st April 2003 became obsolete and was sold for Rs. 3,000.

Show how the Machinery Account would appear in the books of the Company. The Machinery was depreciated by the Fixed Instalment Method @ 10% p.a

SOLUTION

Machinery Account

Dr. **Cr.**

		Rs			**Rs**
2003			**2003**		
April 1	To Cash account	30,000	Dec.31	By Depreciation A/c **(Rs2,250 + 500)**	2,750
Oct 1	To Cash account	20,000	Dec. 31	By Balance c/d	47,250
		50,000			50,000
2004			**2004**		
Jan.1	To Balance b/d	47,250	Dec.31	By Depreciation A/c **(Rs5,000 + 500)**	5,500
July 1	To Cash account	10,000	Dec.31	By Balance c/d	51, 750
		57,250			57,250
2005			**2005**		
Jan 1	To Balance b/d	57,250	Jan.1	By sales account	3,000
			Jan.1	By Profit and loss account	5,250
			Dec .31	By Depreciation account	5,000
			Dec. 31	By Balance c/d	38,500
		57,250			57,250
2006					
Jan. 1	To Balance b/d	38,500			

***Loss on Sale of Machine:**

Cost of Machinery (Rs.30, 000 x 1/3) 1,000

Less: Depreciation for 2003(9 months)	750	
	9,250	
Less: Depreciation for 2004(1 year)		1,000
Book value on 1-1-2005	8,250	
Less: Sale Proceeds	3,000	
LOSS	5,250	

Merits (Fixed Instalment)

1. The method is very simple and easy.
2. There is no complicated calculation.
3. The value of asset can be reduced to zero
4. There is realistic matching to cost and revenue.
5. It facilitates easy comparison from year to year

Demerits

1. When additions made to asset, calculation becomes difficult.
2. Depreciation remains the same every year, but maintenance cost increase as the asset growing older and older.
3. The method does not make any provision for interest on capital invested in fixed assets.
4. It may not be possible for the correct calculation of effective working life of any asset.

2. Diminishing Balance Method (Reducing Balance Method)

Under this method, the amount of depreciation is calculated as a fixed percentage of the reducing value of the asset. The amount of depreciation decreasing every year. The amount of depreciation charged in each period is not fixed. Under this method, the asset can never be reduced to zero. This method is suitable of assets like plant, Machinery, Boiler, Building, etc.

Illustration: 5 On 1st Jan 2003 machinery was purchased for Rs. 80,000 on 1st 2004 additions were made to the machinery of Rs.40,000. On 31st March 2005, machinery purchased on 1st January 2004, costing Rs. 12,000 was sold for Rs.11,000 and on 30th June 2005, machinery purchased on 1st Jan 2003 costing Rs.32,000 was sold for Rs 26,700. On 1st Oct 2005 addition were made to the amount of Rs. 20,000. Depreciation was provided at 10% p.a. on the diminishing balance method. Show the machinery account for the three year from 2003 to 2005 December 31st

Machinery Account

Dr **Cr**

		Rs	Rs		
2003			**2003**		
Jan.1	To cash Account	80,000	Dec.31	By Depreciation Account	8,000
			Dec.31	By Balance c/d	72,000
		80,000			80,000
2004			**2004**		
Jan.1	To Balance b/d	72,000	Dec.31	By Depreciation Account	11,200
Jan.1	To cash a/c	40,000	Dec.31	By Balance c/d	1,00,800
		1,12,000			1,12,000
2005			**2005**		
Jan.1	To Balance b/d	1,00,800	Mar.31	By Depreciation A/c (for 3 month)	270
Oct . 1	To Profit and Loss A/c	470	Mar.31	By Bank Account	11,000
	To Profit and Loss A/c	2,076	June.30	By Depreciation A/c (for 6 month)	1,296
	To Bank Account	20,000	June.30	By Bank A/c	26,700
			Dec.31	By Depreciation A/c	5,908
			Dec.31	By Balance c/d	78,172
		1,23,346			1,23,346
2006					
Jan.1	To Balance c/d	78,172			

Notes:

Profit on sale of machinery **Rs.**

1. Cost of machinery (1-1-2004) 12,000

 Less: Depreciation for 2004 1,200

	10,800
Less: Depreciation for 2005(3months)	270
Book value on 31-3-2005	**10,530**

Sales Proceeds Rs.11, 000

Profit = Rs.11, 000 - 10,530

2. Cost of Machinery (1-1-2003)	32,000
Less: Depreciation for 2003	3,200
	28,000
Less: Depreciation for 2004	2,880
Less: Depreciation for 2004	25,920
Less: Depreciation for 2005(6 Month)	1,296
Book Value on 30-6-2005	24,624

Sale Proceeds Rs 26,700

Profit = Rs 26,700-24,624 2,076

3. Depreciation for the remaining Asset:

Book value of machinery on 1-1-2004	1, 00,800
Book value of machinery sold Rs 10,800 + Rs 25,920	36,720
	64,080
Depreciation for 2005	6,408
Depreciation for the machinery Purchased	500
On 1-10-2005 (3months)	5,908

Distinction between straight line and Diminishing Balance Method;

Straight line	Diminishing Balance
1. Depreciation is calculated on the original cost each year.	1. Depreciation is calculated on written down value.
2. Amount of depreciation is equal each year.	2. Amount of depreciation declines each year.
3. The system is simple but not scientific.	3. The system is simple and scientific.
4. The system is not accepted by law.	4. The system is accepted by law.
5. At the end of the life of the asset, the value of the asset will be zero.	5. At the end of the life of the asset, the value of the asset can never be zero.

Merits (Diminishing Balance Method)

1. The amount of depreciation to be charged reduces with the reduction in the effective life of the asset.
2. This method is recognized by the Income authorities.
3. As the probability of services to be received from the asset reduces, the amount of depreciation also reduces.
4. Elimination of a major portion of cost in earlier years minimize the impact of obsolescence.

Demerits

1. The value of asset can never be zero.
2. When additions are disposal take place, computation of depreciation becomes difficult.
3. This method puts too much emphasis on the historical cost.
4. Interest on capital invested is not considered.

3. Annuity Method

Under this method, it is assumed that the amount spent in the purchase of the asset is an investment which should yield interest. The amount spent in acquiring an asset assumed as an investment and interest is charged at a certain rate on the diminishing balance of the asset.

The amount of depreciation is calculated from the ready Annuity Tables. The amount of depreciation will be different according to the rate of interest and the life time of the asset. This method is used in leased asset over a number of years.

Journal entries are:

1. When the asset is purchased.	Asset Account Dr. To Bank Account
2. For charging interest.	Asset Account Dr. To interest account
3. For charging depreciation	Depreciation Account Dr. To asset account

Merits

1. The amount of depreciation to be charged is ascertained from Annuity tables. Therefore, this method is scientific.

2. This method provides for recovery of invested capital along with interest.

3. This method of most suitable to such asset which require heavy initial investment.

Demerits:

1. Calculation of depreciation becomes very difficult when additions are made to assets.
2. Calculation of interest is arbitrary.
3. This system is not at all suitable for those assets which are of small value.
4. Depreciation and interest taken together are not uniform.

Illustration: 6

A five year lease worth Rs.30, 000 is to be depreciated by Annuity systems, the unwritten balance of the asset bearing interest at 5%. The annual amount to be written off as shown by the Annuity table is Rs.6, 929.24. Show the working of the lease account for the five years.

Solution:

Lease Account

Dr. **Cr**

Date	Particulars	Rs Amount	Date	Particulars	Rs Amount
1st year		30,000	**1st year**		6,929.24
Jan 1	To bank account	1,500	Dec 31	By depreciation	24,570.76
Dec 31	To interest account	31,500	Dec 31	By balance c/d	31,500
2nd year			**2nd year**		
Jan1	To balance b/d	24,570.76	Dec.31	By depreciation a/c	6,929.24
Dec 31	To interest account	1,228.54	Dec 31	By balance c/d	18,870.06
		25,799.30			25,799.30
3rd year			**3rd year**		
Jan1	To balance b/d	18,870.06	Dec 31	By depreciation a/c	6,929.24
Dec31	To interest account	943.50	Dec 31	By balance c/d	12,884.32
		19,813.56			19,813.56
4th year			**4th year**		
Jan 1	To balance b/d	12,884.32	Dec 31	By depreciation a/c	6,929.24
Dec31	To interest account	644.22	Dec 31	By balance c/d	6,599.30
		13,528.54			13,528.54
5th year			**5th year**		
Jan1	To balance b/d	6,599.30	Dec 31	By depreciation a/c	6,929.24
Dec 31	To interest account	329.94			
		6,929.24			6,929.24

4. Depreciation Fund Method (sinking fund method)

This method not only takes depreciation in to account but also makes provision for the replacement of asset when it becomes useless. Under this method a fixed amount is debited every year to depreciation account or profit and loss account and is credited to depreciation fund account instead of asset account.

First year

1. When the asset is purchased	Asset account Dr To bank account
2. When depreciation is provided 3. When depreciation is transferred	Depreciation account Dr To depreciation fund account Profit and loss account Dr To depreciation account
4. When the amount of depreciation is invested	Depreciation fund investment a/c To bank account

Second and Subsequent Years

1. When depreciation is provided.	Depreciation account Dr. To depreciation fund account
2. When the depreciation is transferred.	Profit and loss account Dr. To depreciation account
3. When interest on depreciation fund investment is received	Bank account Dr. To interest on depreciation fund investment a/c
4. When interest is transferred	Interest on depreciation fund investment a/c Dr To depreciation fund account
5. When investment is made with depreciation and fund account.	Depreciation fund investment a/c Dr. To bank account

Last year

1. When depreciation is provided	Depreciation account Dr. To depreciation fund account
2. When the depreciation is transferred.	Profit and loss account Dr. To depreciation account
3. When interest on depreciation fund investment is received.	Bank account Dr. To interest on depreciation fund investment account.
4. When interest is transferred	Interest on depreciation fund investment a/c dr To depreciation fund account
5. When investment are sold	Bank account Dr. To depreciation fund investment account.
6. Profit or loss on investment is transferred. If **Profit** If **Loss**	Depreciation fund investment a/c Dr. To depreciation fund account Depreciation fund account Dr. To depreciation fund investment account.
7. When the old asset written of	Depreciation fund account Dr.

8. Balance, if, any in the depreciation fund account 9. When new asset is purchased.	To asset account It may be transferred to profit and loss account New asset account. Dr To bank account.

Illustration: 7

On 1.1.2001, a Company purchased machinery at a cost of Rs.50, 000. The machinery is expected to run for 5 years at the end of which the estimated scrap value is Rs 10,000. In order to provide sufficient fund for the replacement of the machinery at the end of its life it is decided to create a Sinking Fund and to invest the amount of gilt edged securities yielding 4% interest.

On 31.12.2005 the machinery is sold off as scrap for Rs.8, 500. On the same date investments are realised at Rs.31, 500. New machinery is purchased for Rs.75, 000 on the following date. Show the necessary accounts in the books of the company for 5 years. (Re 0.1846 at 4% will produce Re 1 in 5 years)

Solution:

To write off Re 1 at 4% interest annual depreciation will be Re 0.1846.

So to write off Rs 40,000 (Rs 50,000-10,000) annual depreciation will be

0.1846 X 40,000 = Rs.7, 384

Sinking Fund Account

Dr **Cr**

		Rs			**Rs**
2001 Dec. 31	To Balance c/d	7,384	**2001** Dec. 31	By profit and Loss a/c	7,384
2002 Dec.31	To Balance c/d	15,063	**2002** Jan. 1 Dec. 31 Dec. 31	By balance b/d By bank A/c Interest By Profit and Loss A/c	7,384 295 7,384

		15,063			15,063
2003			**2003**		
Dec. 31	To Balance c/d	23,050	Jan. 1	By Balance b/d	15,063
			Dec. 31	By Bank A/c Interest	603
			Dec.31	By Profit and Loss A/c	7,384
		23,050			23,050
2004			**2004**		
Dec.31	To Balance c/d	31,356	Jan. 1	By Balance b/d	23,050
			Dec. 31	By Bank A/c Interest	922
			Dec. 31	By Profit and Loss A/c	7,384
		31,356			31,356
2005			**2005**		
Dec. 31	To Machinery Account Transfer	40,138	Jan. 1	By Balance b/d	31,356
			Dec. 31	By Bank A/c Interest	1,254
			Dec.31	By Profit and Loss A/c	7,384
			Dec.31	By Sinking Fund Investment A/c Profit	144
		40,138			40,138

Sinking Fund Investment Account

Dr **Cr**

		Rs			Rs
2001			**2001**		
Dec.1	To Bank Account	7,384	Dec.31	By Balance c/d	7,384
2002			**2002**		
Jan.1	To Balance b/d	7,384	Dec. 31	By Balance c/d	15,063
Dec.31	To Bank Account Rs 295+7,384	7,679			
		15,063			15,063
2003			**2003**		
Jan. 1	To Balance b/d	15,063	Dec. 31	By Balance c/d	23,050
Dec. 31	To Bank Account Rs 603+7,384	7,987			
		23,050			23,050

2004			**2004**		
Jan. 1	To Balance b/d	23,050	Dec. 31	By Balance c/d	31,356
Dec. 31	To Bank Account Rs 922+7,384	8,306			
		31,356			31,356
2005			**2005**		
Jan. 1	To balance b/d	31,356	Dec. 31	By Bank Account Sale Proceeds	31,500
Dec. 31	To Sinking Fund Account Profit and sale	144			
		31,500			31,500

5. Insurance Policy Method

In this method, instead of purchasing securities, an insurance policy is purchased for an amount equal to the cost of replacement of asset. The Insurance company agrees to pay a lump sum is return for a sum known as premium to be paid at the beginning of every year.

