KARPAGAM ACADEMY OF HIGHER EDUCATION

(Deemed to be University)
(Established under section 3 of UGC Act, 1956)
Coimbatore – 641021

Department of Management

17BAU202	CORE - BUSINESS ACCOUNTING	L	T	P	C
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SCOPE

Business Accounting represents the basic concepts underlying the accounting practices and its techniques with special reference to Sole Proprietorship. It also touches upon the various aspects of accounting related to Non trading Concerns. This paper gives the principles of financial accounting and their applications in business organizations.

OBJECTIVES

- To make the students learn the concepts and conventions of accounting and basic accounting framework
- To expose the students to the fundamentals of accounting procedure

UNIT I

Accounting - Meaning - Definition - Concepts - Conventions - Accounting as an Information System - Importance - Scope - Limitations - Users of Accounting Information - Generally accepted Accounting Principles - Accounting Equation - Nature of Accounts - Rules of Debit and Credit - Recording Transactions in General Journal - Ledger - Trial balance - Subsidiary Books.

UNIT II

International Financial Reporting Standards (IFRS) - Understanding Accounting Standards issued by the ICAI related to Disclosure of Accounting Policies. Depreciation Accounting - Revenue Recognition - Methods of