Accounting Entries

First and subsequent years	
On payment of premium (Beginning of the year)	Depreciation insurance policy a/c Dr. To bank account
When depreciation is provided (End of the year)	Profit and loss account Dr. To depreciation reserve account
Last year	
When policy amount is received on maturity	Bank account . Dr. To depreciation insurance policy a/C
When writing off old asset	Depreciation reserve account Dr. To asset account
For transfer of profit on insurance policy	Depreciation insurance policy a/c Dr. To depreciation reserve account
On purchase of new asset	New asset account Dr To bank account

ILLUSTRATION: 8

On 1st January 2002 a merchant purchased a four years lease of premises costing Rs 50,000. It has been decided to provide for its replacement by means of an insurance policy, the annual premium an which amounts to Rs12,000. Show the necessary accounts recording the depreciation and replacement of the lease.

Solution

Dr. **Leasehold premises account** **Cr**

2002		**Rs.**	**2002**		**Rs**
Jan1	To bank account	50,000	Dec31	By depreciation fund a/c	50,000

Depreciation Fund Account

Dr **Cr**

		Rs			**Rs**
2002 Dec31	To balance c/d	12,000	**2002** Dec 31	By depreciation a/c	12,000
2003 Dec 31	To balance c/d	24,000	**2003** Jan 1	By balance b/d	12,000
			Dec.31	By depreciation account	12,000
		24,000			24,000
2004 Dec 31	To balance c/d	36,000	**2004** Jan 1	By balance b/d	24,000
			Dec 31	By depreciation account	12,000
		36,000			36,000
2005 Dec 31	To leasehold premises account	50,000	**2005** Jan 1	By balance b/d	36,000
			Dec 31	By depreciation account	12,000
			Dec 31	By depreciation fund policy account	2,000
		50 ,000			50,000

Depreciation Fund Policy Account

Dr **Cr.**

		Rs			Rs
2002			**2002**		
Jan 1	To bank account	12,000	Dec 31	By balance c/d	12,000
		12,000			12,000
2003			**2003**		
Jan 1	To balance b/d	12,000	Dec 31	By balance c/d	24,000
Jan 1	To bank account	12,000			
		24,000			24,000
2004			**2004**		
Jan 1	To balance b/d	24,000	Dec 31	By balance c/d	36, 000
Dec 31	To bank account	12,000			
		36,000			36,000
2005			**2005**		
Jan 1	To balance b/d	36,000	Dec 31	By bank account	50,000
Jan1	To bank account	12,000			
Dec 31	To depreciation fund account	2000			
		50,000			50,000

Merits Insurance Policy Method (Insurance policy method)

(1) It provides adequate funds for replacement of assets.

(2) Better security is provided to the investor by assumption of risk by insurance companies.

(3) The insurance company will pay a stipulated amount with which replacement of asset can be made.

Demerits

(1) This method is more expensive since insurance company keeps its own margin.

(2) When policy is surrendered for one reason or other, there is greater loss.

(3) The method is unsuitable, where additions are made to asset during the period.

5. Depreciation Reserve and Repairs Fund Method

In this system, the fund or provision method not only equalizes the burden on profit and loss account but also provides for replacement of asset and repairs too. Depreciation reserve and repairs fund method is a provision one step further than the depreciation fund method.

Journal Entries

1. When the fund is created	Profit and loss account Dr. To depreciation reserve and repairs fund account
2. When payment made for repairs.	Repairs and Renewals account Dr. To bank account
3. When the repairs expenses are transferred.	Depreciation reserve and repairs Fund a/c Dr. To repairs and renewals account
4. On closing the depreciation reserve and repairs fund account.	Depreciation reserve and repairs Fund account Dr. To asset account
5. If there is any difference in fund account it will be transferred to profit and loss account.	It will may be transferred to Profit and Loss Account

ILLUSTRATION: 9

A company decided to create and maintain a Repairs and Renewals Fund by charging to revenue to revenue each year with a fixed amount of Rs.2,000. The actual repairs and renewals for the three years are Rs.1,000; 850 and Rs.950. open ledger account for three years.

Reserve for Repairs and Renewals

Dr . **Cr.**

		Rs			Rs
1st year			**1st year**		
Dec 31	To repair account	1,000	Dec 31	By profit and loss account	2,000
Dec.31	To balance c/d	1,000			
		2,000			2,000
2nd year			**2nd year**		
Dec 31	To repairs account	850	Jan 1	By balance c/d	1,000
Dec 31	To balance c/d	2,150	Dec 31	By profit and loss account	2,000
		3,000			3,000
3rd year			**3rd year**		
Dec 31	To repairs account	950	Jan 1	By balance b/d	2,150
Dec 31	To balance c/d	3,200	Dec 31	By profit and loss account	2,000
		4,150			4,150
			4th year		
			Jan 1	By balance b/d	3,200

(7) Revaluation Method

This is the simplest method. With the help of experts, compare the value of the assets at the end of the year with the value in the beginning of the year.

ILLUSTRATION: 10

On 1st July 2003, a firm has loose tools worth Rs.10, 000. During the year they purchased tools of Rs.6, 000. On October 2003, the loose tool valued at Rs.13, 500. On 1st June 2004, loose tools of Rs.8000 were purchased .during the year tools worth Rs.1000 were stolen by the workers. The remaining tools valued at Rs.20, 000. During the year 2005, tools worth

Rs.800 were broken and sold as scrap for Rs.150. in the same years tools for Rs.800 purchased Dec.2005, tools were valued at Rs.18500. prepare loose tool account and depreciation account for three years.

SOLUTION

Dr. **Loose Tools Account** **Cr**

2002		**Rs**	**2003**		**Rs**
July1	To balance b/d	10,000	Dec.31	By depreciation account	2,500
	To bank account	6,000	Dec.31	By balance c/d	13,500
		16,000			16,000
2004			**2004**	By profit and loss a/c (loss by theft)	1,000
Jan 1	To balance b/d	13,500	Dec.31	By depreciation account	500
Jan 1	To bank account	8,000	Dec.31	By balance c/d	20,000
		21,500			21,500
2005			**2005**	By balance account	150
Jan.1	To balance b/d	20,000	Dec. 31	By depreciation account	2,150
	To bank account	800	Dec. 31	By balance b/d	18,500
		20,800			20,800
2006					
Jan 1	To balance b/d	18,500			

Dr **Depreciation Account** **Cr**

		Rs			Rs
2003 Dec 31	To loose tool a/c	**2,500**	**2003** Dec 31	By profit and loss a/c	2,500
2004 Dec 31	To loose tool a/c	500	**2004** Dec 31	By profit and loss a/c	5,00
2005 Dec 31	To loose tool a/c	2,150	**2005** Dec 31	By profit and loss a/c	2,150

8. Machine Hour Rate Method:

Under this method hourly rate of depreciation is calculated. The cost of the asset is divided by the estimated working hours.

$$\textbf{Depreciation per hour} = \frac{\textbf{Original cost of machine – Scrap Value, if any}}{\textbf{Estimated life of the machine in hours}}$$

ILLUSTRATION: 11

A Machine was purchased on 1st January 2004 at a cost of Rs.50,000 and the cost of installation being Rs.8,000 its expected that its total working life will be 1,00,000 hours. The scrap value may be Rs.3, 000. During the year 2004, the machine worked for 1,200 hours and in 2005 for 1,350 hours. Calculate the depreciation for 2004 and 2005.

SOLUTION:

Expected working life of machine = 1, 00,000 hours

Cost of machine **(Rs. 50,000+8,000)** = Rs.58,000

Scrap value = Rs. 3,000

$$\textbf{Hourly Rate of Depreciation} = \frac{\textbf{Original Cost- Scrap Value}}{\textbf{Life of Asset in hours}}$$

$$= \frac{\text{Rs.58, 000 - 3,000}}{\text{1, 00,000}}$$

= 0.55 paise per hour

Depreciation for 2004 = 1200x 0.55

= Rs.660

Depreciation for 2005 = 1350 x 0.55

= Rs.742.50

9.**KilometerMethod:**

In the undertakings this method is used to calculate depreciation because kilo meter run is the main factor causing depreciation.

1. Estimated life in kilo meters
2. Total cost of vehicle
3. Scrap value , any value

$$\text{Depreciation per kilometre} = \frac{\text{Cost of vehicle – Scrap Value}}{\text{Estimate life (in kilometres)}}$$

ILLUSTRATION: 12

A second hand lorry is purchased for Rs.80, 000 and further spends Rs.35, 000 to put it in good working condition. It’s estimated that the lorry may cover 1, 00,000 kilo meters. Find out the depreciation per kilo meter.

SOLUTON

$$\text{Depreciation per kilo meter} = \frac{\text{Cost of vehicle – Scrap Value}}{\text{Estimate life (in kilometre)}}$$

$$= \frac{80{,}000 + 35{,}000}{1,\ 00{,}000}$$

=Rs.1.15

10. Depletion Method

Depletion means the exhaustion of natural resources, for example, oil well, mineral deposit, timber etc. Here the purchase price is paid for the acquisition of natural resource.

ILLUSTRATION: 13

In 2003, a company acquired a mine at a cost of Rs.3, 00,000. The estimated reserve of minerals in tons is 30, 00,000 0f which 80% is expected to be raised. The first three years raisings are:

2003 - 1, 60,000 tons,

2004 - 2, 24,000 tons,

2005 - 2, 00,000 tons,

Show the Mines Account charging depreciation under the Depreciation method.

SOLUTION

To quantity expected to be extracted:

80% of 30, 00,000 tons = 24, 00,000 tons

Cost of the mine = Rs.3, 00,000

$$\text{Charge per ton} = \frac{\text{Rs.3, 00,000}}{24,\ 00,000} = \frac{1}{8}$$

MINES ACCOUNT

		Rs			Rs
2003 Jan 1	To bank account	3,00,000	**2003** Dec 31	By depreciation a/c **(1,60,000x1/8)**	20,000
			Dec 31	By balance c/d	2,80,000
		3,00,000			3,00,000
2004 Jan 1	To balance b/d	2,80,000	**2004** Dec 31	By depreciation a/c **(2,24,000x1/8)**	28,000
			Dec 31	By balance c/d	2,52,000
		2,80,000			2,80,000
2005 Jan 1	To balance b/d	2,52,000	**2005** Dec 31	By depreciation a/c **(2,00,000x1/8)**	25,000
			Dec 31	By balance c/d	2,27,000
		2,52,000			2,52,000
2006 Jan 1	To balance b/d	2,27,000			

11. Sum of the Years Digits Method:

Depreciation = Remaining life of asset/ Total of all digits representing the life of the assets * Amount to be written off

ILLUSTRATION: 14

An asset has been purchased for Rs 50,000, its effective life being 5 years . The scrap value is estimated at Rs.5000, Depreciation **for** the years is calculated as follows;

SOLUTION: Amount to be written off = Rs.50,000 - Rs.5000 = Rs.45,000
The sum of all digits is i.e. 1+ 2 + 3 + 4 + 5 = 15

First year depreciation	= Rs.45, 000 x 5/15 = Rs.15, 000
Second year depreciation	= Rs.45, 000 x 4/15 = Rs.12, 000
Third year depreciation	= Rs.45, 000 x 3/15 = Rs. 9,000
Fourth year depreciation	= Rs.45, 000 x 2/15 = Rs. 6,000
Fifth year depreciation	= Rs.45, 000 x 1/15 = Rs. 3,000
Total	= Rs.45, 000

PROVISION AND RESERVE:

Provision means the setting aside of certain amount to meet some contingencies which may be expected but not yet incurred. The provision is charge to the profit and loss account and is created to meet any depreciation in the value of an asset or provide for any known liability, the amount of which or cannot be ascertained.

OBJECTIVES:

Thus a provision may be created either

i) For a known reduction in the value of an asset or

ii) For a known liability, the amount of which cannot be ascertained accurately.

iii) That is provision are usually created by debiting the profit and loss account.

Reserve or reserve fund consist of sums set aside out of divisible profits are the purpose of strengthening the financial position of the business. Reserve is the amount set aside out of undivided profits and other surpluses in order to strengthen the financial position of the business, but not designed to meet any liability or contingency known to exist at the date of Balance sheet undistributable profits or surplus asset. Its increase the working capital of the business. A provision is excess of the amount actually needed for the purpose for which it’s created is to be considered as a reserve.

DEFINITION

“Reserve is the amount of set aside out of undivided profits and other surpluses in order to strengthen the financial position of the business , but not designed to meet any liability are contingency known to exist at the date of balance sheet “.

Reserve created for a particular purpose is called a specific reserve, for example, Debenture Redemption reserve fund. Reserve not create for any particular purpose but for increasing working capital and strengthening financial position for the business is called general reserve

DISTINCTION BETWEEN RESERVE AND PROVISION

Reserve	Provision
1. Reserve is an appropriation of profits.	1. A provision is a charge against a profit.
2. Reserves are created to strengthen the financial resources of a concern.	2. Provision is created to meet some known liability, the amount of which is not certain.
3. It's shown always on the liability side of the balance sheet.	3. It can be shown on the liability side of the balance sheet are shown as a deduction from the asset concerned on the asset side.
4. It can be invested outside the business.	4. It cannot be invested elsewhere.
5. It is not created when there is no profit.	5. It is created even if there is no profit.
6. Creation of reserve depends on the decision of the directors.	6. Creation of provision is a must for redemption of liability and this does not depends upon the decision of directors.
7. It helps the inner worth or intrinsic value of the business to increase.	7. It helps to meet and adjust future losses or expenses.
8. In case of need, it may be distributed to shareholders as dividend.	8. Provision cannot be distributed to shareholders as dividend.

UNIT-IV

SINGLE ENTRY

Introduction:

Single entry is that practice which falls short of Double Entry. In single entry system, businessman do not follow any uniform system or scientific principles and the records maintained are mostly incomplete. It is more appropriate to call it an incomplete system recording transactions. The double effect of every transaction is ignored.

Types of single entry system:

1. Pure Single Entry System:

Small shopkeepers or hawkers keep their books under Pure Single Entry System , where only personal accounts are maintained;

2. Simple Single Entry System:

Personal accounts, books and cash books are maintained.

3. Quasi Single Entry System:

Personal accounts, few subsidiary books and cash books are maintained.

SALIENT FEATURES

1. The system is adopted by sole traders, who keep only personal accounts and ignore all other accounts.
2. It has a Cash Book which contains both business transactions as well as personal transactions, mixing of both transactions.
3. In a business concern, there may be purchases and sales. To know the purchases and sales, one has to depend on original vouchers.
4. This system does not follow uniformity and differ from firm to firm because of individual requirements and convenience.
5. This system gives only partial information.
6. It needs less number of books and is suitable only to petty trades.

DIFFERENCE BETWEEN DOUBLE ENTRY AND SINGLE ENTRY

Double Entry System	Single Entry System
1. The two-fold aspects as all transactions are recorded.	1. No such system is followed
2. All accounts-Personal, Real and Nominal are prepared.	2. Only Personal and Cash accounts are kept.
3. Trial Balance can be prepared to check the arithmetical accuracy.	3. Trial Balance cannot be prepared. Thus, there is no scope to check the arithmetical accuracy.
4. Final Accounts can be prepared.	4. No Trading and Profit and Loss and Balance Sheet can be prepared.
5. This system is accepted by all.	5. It is not accepted by all.
6. The system follows scientific basis.	6. There is no scientific basis.
7. Reliable financial position can be known.	7. Rough financial position is available.
8. This system is suitable for all types of business of any size-big or small	8. This system is suitable and followed by only in small businesses.
9. Planning and decision-making are possible	9. Nothing is possible.
10. Internal check up is possible.	10. No such check up is possible.

Limitation of Single Entry

1. Full information about the business cannot be obtained because incomplete records are maintained.
2. The arithmetical accuracy of the accounts (i.e., Trial Balance) cannot be tested in the absence of Double Entry.
3. In the absence of arithmetical test, the risk of fraud and errors and their non-discovery is increased.
4. It is not possible to prepare a Profit and Loss Account as nominal accounts are not maintained and so the source of profit or loss cannot be ascertained.
5. To know the profit or loss, Statement of Affairs at the beginning and at the end are prepared. But the reasons for the profit or loss are not known.
6. Balance Sheet cannot be drawn up because real account is not maintained. Therefore, true financial position cannot be known.

7. Comparison of business from year to year is not possible because statistical data are absent.
8. Errors are quite common. Errors happened cannot be traced out easily.
9. At the time of disposal of business, problems arise in proper valuation of intangible assets e.g., Goodwill.
10. Counter check is not at all possible, as in Double Entry System.

ASCERTAINMENT OF PROFIT

Every businessman wishes to know the amount of profit or loss during any year. There are two methods by which the profit or loss can be ascertained and they are:

1. Net Worth Method (Statement of Affairs Method) (or Net Asset Method)
2. Conversion Method.

1. Net worth Method: Under this system, i.e., Net worth Method, a trader has to prepare two Statements of Affairs, one at the beginning and other at the end. From these Statements, the amount of Capital at the beginning as well as at the end is ascertained. Then the comparisons of the capitals reveal the profit or loss made during the period. This system is also known as Capital Comparison Method.

The following is the procedure to be adopted and through which the profit or loss can be ascertained from the books, which are written under Single Entry System.

Step1. A Statement of Affairs at the beginning of the period is prepared to find out the amount of capital invested in the beginning. This is done when the capital is not given; because the purpose of preparing the Statement of Affairs is to know the Capital or Net Worth.

Step2 In the same manner, a statement of affairs at the closing period is prepared to ascertain the Capital or Net Worth at the end.

Step3. The Capital derived at the step 2 may be adjusted by adding back the drawings, if any, by the proprietor. That is, the amounts of drawings are to be added to the closing capital because, the capital would have been more to that extent of amount drawn by the proprietor. For instance a proprietor has withdrawn Rs 5,000 from the business and this means the closing Capital would have been less by Rs 5,000. Had he not withdrawn Rs 5,000, then the Capital at the end would have been more by Rs 5,000.

Step4. In addition to the initial Capital, it is possible that a trader might have invested fresh amount of capital in the business during the course of the year the closing capital would have been less in the absence of additional Capital. That is, additional Capital will increase the Capital of the proprietor at the end of the accounting period. Therefore, it is necessary to reduce the amount of fresh Capital from the amount of Capital at the end. This is because the closing Capital would have been less, in the absence of additional Capital during the accounting period.

Step5. The beginning Capital as ascertain (in Step 1) should be deducted from the adjusted capital. Adjusted Capital means Closing Capital (as in Step 2) is added to the amount of Drawals (as in Step3) then from this, the amount of Additional Capital (as in Step 4) is deducted. In other words, Adjusted Capital =Closing Capital (as in Step 2) + Drawings (as in Step 3) – Additional Capital (as in Step 4).

The Comparison of the Capital (adjusted Capital) at the end and the Capital at the beginning shows some difference, which is either gain or loss. If the adjusted Capital at the close is more than the Capital in the beginning, the trader has made a profit to the extent of excess. If, On the other hand, the adjusted Capital is less than the initial Capital, there is a loss. Then the Profit or Loss so arrived may further be adjusted for Depreciation, Interest on Capitals, Interest on Drawings, Provision for Doubtful Debts etc.; the resultant figure is net profit or Net Loss.

Steps to prepare Statement of Affairs

A Statement of Affairs is just like a Balance Sheet. When preparing a Statement of Affairs, the following points may be given attention, (in brief);

1. Find out the correct Cash and Bank balances.
2. Record correct stock through physical stock taking.
3. Value of assets should be ascertained from vouchers and other sources. Depreciation on assets should be provided.
4. Summaries the amount payable and receivable-Sundry Debtors and Sundry Creditors.

5. Verify all the accounts of expenses and incomes outstanding and paid in advance.

All these items to be entered in the statements. The difference between the liability side and the asset side is the amount of capital.

STATEMENT OF PROFIT

Statement of Profit or loss for the year………

Capital at the end	………………
Add: Drawings	………………
	………………..
Less: Additional Capital introduced	………………..
	………………
Less: Capital at the beginning	………………
Profit or Loss subject to adjustment	………………..

Alternatively:

Net Income = [Closing Capital + Drawings – Further Capital introduced] – Opening Capital

Balance Sheet	Statement of Affairs

1. It is prepared on the basis of those books which are maintained in Double Entry.	1. It is prepared on the basis of those books which are maintained partly on the basis of Double Entry and partly on the basis of Single Entry.
1. It is possible to prepare a Trial Balance, on the basis of books. Thus the arithmetical accuracy can be verified	2. It is not possible to prepare a Trial Balance, on the basis of books. Therefore, arithmetical accuracy cannot be verified.
2. Capital is taken from the Capital Account maintained in the ledger.	3. Capital Account is not maintained. Excess Of assets over liabilities is treated as Capital.
3. The purpose of Balance Sheet is to find out the financial position of the firm.	4. The purpose of Statement of Affairs is to find out Capital.
4. The value of assets and liabilities in a Balance Sheet are based on ledger balances.	5. Value of Assets and liabilities in a Statement of Affairs are prepared on the basis of estimates, except the figures of Debtors, Creditors, Cash and Bank.
5. mission of assets or liabilities can easily be found out when Balance Sheet disagrees	6. It is difficult to trace out omission of assets or liabilities in a Statement of Affairs.

ILLUSTRATION: 1

From the following information, calculate the profit earned by a petty trader during the year 2004:

		Rs
Capital as on	31.12.2004	66,000
Capital as on	1.1.2004	65,000
His Drawing during	2004	12,000
Further Capital introduced by him		7,000

SOLUTION

Statement of Profit for the year 2004

	Rs
Capital as on 31st December 2004	66,000
Add: Drawings during 2004	12,000
	78,000
Less: Further Capital introduced in 2004	7,000
Adjusted Capital	71,000
Less: Capital as on 1.1.2004	65,000
Profit made during the year (2004)	**6,000**

ILLUSTRATION .2

Mr. Ram informs you that he had started a business on 1.1.2004 with a capital of Rs 20,500 and on 31.12.2004 his capital was Rs 32,800. Further, he informs you that he gave his son Rs 2,000 and he withdraws Rs 500 every month for personal purpose. He had a scooter, which had been sold for Rs 5,000 and invested the same into the business. Further, there is no other information.

Calculate the amount of profit made by him during the year 2004.

		Rs
Capital at the end (given)		32,800
Add: Withdrawals:		
Expense for his son	2,000	
Withdrawals @ Rs 500 per month (Rs.500x12month)	6,000	
		8,000
		40,800
		5,000
Less: Further Capital introduced		35,800
Adjusted Capital at the end		
		20,500
Less: Capital in the beginning (1.1.2004)		
Profit made for the year 2004		15,300

Note: In this problem, his closing capital would have been Rs 8,000 (Rs 2,000 + Rs 6,000) more, had he not withdrawn money from his business.

Similarly, had he not introduced fresh capital of Rs 5,000, his closing capital would have been Rs 5,000 less than what it is now.

ILLUSTRATION 3

Mr.Gopal started a business with Rs 30,800 0n 1.1.2004. The drawings during the year amounted to Rs 16,400 and further Capital of Rs 9,600 was introduced on 1st July 2004. Prepare statement to show profit and loss made during the year from the following particulars, as on 31st December 2004

Creditors	38,800
Debtors	24,600
Furniture	4,800
Machinery	6,600
Cash	1,800
Investments	23,600
Bill Payable	10,800
Stock	22,200
Bank Overdraft	7,600

Write off Rs 1,200 towards Bad Debts and a further of 5% is to be made towards Doubtful Debts. Depreciate Furniture by 5% and Machinery by 10%

Outstanding salaries Rs 480 and prepaid Rent Rs 320.

SOLUTION

Statement of Affairs as on 31st December 2004

Liabilities	Rs		Assets	Rs
Creditors	34,800		Cash	1,800
Bank Overdraft	7,600		Debtors	24,600
Bills Payable	10,800		Prepaid Rent	320
Salary Outstanding	480		Stock	22,200
Capital (Balancing Figure)	**30,240**		Investments	23,600
			Furniture	4,800
			Machinery	6,600
	83,920			83,920

Statement of profit for the year ended 31st Dec. 2004

		Rs
Capital as on 31st Dec. 2004		30,240
Add: Drawings		16,400
		46,640
Less: Additional Capital introduced		9,600
Adjusted Capital		37,040
Less: Capital as on 1st January 2004		30,800
Profit before Adjustments:		6,240
Less: Bad Debts		
Reserve for Doubtful Debts	1,200	
Depreciation: Furniture	1,170	
Depreciation: Machinery	660	3,270
Profit for the year 2004		2,970

Adjustment Statement of Affairs

as on 31st December 2004

Liabilities		Rs	Assets		Rs
Creditors		34,800	Cash		1,800
Bank Overdraft		7,600	Debtors:	24,600	
Bills Payable		10,800	**Less:** Bad Debts	1,200	
Salaries: Outstanding		480		23,400	
Capital (1.1.2004)	30,800		**Less:** Provision for doubtful debt	1,170	
					22,230
Add: Net Profit	2,970				
			Rent Prepaid		320
	33,770		Stock		22,200
Add: Additional capital	9,600		Investments		23,600
	43,370		Furniture	4,800	
Less: Drawings	16,400		**Less:** Depreciation	240	
					4,560
		26,970	Machinery	6,600	
			Less: Depreciation	660	5,940
		80,650			80,650

Note: 1. Opening Statement of Affairs is not prepared because the opening capital is given in this problem.

2. Adjusted Statement of Affairs incorporates all adjustments

ILLUSTRATION: 4

Following balances are extracted from the books of Joseph, who keeps incomplete records of his transactions:

	1st Jan. 2004	31st Dec. 2004
	Rs	**Rs**
Stock	2,400	3,000
Debtors	4,000	3,200
Creditors	1,700	3,900
Cash in Hand	2,000	3,800
Bank Overdraft	2,400	-
Furniture and fittings	800	1,000
Motor Bike	9,500	9,500
Bills Receivable	2,000	4,300

Drawings during the year amounted to Rs 2,800. Depreciate Furniture and Fittings @ 5% and write off Rs.500 on Motor Bike. Rs.100 is irrecoverable and a further provision of 5% for Doubtful Debts is to be provided. Further, provisions of Rs.200 in respect of bills are also to be provided.

Ascertain the profit or loss for the year ended 31st December 2004 and prepare a Statement of Affairs as on that date.

SOLUTION

Statement of Affairs as on 1st Jan., 2004

Liabilities	Rs	Assets	Rs

Bank Overdraft Creditors Capital (Balancing figure or Excess of assets over liabilities)	2,400 1,700 16,600 20,700	Cash in Hand Stock Bills Receivable Debtors Furniture and Fittings Motor Bike	2,000 2,400 2,000 4,000 800 9,500 20,700

Statement of Affairs as on 31st Dec., 2004

Liabilities	**Rs**	**Assets**	**Rs**
Creditors	3,900	Cash in Hand	3,800
Capital (Balancing Figure)	20,900	Stock	3,000
		Bills Receivable	4,300
		Debtors	3,200
		Furniture and Fittings	1,000
		Motor Bike	9,500
	24,800		24,800

Statement of Profit or Loss for the year 2004

		Rs
Capital at the end (31.12.200)		20,900
Add: Drawings during the year		2,800
Adjusted Capital		23,700
Less: Capital at the beginning (1.1.2004)		16,600
Profit, subject to adjustments:		7,100
Less: Bad Debts	100	
Provision for Doubtful Debt	155	
Provision (B/R)	200	
Depreciation: Furniture	50	
Motor Bike	500	1,005
Profit for the year 2004		6,095

Adjusted Statement of Affairs as on 31st December 2004

Liabilities	Rs	Assets	Rs

Creditors			Cash in Hand		3,800
Capital:	16,600	3,900	Stock		3,000
Less: Drawings	2,800		Bills Receivable:	4,300	
			Less: Provision	200	
	13,800		Debtors:	3,200	
Add: Profit	6,095		**Less:** Bad Debts	100	
		19,895			
				3,100	
			Less: Provision for Doubtful Debts	155	
					2,945
			Furniture and Fittings	1,000	
			Less: Depreciation	50	
					950
			Motor Bike	9,500	
			Less: Depreciation	500	
					9,000
		23,795			23,795

2. CONVERSION METHOD

The Net worth Method does not provide clear operational results of a firm. It does not provide the needed accounting information. In the absence of complete records, the correct profit and financial position cannot be known. Therefore, a trader may wish to convert the Single Entry System into Double Entry so that he can prepare final accounts, which reveal the exact financial position of the business, apart from knowing the correct profit. The work involved in the conversion of Single Entry into Double Entry will vary with the set of books maintained. The following procedure may be followed for conversion:

1. A Statement of Affairs at the beginning period (at the end of the previous period) should be prepared and open all those assets and liabilities account which have not been already opened. It is possible that some of the items, for the Statement of Affairs, are missing, such as, Debtors or Creditors or Cash –in-hand or any other items at the beginning. If it is so, one has to find them out by preparing ledger accounts.
2. Cash Book should be verified and the unposted items, from the debit side and credit side of the Cash Book, should be posted to respective accounts, because generally Nominal Accounts and Real Accounts might not have been opened under Single Entry. Cash balance shown by

the Cash Book with Cash-in-hand should be compared. In certain cases, opening balance, closing balance, etc.

3. Impersonal accounts (mainly Sales Account, Purchase Account etc.) must be verified to know the correct figure of sales or purchases. These figures might not have given in Single Entry. Thus, Credit Sales or Credit Purchases may be found out by preparing Total Debtors Account or Total Creditors Account.

4. Similarly, verify the Cash Book entries relating to discount, allowances, commission etc. To be posted to respective accounts, if not posted already, or open such account if not opened already.

5. Even if no records are kept in respect of certain transactions, such transactions must be journalized and posted. In fact, conversion of Single Entry into Double Entry involves the complete process of journalizing, postings and preparation of Trial Balance. Theoretically, it is possible but practically it is a tedious process and consumers a lot of time.

Therefore, one should search out the figures which are needed for the preparation of final accounts. The pieces of information may be scattered in the problem or they may be missing. If such information is missing, it should be got by preparing necessary accounts, before proceeding to prepare final accounts i.e. Trading Account, Profit and Loss Account and Balance Sheet. The following figures are needed:

FOR TRADING ACCOUNT (Dr. side)	Opening Stock Purchases Direct Expenses Manufacturing Expenses
FOR TRADING ACCOUNT (Cr. Side)	Sales Closing Stock
FOR PROFIT & LOSS A/C (Dr. side)	Indirect Expenses and Losses Depreciation etc.
FOR PROFIT & LOSS A/C (Cr. Side)	Gross Profit Gain and Income etc.
FOR BALANCE SHEET (Asset side)	Cash in hand and Bank Sundry Debtors/Bills Receivable Fixed Assets Closing Stock
FOR BALANCE SHEET (Liability side)	Sundry Creditors/Bill Payable Capital Net Profit/Loss Drawings etc.

How to search out the missing or required information? They are in brief

Items	From where to find out
Opening Stock	Statement of Affairs Or Memorandum Trading Account
Cash Purchases Credit Purchases	Cash Book (Credit side) Total Creditors Account Or Other information
Manufacturing Expenses Buying Expenses Purchase Returns Cash Sales Credit Sales Sales Returns Closing Stock	Cash Book or other information Cash Book or other information Other information Cash Book or other information Total Debtors Account or other information Other information Closing Balance of Stock Account Or other information
Gross Profit/Loss	Trading Account

	Items	From where to find out
Profit & Loss A/C (Dr. side)	Discount Allowed, Bad debts etc. Selling Expenses Gross Loss	Total Debtors Account Or other information given Payment side of the Cash Book and adjustments or through Information given Trading Account
Profit & Loss A/C (Cr. Side)	Gross Profit Incomes Received Incomes Receivable	Trading Account Cash Book Given information.
Balance Sheet (Asset)	Cash/Bank Balance Closing Debtors Closing Bills Receivable Assets (New) Assets (Old) Additional made to assets	Opening Statement of Affairs Or other information given Total Debtors Account Or given information Bills Receivable Account Or given information Cash Book or given information From Opening Statement of Affairs Cash Book

Balance Sheet (Liability)	Bank Overdraft Sundry Creditors (Closing) Bills Payable (Closing) Capital (Closing) Additional Capital Net Profit/Loss Drawings Interest on Capital	Cash Book Total Creditors Account Or given information Bills payable Account Or given information Statement of Affairs (Beginning) Cash Book Profit and Loss Account Cash Book (Payment side) Other information.

Some practical approach to find out missing figures is explained below:

ILLUSTRATION 5: (Missing value of Opening Stock)

During the year 2004, the following transactions took place:

	Rs
Purchases during the year	75,000
Sales during the year	1, 25,000
Closing Stock on Dec. 2004	15,000
Manufacturing Expenses	10,000

Rate of Gross Profit was 25% on cost. Find out the Opening Stock

SOLUTION

When opening stock is missing, it can be found out by preparing a Memorandum Trading Account.

Memorandum Trading Account

Dr. **Cr.**

	Rs		Rs
To Opening Stock (Balancing figure)	30,000	By Sale	1,25,000
To Purchases	75,000	By Closing Stock	15,000
To Manufacturing Expenses	10,000		
To Gross Profit	25,000		
	1,40,000		1,40,000

25% on cost = 20% on sales

Therefore gross profit = 20% of Rs 1, 25,000 = Rs 25,000

Credit purchase or Credit sales can be known by preparing Total Creditors Account or Total Debtors Account.

1. **Total Debtors Account:**

Total Debtors Account is to be prepared to find out either the missing CREDIT SALES or CLOSING BALANCE OF DEBTORS or OPENING BALANCE OF DEBTORS, in the following manner.

Total Debtors Account

Dr. **Cr.**

	Rs			Rs
To Opening Balance (either given or Balance figure)			By Cash Received	
To Bills Receivable Dishonoured			By Bills Receivable	
To Credit Sales (either given or Balancing figure)			By Discount Allowed	
			By Returns Inwards	
			By Bad Debts	
			By Transfer to Creditors	
			By Balance (either given or Balancing figure)	

2. **Total Creditors Account:**

Total Creditors Account is to be prepared to find out either the missing CREDIT PURCHASES or CLOSING BALANCE OF CREDITORS or OPENING BALANCE OF CREDITORS, in the following manner.

Total Debtors Account

Dr. **Cr.**

To Cash Paid To Bills Payable To Return Outwards To Discount Received To Transfer to Debtors To Balance c/d (either given or Balancing figure)	**Rs**		By Balance b/d (either given or Balancing figure) By Bills Payable Dishonoured By Credit Purchase (either given or Balancing figure)	**Rs**

3. Bills Receivable Account:

It is prepared to find out either to know the Bills Receivable received from Debtors or to know the closing balance.

Dr. **Bills Receivable Account** **Cr.**

Rs To Opening Balance(either given Or Balancing figure) To Sundry Debtors (Bills Receivable received) (either or Balancing figure)	**Rs** By Cash (on Bills) By Sundry Debtors (Bills dishonoured) By Balance c/d (either or Balancing figure)

4. Bills Payable Account:

It is to be prepared to find out either to know Bills Payable accepted or to know the closing balance

Dr. **Bills Payable Account** **Cr.**

To Cash (against Bills) To Sundry Creditors (Bills dishonoured) To Closing Balance (either given or Balancing figure)	**Rs**		By Balance b/d By Sundry Creditors (Bills Accepted)	**Rs**

ILLUSTRATION 6:

During the year 2004, the following transactions took place and you are required to find out the amount of Credit purchase made during the year.

	Rs
Balance of Creditors on Jan 2004	16,000
Cash paid to Creditors during the year	30,000
Bills Payable accepted during the year	8,000
Purchase Returns	1,000
Balance of Creditors on Dec. 2004	17,000

SOLUTION

When the credit purchases are missing, we have to prepare the Total Creditors Accounts to know the amount of credit purchase.

Dr. **Total Creditors Account** **Cr.**

	Rs.		Rs.
To Cash Paid	30,000	By Balance b/d	16,000
To Bills Payable Accepted	8,000	By Purchases	
To Purchase Returns	1,000	(Balance figure)	40,000
To Balance c/d	17,000		
	56,000		56,000

Thus the credit purchases during that year are Rs 40,000.

There may arise occasions where Bills Payable Accepted during the year may be missing. In such a situation, first the Bills Payable Account is to be prepared to find out the amount of

Bills accepted during the year; and then the Total Creditors Account is prepared to find out the Credit Purchases.

ILLUSTRATION: 7 (Missing value of Bills Accepted during the year and Credit Purchases)

From the following facts supplied by A who keeps his books on Single Entry, you are required to calculate total purchases:

	Rs
Opening Balance of Bills Payable	5,000
Opening Balance of Creditors	6,000
Closing Balance of Bills Payable	7,000
Closing Balance of Creditors	4,000
Cash paid to Creditors during the year	30,200
Bills payable discharged during the year	8,900
Returns Outwards	1,200
Cash Purchases	25,800

SOLUTION

Dr. Bills Payable Account Cr.

	Rs		**Rs**
To Cash	8,900	By Balance b/d	5,000
To Balance c/d	7,000	By Creditors (Bills Accepted during the year) (Balancing figure)	10,900
	15,900		15,900
		By Balance b/d	7,000

Dr. Total Creditors Account Cr.

	Rs.			Rs.
To Cash To Returns To Bills Payable To Balance c/d	30,200 1,400 10,900 4,000		By Balance b/d By purchase (credit) (Balance figure)	6,000 40,300
	46,300			46,300
			By Balance b/d	4000

Total Purchases:

Cash Purchases	25,800
Credit purchases	40,300
Total Purchases	66,100

ILLUSTRATION: 8 (Missing value of Credit Sales)

From the following, find out the credit sales:

	Rs
Cash Received from Debtors	53,000
Discount Allowed to them	800
Return inward	1,500
Balance of Debtors on Jan. 2004	10,000
Balance of Debtors on Dec. 2004	9,500
Bills Receivable from Debtors	13,000
Bad Debts during the year 2004	7,000
Bills Dishonoured by debtors	950

SOLUTION

Dr. **Total Debtors Account** **Cr.**

	Rs		Rs
To Balance b/d	10,000	By Cash	53,000
To Bills Dishonoured	950	By Discount	800
To Credit Sales	67,550	By Returns Inwards	1,500
(Balancing figure)		By Bills Receivable	13,000
		By Bad Debts	700
		By Balance c/d	9,500
	78,500		78,500

Sometimes, the bills receivable received during the year may not be available in the problem. In such cases first prepare the Bills Receivable account so that the amount of Bills Receivable received during the year can be known. This figure appears on the credit side of the Total Debtors Account. Then the Total Debtors Account is prepared.

ILLUSTRATION: 9 [Finding (i) Bills Receivable received during the year and (ii) Credit sales]

From the following find out the amount of credit sales made during the year 2004

Bills Receivable encashed during 2004	19,000
Cash Received from debtors during the year	15,000
Balance of Bills Receivable on Jan. 2004	6,000
Balance of Bills Receivable on Dec. 2004	7,000
Balance of Debtors on Jan. 2004	19,000
Bad Debts written off	200
Returns Inwards	300
Bills Receivable Dishonoured	1,000
Balance of Debtors on Dec. 2004	15,000

SOLUTION

Dr. **Bills Receivable Account** **Cr.**

	Rs		Rs
To Balance b/d	6,000	By Cash	19,000
To Sundry Debtors	21,000	By Sundry Debtors	1,000
(Bills Received)		(Bills dishonoured)	
(Balancing figure)		By Balancing c/d	7,000
	27,000		27,000

Dr. **Total Debtors Account** **Cr.**

	Rs		Rs
To Balance b/d	19,500	By Cash	15,000
To Bills Dishonoured	1,000	By Bad Debts	200
To Credit Sales	31,000	By Bills Receivable Received	21,000
(Balancing figure)		By Returns Inwards	300
		By Balance c/d	15,000
	51,500		51,500

ILLUSTRATION 10: (Finding credit purchases and credit sales)

Ascertain credit purchase and credit sales from the following:

	Rs
Sundry Debtors on 1.2.2004	12,809

Sundry Debtors on 31.12.2004	9,800
Sundry Debtors on 1.1.2004	7,600
Sundry Creditors on 31.12.2004	9,030
Cash Received from Debtors	6,400
Cash paid to creditors	1,750
Discount Allowed	350
Discounted Received	250
Bills Received from Debtors	2,500
Acceptance given to creditors	5,870
Bad Debts	300
Bills Dishonoured by Debtors	400

SOLUTION

Dr. Total Debtors Account Cr.

	Rs			Rs
To Balance b/d	12,800		By Cash	6,400
To Bills Receivable Dishonoured	400		By Discount	350
To Sales (Credit			By Bad Debts	300
(Balancing figure)	6,150		By Bills Receivable	2,500
			By Balance c/d	9,800
	19,350			19,350
To Balance b/d	9,800			

Dr. Total Creditors Account Cr.

	Rs			Rs
To Cash	1,750		By Balance b/d	7,600
To Discount	250		By Purchases (Credit)	
To Bills Payable	5,870		(Balancing figure)	9,300
To Balance c/d	9,030			

	16,900		By Balance b/d	16,900 9,030

ILLUSTRATION 11:

Mr. Manoharan kept no books of account for his business. An analysis of his rough Cash Book for the year 2004 showed the following particulars:

Receipts	**Rs**		**Payments**	**Rs**
Received from Debtors	60,000		Overdraft (Jan. 2004)	
Further Capital	5,000		Paid to creditors	7,400
			Business Expenses	25,000
			Wages Paid	10,000
			Drawings	15,500
			Balance at Bank	3,000
			Balance of Cash in Hand	4,000
				100
	65,000			65,000

Further, the following information is also available:

	31.12.2003	31.12.2004
	Rs	**Rs**
Debtors	53,000	88,000
Creditors	15,000	19,500
Stock-in-hand	17,000	19,000
Plant	20,000	20,000
Furniture	1,400	1,400

All his sales and purchases were on credit. From the above particulars, prepare Trading and Profit and Loss Account for the year ended 31st December 2004 and a Balance Sheet as on that date after providing for depreciation on Plant at 10% and on Furniture at 5% p.a.

SOLUTION

Let us solve the problem in both the ways. That first we solve it under Capital Comparison Method and then under Conversion Method

(a) Capital Comparison Method: (Net worth Method)

Statement of affairs

Liabilities	As on 31.12.2003	As on 31.12.2004	Assets	As on 31.12.2003	As on 31.12.2004
	Rs	Rs			Rs
Creditors	15,000	19,500	Cash at Bank	-	4,000
Bank Overdraft	7,400	_	Cash in Hand	-	100
Capital(Balancing Figure)	69,000	1,13,000	Sundry Debtors	53,000	88,000
			Stock-in Trade	17,000	19,000
			Plant	2o,000	20,000
			Furniture	1,400	1,400
	91,400	1,32,500		91,400	1,32,500

Statement of Profit or Loss

For the year ended 31st Dec. 2004

		Rs
Capital as on 31st Dec. 2004		1,13,000
Add: Drawings during the year		3,000
		1,16,000
Less: Further Capital		5,000
Adjusted Capital		1,11,000
Less: Capital as on 31st Dec. 2003		69,000
Profit:		42,000
Less: Depreciation: Plant	2,000	
Furniture	70	2,070
Final Profit		39,930

Statement of Affairs with Adjustments

as on 31st December 2004

Liabilities		Rs	Assets		Rs
Creditors		19,500	Cash in Hand		100
Capital:	69,000		Cash at Bank		4,000
Add: Net Profit	39,930		Debtors		88,000
Add: Additional capital	5,000		Stock		19,000
			Furniture	1,400	
	1,13,930		Less: Depreciation	70	1,330
Less: Drawings	3,000	1,10,930			
			Plant	20,000	
			Less: Depreciation	2,000	18,000
		1,30,430			1,30,430

B) **Conversion Method:** We have to find out credit sales and opening capital. Thus we have to prepare Total Creditors Account, Total Debtors Account and Statement of Affairs as on 31.12.2004

Trading and Profit and Loss Account for the year ended 31st Dec. 2004

Dr. **Cr.**

	Rs		Rs
To Stock on 1.1.2004	17,000	By Sales	95,000
To Purchases	29,000	By Stock on 31. 12. 2004	19,000
To Wages	15,500		
To Gross Profit c/d	52,000		
	1,14,000		1,14,000
To Business Expenses	10,000	By Gross Profit b/d	52,000
To Depreciation:			
Plant	2,000		
Furniture	70		
To Net Profit, transferred to Capital A/c	39,930		
	52,000		52,000

Balance Sheet as on 31st December 2004

Liabilities	Rs	Assets	Rs
Creditors	19,500	Cash in Hand	100
Capital: 69,000		Cash at Bank	4,000
Add: Net Profit 39,000		Debtors	88,000
Add: Additional capital 5,000		Stock	19,000
		Furniture 1,400	
1,13,930		**Less:** Depreciation 70	1,330
Less: Drawings 3,000	1,10,930		
		Plant 20,000	
		Less: Depreciation 2,000	18,000
	1,30,430		1,30,430

Working Notes:

1. **CALCULATION OF CREDIT PURCHASES:**

Dr **Total creditors Account** **Cr.**

	Rs		**Rs**
To Cash	25,000	By Balance b/d (Dec. 2003)	15,000
To Balance c/d (Dec. 2004)	19,500	By Purchases (Balancing figure)	29,500
	44,500		44,500

Alternative methods to find out credit purchases

		Rs
	Closing Balance of Creditors (Dec. 2004)	19,500
Add:	The amount paid during the year	25,000
		44,500
Less:	Opening Balance of Creditors (Dec. 2003) (i.e., the amount outstanding against Previous years purchase)	15,000

The amount of Credit purchase during the year 2004 29,500

(Jan. to Dec.) =======

1. CALCULATION OF CREDIT SALES:

Dr. Total Debtors Account Cr.

	Rs		Rs
To Balance b/d (Dec. 2003)	53,000	By Cash	60,000
To Sales (Balancing figure)	95,000	By Balance c/d (Dec. 2004)	88,000
	1,48,000		1,48,000

Alternative method to find out credit sales

	Rs
Closing Balance of debtors (Dec. 2004)	88,000
Add: The amount received during the year	60,000
	1,48,000
Less: Opening Balance of debtors (Dec. 2003) (i.e., the amount outstanding against previous Years sales)	53,000
The amount of credit sales during the year 2004 (Jan. to Dec.)	95,000

2. FIND OUT THE OPENING CAPITAL

Statement of Affairs as on 31st December 2003

Liabilities	Rs	Assets	Rs
Creditors	15,000	Debtors	53,000
Bank Overdraft	7,400	Stock	17,000
Capital (Balancing figure)	69,000	Furniture	1,400
		Plant	20,000
	91,400		91,400

ILLUSTRATION 12:

Mr. Kumar does not keep his book on double entry system. From the following information, prepare his final accounts for the year ended 30th June 2004

His position on 1st July 2003 was as follows:

	Rs		Rs
Stock	12,500	Debtors	27,500
Buildings	20,000	Creditors	9,500
Furniture	5,000s		

Cash Book analysis revealed the following facts:

	Rs		Rs
Bank overdraft	5,500	Cash purchases	8,250
Interest on above	375	Salary	1,500
Receipt from Debtor	35,000	Sundry Expenses	3,250
Cash Sales	12,500	Rent and Rate	600
Payment to creditors	20,000	Drawings	1,500

From the analysis of personal accounts, it was found that the trader allowed discount Debtors amounted to Rs 1,750 and received discount from Creditors amounted to Rs 1,000. Gopi, a Debtor, from whom Rs 300 were due, paid only Rs 150, balance being treated as Bad Debt.

On 30th June 2004 he had Balance at Bank Rs 6,525, Stock valued at Rs 20,000; Debtors Rs 33,000; Bills Receivable Rs 1,500; creditors Rs 9,500 and bills payable Rs 2,000. Provide depreciation on Building at 10% interest on Capital at 5% and create provision for doubtful debts of Rs 1,200.

SOLUTION

In this problem the missing figures are (1) credit sales (2) credit purchases and (3) opening capital. See working notes:

Dr. **Trading and Profit and loss Account** **Cr.**

	Rs		Rs
To Stock	12,500	By Sales:	
To Purchases:		Cash 12,500	
Cash 8,250		Credit 43,950	
Credit 23,000	**31,250**		**56,450**
		By Stock closing	20,000
To Gross profit	32,700		
	76,450		76,450
To Salaries	1,500	By Gross profit b/d	32,700
To Sundry expenses	3,250	By Discount received	1,000
To Rent and rate	600		
To Interest	375		
To Discount allowed	1,750		
To Bad debts	150		
To Provision for doubtful debts	1,200		
To Depreciation on buildings	2,000		
To Interest on capital	2,500		
To Net profit, transferred to capital a/c	20,375		
	33,700		33,700

Balance Sheet as on 30th June 2004

Liabilities		**Rs**	**Assets**		**Rs**
Bills payable		2,000	Cash at bank		
Creditors			Stock		
Capital:			Bills received		
ON 1.7.2003	50,000		Debtors	33,050	
Add: Interest	2,500		**Less:** Provision	1,200	
Add: Net profit:	20,375			20,000	
	72,875		Buildings:		
Less: Drawings	1,500		**Less:** Depreciation	200	
		71,375			18,000
			Furniture		5,000
		82,875			**82,875**

Working Note:

(1) Credit Sales is found out preparing total debtors account.

Dr. Cr.

	Rs		Rs
To Balance b/d	27,500	By Cash	35,000
To Sales (Balancing figure)	43,950	By Discount allowed	1,750
		By Bills receivable	150
		By Bad debts	1,500
		By Balance c/d	33,050
	71,450		**71,450**

(2) **Credit Purchases is found by preparing total debtors account.**

Dr. **Total Creditors Account** Cr.

	Rs		Rs
To Cash	20,000	By Balance b/d	9,500
To Bills payable	2,000	By Purchases (Balancing fig.)	23,000
To Discount	1,000		
To Balance c/d	9,500		
	32,500		**32,500**

(3) Capital is found out by preparing Statement of Affairs

Statement of Affairs as on 1st July 2003

	Rs		Rs
Liabilities	5,500	Assets	12,500
Bank overdraft		Stock	27,000
Creditors	9,500	Debtors	5,000
Capital (Balancing fig.)	50,000	Furniture	20,000
		Buildings	
	65,000		65,000

UNIT-V

ACCOUNTS OF NON-PROFIT ORGANISATION

INTRODUCTION

Non-trading institutions are created for promotion of Arts, Culture, Games and Sports, Fine Arts, Hospital etc.Example of such institutions are Schools, Colleges, Libraries, Athletic Clubs, Societies Associations etc. These non-trade institutions do not prepare Trading and Profit and Loss Account because it is not their objective to earn profit. These type of associations, consisting of persons, are formed with a view to render services to his members in particular, and to the society in general.

FINAL ACCOUNTS OF NON-TRADING CONCERN

The Final Accounts of non-trading concerns consists of:

1. Receipts and Payments Account
2. Income and Expenditure Account, and
3. Balance Sheet

1**. Receipts and Payment Account:**

It is a Real Account. It is prepared at the end of the accounting period. All cash receipts are recorded on the debit side and all cash payments are recorded on the credit side. It starts with opening balance of cash and bank and ends with closing balance of cash and bank. It does not take into account outstanding amounts of receipts and payments. Receipts and Payment may be of capital or revenue nature; they may relate to the current or subsequent year; so long as they are actually received or paid, they must appear in this account.

Features of Receipts and Payment Account:

1. It starts with opening balance and end with closing balance
2. It is the summary of cash and bank transactions.
3. Actual cash transactions are entered.
4. It includes capital as well as revenue items.
5. It follows cash system of accounting.
6. It is a real account.
7. It shows cash position and excludes all non-cash items.

8. It does not take any income/expense outstanding at the beginning or at the end.

2. Income and Expenditure Account

It is a Nominal Account. It is in the form of profit and loss account. It is concerned with only revenue items-expenses and incomes. It records all losses and expenses on its debit side and all incomes and gains on its credit side. The incomes and expenses of revenue nature, only the portion pertaining to the current year is show in the income and expenditure account i.e. amount relating to the previous year or future year are excluded.

Income and Expenses have to be adjusted for both out-standing and pre-payments. All non-cash items, Depreciation, Bad Debts, Provision for doubtful debts etc. are taken into account.

The difference between the debit side and the credit side is either surplus or deficit for the year concerned and the difference will be transferred to the capital fund appearing in Balance Sheet.

Features of Income and Expenditure Account:

1. It is prepared in lieu of profit and loss account.
2. It is a nominal account.
3. It is based on mercantile system of accounting.
4. There is no opening balance.
5. It ends with surplus or deficit.
6. It excluded all capital income and capital expenses.
7. It includes only revenue items.
8. It records all expenses whether paid or not, and all incomes whether received or not.

Distinction between Receipts and Payment Account and Income and Expenditure Account

Receipts and Payment Account	Income and Expenditure Account
1. It is a Real Account 2. It starts with opening balance. 3. It ends with closing balance either cash	1. It is a Nominal Account 2. It does not start with opening balance 3. It ends with a surplus (excess of income over expenditure) or deficit

In hand or cash bank	(excess of expenditure over incomes)
4. It is similar to cash book.	4. It is similar to profit and loss account.
5. Receipts are shown on the debit side and payments are shown on the credit side.	5. Expenses or losses are shown on the debit side and incomes and gains are shown on the credit side.
6. It contains both Capital and Revenue items.	6. It contains only Revenue items.
7. It includes receipts and payment whether they relate to any period past, previous and subsequent.	7. It includes only revenue items of the current year only.
8. No adjustments are made for outstanding or prepaid incomes and expenses.	8. It is taken into account the outstanding Expenses and incomes.
9. Generally, it is not followed by Balance Sheet.	9. It is followed by Balance Sheet.
10. This is based on Cash system of accounting.	10. This is based on mercantile system.

3. Balance Sheet:

Balance Sheet in case of non-trading concern is prepared in the usual manner and consists of all liabilities and assets on the date on which it is prepared. The excess of assets over liabilities is termed Capital Fund or General Fund.

TREATMENT OF SPECIAL ITEMS

Subscriptions from members are collected periodically. These are regular revenue incomes and credited to Income and Expenditure Account.

1. Donations: Charitable institution may receive donations from time to time. If the amount is small and if such collections are frequent, then they may be treated as an income. Donations may also be of two types

i) General Donations and

ii) Specific Donations.

Any donations of comparatively small amount may be taken to Income Expenditure Account.

i) General Donations of comparatively huge amount may be which are of non-recurring nature, may be added to the Capital Fund.

ii) In case of donations received for any specific purpose then it is termed Specific Donations. Such amount cannot be used for any other purpose, except the purpose of donor.

Therefore, such amount may be

* Special donations shown in Balance Sheet (liability side).
* All the Donations debited to Receipts and Receipts and Payment Account and this amount may be credited to Income and Expenditure Accounts or Liability side of the Balance Sheet, if it is for a specific purpose.

2. Legacy: It is like donation. It is the amount given to a non-trading concern as per the will of deceased person. It is taken to the Receipts and Payment Accounts as Capital Receipts.

3. **Life Members Fee:** Non-trading concerns usually collect subscriptions every month from their ordinary members. Such subscription is called life subscription and is capital receipts.

4. Entrance Fee (Admission Fee): These are the fees collected from every member at the times of his admission into membership. It is paid only by the new entrants on becoming a member of a society or a club; it may be treated as an income and is credited to Income and Expenditure Account

5. Sales of Old Sports Material and Old Newspapers: The amount received on account of sale of sports materials and old newspapers are recurring incomes to a concern and therefore, treated them as revenue incomes. The purchase of balls, nets etc. are revenue expenditure.

6**. Purchase of Equipment:** The price paid for acquiring any equipment is a Capital Expenditure.

7. Honorarium Paid: It is a payment of remuneration to a person who is not an employee of the organization honorarium is taken to Income and Expenditure Account as it is a revenue expenditure.

8. Subscription: It is a primary source of income of a non- profit organization. It is usually collected every month from all the ordinary members. Subscription received is credited to Income and Expenditure Account.

9. **Special Fund:** If there is any specific fund, such as Prize Distribution Fund, the expenses or income relating to the fund may be adjusted itself (on the liability side of the Balance Sheet).

10. **Sale of Old Assets:** If any asset is sold, the amount is debited to Receipts and Payments Accounts. It is not taken to income and expenditure account. The profit or loss made on sale of old asset is recorded in Income and Expenditure Account

SOME IMPORTANT ADJUSTMENTS

(**A)Subscription:** Subscription received from members is treated as revenue income. If total subscription received as per received as per Receipts and payments account during the year is given, adjustments will be made for outstanding subscription in the beginning and at the end of the year, and advance subscription in the beginning and at the end of the year.

(B) Expenses: Total expenses paid during the year are shown in receipts and payments Account. These expenses may include outstanding of previous year and advance for next year, to calculate correct figure of expenses to be shown in Income and Expenditure account, adjustments will have to be made.

(**C) Consumable Items**: If institution consumes certain items such as medicines by hospital or sports items by clubs, relevant figures for Receipts and payments Account and Income and Expenditure Account will be calculated. The value of goods consumed is shown in Income and Expenditure Account and the amount paid to creditors is shown in Receipts and payments Account.

ILLUSTRATION 1

Calculate the amount to be posted to Income and expenditure account for the year ended 2004:

Receipts and payments account show that subscriptions received Rs 9,000. This account of subscriptions includes Rs 800 outstanding in the previous year and Rs 1,000 for the next year Rs 2,000 is still outstanding for current year.

SOLUTION

Income and expenditure account for the year ended Dec.2004

Income	Expenditure		Rs.	Rs
	By Subscription received		9,000	
	Add: outstanding for current year		2,000	
	Less: outstanding for previous year	800	11,000	
	Less: received for next year	1,000		
			1,800	**9,200**

ILLUSTRATION: 2

In 2004, the subscriptions received were Rs 17,500 which include Rs 400 for 2003 and Rs 600 for 2005. At the end of 2004 subscriptions outstanding were Rs 500. The subscriptions due but received at the end of the previous year i.e., 2003 were Rs 600.

What amount should be credited to income and expenditure account as subscriptions.

SOLUTION

Income and Expenditure Account for the year ended 31st Dec. 2004

Income	Expenditure	Rs	Rs
	By Subscription (2004)	17,500	
	Less: Subscription received for 2003	400	
		17,100	
	Less: Subscription received for 2005	600	
		16,500	
	Add: Subscription outstanding for 2004	500	**17,000**

ILLUSTRATION: 3

During the year 2004, the expenses actually paid were Rs 3,250. Find out the actual expenses chargeable to income expenditure account for the year ended 2004, if prepaid and outstanding are as follows:

Prepaid Expenses on 31.12.2003	Rs 300
Prepaid Expenses on 31.12.2004	Rs 400
Outstanding Expenses on 31.12.2003	Rs 450
Outstanding Expenses on 31.12.2004	Rs 500

SOLUTION:

Income and Expenditure Account for the year 31st Dec., 2004

Expenditure		**Rs**	
To Expenses Paid	3,250		
Add: Prepaid expenses in 2003	300		
Add: Outstanding Expenses in 2004	500		
	4,050		
Less: Prepaid Expenses in 2004	400		
	3,650		
Less: Expenses Outstanding in 2003	450	**3,200**	

ILLUSTRATION 4

1. Subscriptions received as per receipts and payment accounts during the year 2004 — Rs 15,960
2. Subscription received in advance for 2005, during 2004 — Rs 1,500
3. Subscription outstanding on Dec. 2003 — Rs 750
4. Subscription received in advance i.e. for 2004, during 2003 — Rs 710
5. Subscription outstanding on 31st Dec. 2004 — Rs 500

SOLUTION

		Rs
Subscriptions as per Receipts and Payment Account		15,960
Add: Subscriptions received in 2003 for 2004		710
Add: Subscriptions outstanding on 31st Dec. 2004		500
	Rs.	________
Less: Subscription received during 2004 for the year 2005	1,500	17,170
Less: Subscription outstandingfor2003	750	
	________	2,250
Subscription to be credited to Income and Expenditure Account during 2004		________ **14,920**

ILLUSTRATION 5

Calculate the amount of stationery to be debited to income and expenditure account during 2004.

1.	Amount paid for stationery during the year 2004, as Per Receipts and Payment Account	Rs. 1,750
2.	Stock of stationery on 1.1.2004	Rs. 150
3.	Paid advance for stationery on 31.12.2004	Rs. 200
4.	Paid advance for stationery during Dec. 2003 But received stationery during the year 2004	Rs. 250
5.	Creditors for stationery on 1.1.2004	Rs. 370
6.	Stock of stationery on 31.12.2004	Rs. 415
7.	Creditors for stationery on 31.12.2004	Rs. 300

SOLUTION

	Rs	Rs
Amount paid for stationery as per receipts and payment A/C		1,750
Add: Stock of stationery on 1.1.2004		150
Add: Paid advance during Dec. 2003 and received during 2004		250
Add: Creditors for stationery on 31.12.2004 (Stationery has Been received but the payment is outstanding)		300
		2,450
Less: Paid advance for stationery 31.12.2004 (payment has been made but stationery not received)	200	985
Less: Creditors for stationery 1.1.2004 (stationery has been received during 2003 but the payment is made in 2004)	370	**1,465**
Less: Stock of stationery on 31.12.2004 (Not consumed)	415	985
Amount of stationery to be debited to income and expenditure A/c		1,465

TYPES OF ACCOUNTING PROBLEMS

1. Preparation of Income and Expenditure Account and Balance Sheet from a given Receipts and Payment Account with additional information.
2. Preparation of opening balance sheet and closing balance sheet from a given receipts and payment account and income and expenditure account.
3. Preparation f receipt and payment account from a given income and expenditure account and other information given.
4. Income and expenditure account and balance sheet from a given trial balance with additional information.

1. Preparation of Income and Expenditure Account and Balance Sheet from a given Receipts and Payment Account with additional information.

The Income and Expenditure account is simply another name for the profit and loss account. Sometimes, Receipts and Payments Account is given and you are required to prepare income and expenditure account and in such situation, the following steps are to be followed:

1. Do not take the opening balance and closing balance of cash in hand and at bank.
2. Do not take Capital receipts and Capital expenditure

3. Pick up only the revenue receipts and revenue payments and exclude the portions relating to pervious and subsequent years.
4. Add the portions of incomes and expenses prepaid in the previous year on accounts of current year.
5. Add also the portions of incomes and expenses of the current year due but remaining unpaid
6. Provide for depreciation, reserve for doubtful debts etc, as needed in the problems.
7. Surplus or Deficit will be transferred to capital fund.

ILLUSTRATION 6

The Calculate cricket club gives you the following inf

Income and Expenditure Account for 2004

Income	Rs	Expenditure		Rs
To Remuneration to coach	4,500	By Donation and Subscriptions		25,500
To Wages	5,000	By Bar Room: Receipts:	3,000	
To Rent	2,500	Payments:	2,500	500
To Printing and Stationery	2,600	By Interest on saving A/C		500
To Repairs	4,500	By Proceeds of Club:		
To Honorarium to Secretary	6,000	Night:	8,800	
To Depreciation on Equipment	4,700	Expenses:	4,000	4,800
To Surplus	1,500			
	31,300			31,300

Balance Sheet as on 31st Dec. 2004

31.12.2003	Liabilities	31.12.2004	31.12.2003	Assets	31.12.2004

Rs		Rs	Rs		Rs
	Expenses unpaid:		1,000	Cash in hand	500
1,000	Printing and stationery	800	3,000	Cash at bank	1,000
	Wages	2,000	20,300	Savings bank	21,100
4,000	Honorarium to secretary	6,000	1,500	Subscription outstanding	1,000
800	Subscriptions received in advance	300			
			8,000	Equipment	17,500
28,000	Capital fund 28,000				
	Entrance fees 2,500				
	Surplus 1,500	32,000			
33,800		41,100	33,800		41,100

Prepare the Receipts and Payments Account of the Club for 2004.

Solution:

In the Books of Kolkata Cricket Club Receipts and Payments Account for the year ended 31st Dec. 2004

Dr. **Cr.**

	Rs		Rs
To Balance b/d:		By Remuneration to coach	4,500
Cash in hand	1,000	By Wages	3,000
Cash at Bank:		By Rent	2,500
Current Account	3,000	By Printing and stationery	2,800
Savings Account	20,300	By Repairs	4,500
To Donations and Subscriptions	25,500	By Honorarium to secretary	4,000
To Bar Room Receipts	3,000	By Bar room expenses	2,500
To Interest on savings A/C	500	By Night club expenses	4,000
To Proceeds of Night Club	8,800	By Equipment	14,200
To Entrance Fees	2,500	By Balance c/d:	
		Cash	500
		Cash at Bank:	
		Current Account	1,000
		Savings Account	21,100
	64,600		64,600

Workings: Rs

1. **Donations and subscriptions received in 2004**

As per income and expenditure account:	25,000
Add: Outstanding on 31st Dec. 2003	1,500
	27,000
Add: Received in advance for 2005	3,00
	27,300
Less: Outstanding on 31st Dec. 2004	1,000
	26,300
Less: Received in advance during 2003	800
	25,500
	=========

2. **Printing and stationery paid in 2004**

As per income and expenditure Rs 2,600

Less: Outstanding on 31st Dec. 2004	800
	1,800
Add: Outstanding on 31st Dec. 2003	1,000
	2,800
	=========

3. **Honorarium to secretary paid in 2004**

As per income and expenditure	Rs 6,000
Add: Outstanding on 31st Dec. 2003	4,000
	10,000
Less: Outstanding on 31st Dec. 2004	6,000
	4,000
	=========

4. **Wages Paid in 2004**

As per income and expenditure	Rs 5,000
Less: Outstanding on 31st Dec. 2004	2,000
	3,000
	========

5. **Purchase of Equipment in 2004**

Equipment on 31st Dec. 2004	Rs 17,500
Add: Depreciation charged	4,700
	22,200
Less: Opening balance	8,000
	14,200
	=======

ILLUSTRATION 7

Calicut Sports Association Extracts the following receipts and payments account for the year ended 31st Dec. 2004. From the particulars given, prepare income and expenditure account for the year ended 31st Dec. 2004

Receipts and Payment Account for the year ended

31st Dec. 2004

Dr. **Cr.**

	Rs		**Rs**
To Balance b/d	1,125	By Newspapers	750
To Subscriptions	2,900	By Rent	250
To Tournament fund	750	By Salaries	1,800
To Life membership	1,000	By Office expenses	1,200
To Entrance Fees	100	By Sports equipments	1,150
To Donations for building	1,500	By Tournament expenses	450
To Sales of newspapers	50	By Balance c/d	1,825
	7,425		**7,425**

Subscriptions outstanding on 31st December 2003 Rs.450 and on 31st December 2004 Rs 400. Subscription received includes Rs 100 on account of the year 2005.

Sports equipment was valued on 31st December 2003 at Rs 550 and on 31st December 2004 at Rs 1,090 Office expenses includes Rs 150 for 2003 whereas Rs 200 is still payable on this account for 2004 **Tournament Fund** is treated as **Capital Receipts**.

SOLUTION

Income and Expenditure Account for the ended 31st December 2004

Dr. **Cr.**

Expenditure	**Rs**	**Income**		**Rs**
To Newspaper	750	By Subscriptions:	2,900	
To Rent	250	**Less:** for 2003	450	
To Salaries	1,800			

To Office expenses	1,200			2,450	
Less: Paid for 2003	150		**Add**: Outstanding (2004)	400	
	______			______	
	1,050			2,850	
Add: Outstanding for 2004	200	1,250			
			Less: Received for 2005	10	2,750
			By Entrance fees		100
To Depreciation on Equipment:		610	By Sale of newspaper		50
			By Excess expenditure		
			Over income		1,760
		4,660			**4,660**

Note: Life members, fee is capitalized. Tournament expenses are shown separately.

ILLUSTRATION 8

The following is the receipts and payments account of he Bombay club for the year ending 31st December 2006

Receipts	**Rs**	**Rs**	**Payment**	**Rs**	**Rs**
To Balance b/d		600	By Rent		10,400
To Entrance fees		1,100	By Stationary expenses etc.,		6,136
To Subscriptions:			By Wages		10,660
2005	400		By Billiards table		7,800
2006	33,800		By Repairs & Renewals		1,612
2007	600		By Interest		3,000
			By Balance c/d		4,792
To Lockers rent		34,800			
To Special subscriptions for governors party		1,000			

	6,900		
	44,400		**44,400**

Lockers rent Rs. 120 refers to 2005 and Rs. 180 is still owing; Rent Rs. 2,600 pertaining to 2005 and Rs.2, 600 is still owing: stationery expenses etc. Rs.624 related to 2005: Still owing Rs.728; Subscription unpaid for 2006 Rs. 1,736; Special subscriptions for Governor's party outstanding Rs. 1,100.

The club owned sports materials of the value Rs. 32,000 on 1.1.2006. This was valued at Rs. 27,000 on 31.12.2006. The club took a loan of Rs. 40,000 in 2005.

Prepare the income and expenditure a/c for 2006 and balance sheet as at 31st December 2006.

SOLUTION

Income & Expenditure Account of Bombay Club for the ending 31st December 2006

Expenditure Rs	**Rs**	**Income Rs**	**Rs**

To Rent paid	10,400		By Entrance fees		1,100
Less: Unpaid for 2005	2,600		By Subscriptions		
			received for 2006	33,800	
	7,800		**Add:** Outstanding	1,736	35,536
Add: Unpaid for 2006	2,600	10,400	By Lockers rent received	1,000	
			Less: Accrued for 2005	120	
To Stationery					
Expenses paid	6,136				
Less: Unpaid for 2005	624				
	5,512			880	
Add: Unpaid for 2006	728	6,240	**Add**: Accrued for 2006	180	1,060
		10,660			
To Wages		1,612			
To Repairs & Renewals		3,000			
To Interest					
Depreciation on sports material		5,000			
(32,000-27,000)					
To Surplus- Excess of income		784			
Over expenditure (Bal. fig)					
		37,696			**37,696**

Note: Special subscriptions for governors party is treated as a special purpose collection and is shown in balance sheet that purpose is served.

Balance Sheet of the Bombay Club as on 31st December 2006.

Liabilities	**Rs**	**Rs**	**Assets**	**Rs**
Expenses unpaid:			Cash balance	4,792
Rent	2,600		Sports material	27,000
Stationery	728		Billiards table	7,800
			Subscription outstanding	1,736
Special subscription for		3,328	Special subscription due	1,100
Governors party received	6,900		Lockers rent outstanding	180

Add: Outstanding 1,100	8,000	Deficiency on 1.1.2006 10,104	
Loan	40,000	**Less:** Surplus for 2006 784	9,320
Subscription received in advance	600		
	51,928		**51,928**

Note: Special subscriptions due is an adjustment which has double effect in balance sheet itself

Working Note:

Computation of Capital Fund:

The club has a deficiency (instead of capital fund). This is ascertained by preparing balance sheet as on 31st December 2005

Bombay Club Balance sheet as on 31st December 2005

Liabilities Rs	Rs	Assets Rs	Rs
Rent Outstanding	2,600	Subscriptions due	400
Stationery etc. Outstanding loan	624	Cash	600
Loan	40,000	Sports material	32,000
		Lockers rent due	120
		Deficiency (Bal. fig)	10,104
	43,224		**43,224**

2. ***Opening Balance Sheet Closing Balance Sheet from a given Receipts and Payments Account and Income and Expenditure Account***.

Follow the following steps:

(A) **Opening Balance Sheet**:

(1) Consider Opening Cash and Bank balances from Receipts and Payments Account and write them in the asset side of the Balance Sheet.

(2) Consider other adjustments from income and expenditure account either income or expenses and put them in asset side or liability side of the Balance Sheet.

(3) The different between the asset side and liability side will reflect the capital fund, as balancing figure.

(B) **Closing Balance Sheet**:

1. Take all the assets from opening balance sheet, after due effect of depreciation additions and sold, then net figure will be written in the asset side of the balance sheet.
2. Take the capital fund from opening balance sheet and add surplus or deduct; and all other liabilities go to liability side of the balance sheet.
3. Closing cash and bank balance will be written on asset side.
4. Compare each item from income and expenditure with receipts and payments account and write suitably to closing balance sheet.

ILLUSTRATION 9

The following particulars related to sports clubs of Delhi income and expenditure account for the year ended 31st December 2004.

Dr. **Cr.**

	Rs		**Rs**
To Salaries	6,000	By Admission fees	15,000
To Printing & stationery	2,500	By Subscription	25,000
To Advertising	1,000	By Rent Receivable	4,800
To Insurance charges	900		
To Electric charges	500		
To Depreciation on sport equipments	12,000		
To Excess of income over expenditure	21,900		
	44,800		**44,800**

Receipts and Payment Account for the year ended 31st Dec. 2004

Dr. **Cr**

		Rs		**Rs**
To Balance b/d		5,000	By Salary(including advance)	7,500
To Admission fees			By Printing and stationery	2,500
2003	2,500		By Advertising	1,000
2004	13,500	**16,000**	By Insurance charges (partly for next year)	1,200
To Subscriptions				
2003	1,000		By Electricity	500
2004	23,000		By Purchase of fixed assets	20,000
2005	2,000	**26,000**	By Balance c/d	17,900
To Rent		3,600		
		50,600		**50,600**

On 1st January 2004, the club had the following assets:

	Rs
Land and Buildings	60,000
Sports equipment	30,000
Furniture	4,500

Prepare opening and closing balance sheets.

SOLUTION

Sports Club of Delhi Balance Sheet as on 1st January 2004

Liabilities	Rs	Assets	Rs
Capital Fund (Balancing Figure)	1,03,000	Cash at bank	5,000
		Subscription outstanding	1,000
		Admission fees outstanding	2,500
		Sports Equipment	30,000
		Furniture	4,500
		Land and Building	60,000
	1,03,000		**1,03,000**

Sports Club of Delhi Balance Sheet as on 31st December 2004

Liabilities		Rs	Assets		Rs
Subscription received in advance		2,000	Cash at bank		17,900
Capital fund:	1,03,000		Subscription outstanding		2,000
Add: Excess of income	21,900	1,24,900	Admission fees outstanding		1,500
			Salary advance		1,500
			Rent outstanding		1,200
			Prepaid insurance		300
			Sports Equipment	30,000	
			Less: Depreciation	12,000	18,000
			Furniture		4,500
			Fixed assets		20,000
			Land and Building		60,000
		1,26,900			**1,26,900**

ILLUSTRATION 10

Receipts and Payments A/C and Income and Expenditure A/C of Asiatic public library for the year ended 31st Dec. 2005 were as follows:

Receipts and Payments A/C

Receipts	**Rs**	**Payments**	**Rs**
To Balance b/d	700	By Books purchased	33,000
To Subscriptions:		By Printing &Stationary	1,500
2004 4,000		By Salaries for 2005	8,000
2005 30,000		By Salaries for 2004	2,000
2006 2,000		By Telephone charges	1,500
	36,000	By Miscellaneous expenses	3,000
To Interest (including		By Balance c/d	200
Rs.200 for 2004)	4,000		
To Donations for specific fund	5,000		
To Rent:			
2005 2,500			
2006 1,000	3,500		
	49,200		**49,200**

Income & Expenditure A/C

Expenditure	**Rs**	**Income**	**Rs**
To Salaries	12,000	By Interest	3,800
To Printing & Stationary	1,500	By Subscription	35,000
To Telephone charges	1,500	By Rent	2,500
To Mis. Expenditure	3,000		
To Depreciation on :			
Books 5,000			
Buildings 5,000			
Furniture 1,000	**11,000**		
To Excess of income over expenditure	12,300		
	41,300		**41,300**

On enquiry you find that the library has the following other assets on 1st January 2005

Buildings	2, 00,000
Furniture	10,000
Books	17,000
Investments	38,000

You are asked to prepare balance sheets of the library as on 31st Dec. 2004 and 2005

SOLUTION:

Asiatic Public Library Balance Sheet as at 31st Dec.2004

Liabilities	Rs		Assets	Rs
Outstanding Salaries	2,000		Cash	700
Capital Fund	2,67,900		Investment	38,000
			Outstanding subscriptions	4,000
			Outstanding interest	200
			Furniture	10,000
			Books	17,000
			Buildings	2,00,000
	2,69,900			**2,69,900**

Balance Sheet as at 31st December 2005

Liabilities		Rs	Assets		Rs
Capital fund	2,67,900		Cash		200
Add: Surplus	12,300		Investment		38,000
	________		Outstanding subscription		
Subscription received in advance		2,80,200	(35,000-30,000)		5,000
Rent received in advance		2,000	Books	17,000	
Salaries outstanding		1,000	**Add**: Additions	33,000	
(12,000-8,000)		4,000		______	
Donations (specific fund)				50,000	
		5,000	**Less**: Depreciation	5,000	
				______	45,000
			Furniture	10,000	
			Less: Depreciation	1,000	
				______	9,000
			Building	2,00,000	
			Less: Depreciation	5,000	
				_______	1,95,000
		2,92,200			**2,92,200**

3. ***Preparation of receipts and payments account from a given income and expenditure account and other information***

Sometimes, income and expenditure is given and students are required to prepare receipts and payments account and in such a situation, the following procedure may be followed:

1. All expenditure, whether capital or revenue, irrespective of the period, are shown on the payment side.
2. All receipts, whether capital or revenue, irrespective of the periods, are shown on receipts side.
3. Pick up opening balance and closing balance to the account.
4. Eliminate all adjustments made- while preparing income and expenditure account .
5. Purchase of assets may be calculated and shown on the payment side

ILLUSTRATION 11

The following is the receipts and payment account of Apollo club in respect of the year 31st March 2004.

Receipts and payment Account

for the year ended 31st March 2004

Date	Particular	Amount Rs	Date	Particular	Amount Rs
1.4.2003	To Balance b/d		31.3.04	By Salaries	3,000
	Cash in hand	2,000		By Stationary	1,000
31.3.2004	To Subscription:			By Rates and taxes	300
	2002-03 3,000			By Telephone charge	1,500
	2003-04 4,000			By 8% Securities at per	5,000
	2004-05 1,000			By Sundry Expenses	200
		8,000		By Balance c/d	
	To Profit on sports	3,000		(Cash in hand)	3,000
	To Interest on 8%				
	Securities	1,000			
		14,000			**14,000**

The following additional facts are ascertained:

1. There are 500 members, each paying an annual subscription of Rs 10, Rs 3,500 being in arrears for 2002-03 at the beginning of 2003-04. During 2002-03, subscription were paid in advance by 30 members for 2003-04
2. Stock of stationery at 31st March 2003 was Rs 400 and at March 2004 Rs500.
3. At 31st March 2004, the rates and taxes were prepaid to the following 31st January, the yearly charge being Rs 3000
4. A quarters charge for telephone is outstanding, the amount accrued being Rs 300. The charge for each quarter is same both for 2002-03 and 2003-04.
5. Sundry expenses accruing at 31st March 2003 were Rs 50 and at 31st March 2004 Rs 60.
6. At 31st March 2003, building stood in the books at Rs 30,000 and it required to write off depreciation at10 % P.A.

7. Value of 8% securities at 31st March 2003 was Rs 15,000 which was purchased at that date at additional securities worth Rs 5,000 are purchased on 31st March 2004.

   You are required to prepare:

   (a) An income and expenditure account for the year ended 31st March 2004.

   (b) A Balance Sheet as at that date.

SOLUTION

Income and Expenditure Account for the ended 31st March 2004

Expenditure	Rs	Income	Rs

To Salaries	3,000	By Subscription (500 X Rs.10)	5,000
To Stationery 1,000		or (400+300+700)	3,000
Add: Opening 400		By Profit on sports	
1,400		By Interest on 8% securities 1,000	1,200
Less: Closing stock 500	**900**	Add: Outstanding 200	
To Rates and taxes 300			
Add: Pre-paid (2002-03) 250			
550			
Less: Pre-paid (2004-05) 250	**300**		
To Telephone charge 1,500			
Less: Outstanding 600			
(2002-03)			
900			
Add: Outstanding			
(2003-04) 300	1,200		
To Sundry expenses 200			
Less: Paid for 2002-03 50			
			9,200
150			
Add: Outstanding 2003-04 60			
	210		
To Depreciation on Buildings	3,000		
To Excess of income and expenditure	**590**		
	9,200		

Balance Sheet as on 31st March 2004

Liabilities	Rs	Assets	Rs
Subscription received in advance	1,000	Cash in hand	300
Outstanding telephone charges	300	Outstanding subscription for 2003-04	700
Outstanding sundry expenses	60	Outstanding subs. for 02-03	500
Capital fund 50,200		Stock of stationery	500
Add: Excess of income		Prepaid rates and taxes	250
Over expenditure 590		Outstanding interest on investment	200
		Investments	20,000
		Building 30,000	
	50,790	**Less:** Depreciation 3,000	
			27,000
	52,150		**52,150**

Workings:

Balance Sheet as on 31st March 2003

Liabilities	Rs	Assets	Rs
Subscription received in advance	3,000	Cash in hand	2,000
Outstanding sundry expenses	50	Outstanding subscription	3,500
Outstanding telephone charges	600	Stock of stationery	400
Capital fund	50,200	Prepaid rates and taxes	250
		Investments	15,000
		Building	30,000
	51,150		**51,150**

4. **Preparation of Income and Expenditure Account and Balance Sheet from given trial balance with additional information.**

Steps:

(1) All the current years' revenue incomes are to be creditors in the expenditure accounts.

(2) All the current years revenue expenditure are to be debited in the income and expenditure account.

(3) If the credit side is greater than the debit side, there will be surplus or excess of income over expenditure and vice-versa in the opposite case.

(4) The surplus or deficit so made is to be added or deducted against the capital fund.

(5) All the capital incomes or capital expenditure are to be shown in the Balance Sheet.

DISTINCTION BETWEEN INCOME AND EXPENDITURE ACCOUNT AND PROFIT AND LOSS ACCOUN

The Income and Expenditure Account of a non-trading concern is similar to profit and loss account of a trading concern. However, the following difference may be noted.

1. Income and Expenditure Account is prepared by a non-trading concern while profit and loss account is prepared by a trading concern.
2. Income and Expenditure shows surplus or deficit while profit and loss account shows net profit or net loss.
3. Income and Expenditure Account does not start with gross profit or gross loss while profit and loss account starts with gross profit or gross .
4. The Surplus (or deficit) shown in the income and expenditure is added (or deducted) to/from capital fund and is not distributed among the owners: whereas the Net Profit shown in the Profit and Loss Account is distributed among the owners.

ILLUSTRATION 12

From the following Trial Balance and accompanying notes for adjustments, prepare Income and Expenditure Account for the year ended 31st December 2004 and the Balance Sheet as on that date of a club:

	Rs	**Rs**
Club Buildings	37,400	-
Library Books	2,280	-
Furniture and Fixtures	3,520	-
Glass, Cutlery etc. (1st Jan. 2004)	2,000	-
Glass, Cutlery purchased during the year	1,000	-
Printing and Stationery	225	-
Rent Received	-	10,370
Annual Subscription	-	12,150
Entertainment cost	345	-
Billiard Room Receipts	-	3,845
Billiard Board	10,400	-
Billiard Room Expenses	2,135	-
Canteen profit	-	1,200
Subscription arrears, on 1st Jan 2004	1,125	-
Honorarium	1,500	-
Sales of tickets for Annual Dinner	-	1,600
Annual Dinner Expenses	1,875	-
Salaries to Staff	2,700	-
Donations	-	8,500
Audit Fees	600	-
Repairing, Clearing etc.	350	-
Newspapers and Magazines	180	95
Interest on Bank Deposit	-	25
Bank Charges	20	-
Entrance Fees	-	225
Election Expenses	2,995	-
Stock of Canteen Provision on 31st Dec. 2004	300	-
Sundry Creditors	-	3,135
Cash in Hand	1,400	-
Cash at Bank General Fund	1,735	-
	-	32,940
	74,085	74,085

Notes for adjustments:

(a) Out of the total subscriptions, Rs 1,125 represented arrears collected and Rs 760 paid in advance.

(b) An amount of Rs 500 was outstanding on account of rent.

(c) Unpaid salary amount to Rs 200.

(d) Entrance fees to be capitalized.

(e) Out of the donation. Rs 3,600 represented donation towards election expenses and of the balance, half the amount shall be capitalized.

(f) Depreciation to be provided as under:

Library Books at 10%

Furniture and Fixture at 15%

Club Buildings at 5%

Glass, Cutlery etc. Rs 1,700

SOLUTION:

Income and Expenditure Account

For the year ended 31st December 2004

Dr. **Cr.**

Expenditure		**Rs**	**Income**		**Rs**
To Printing and Stationery		225	By Rent Received	10,370	
To Entertainment Cost		345	**Add**: Outstanding	500	
To Billiard Room Expenses		2,135		______	10,870
To Honorarium		1,500	By Annual Subscription	12,150	
		1,875	**Less**: For 2003	1,125	
To Salaries	2,700			______	
Add: Outstanding	200			11,025	
			Less: For 2005	760	
	______	2,900		______	10,265
		600	By Billiard Room Receipts		3,845
To Audit fees					

To Repairs and cleaning charges	350	By Canteen Profit	1,200
To Newspapers and Magazines	180	By Sales of tickets for annual dinner	1,600
To Bank Charges	20	By Donations 8,500	
To Depreciation:		**Less**: for Election Expenses 3,600	
Library Books 228			
Furniture and Fixtures 528		4,900	
Club Buildings 1,870		**Less**: Capitalised 2,450	
Glass, Cutlery etc. 1,700			2,450
		By Newspapers and Magazines	95
To Excess of Income over Expenditure	4,326	By Interest on Bank Deposits	25
	15,894		
	30,350		**30,350**

Balance Sheet

As on 31st December 2004

Liabilities		Rs	Assets		Rs
Subscription received in advance		760	Cash in hand		1,400
Outstanding Salary		200	Cash at bank		1,735
Sundry Creditors		3,135	Stock of Canteen provision		300
Donation	3,600		Rent outstanding		500
Less: Election expenses	2,995		Library books	2,280	
		605	**Less**: Depreciation	228	
Capital Fund:					2,052
Entrance fees	225		Glass, Cutlery etc. on 1st		
General fund	32,940		Jan. 2004	2,000	
Add: Donation capitalised	2,450		**Add**: Purchased	1,000	
	35,615			3,000	
Add: Excess of income	15,894		**Less**: Depreciation	1,700	

	51,509				1,300
			Furniture and Fixture	3,520	
			Less: Depreciation	528	
					2,992
			Billiard Board		10,400
			Club Building	37,400	
			Less: Depreciation	1,870	35,530
	56,209				**56,209**

*****

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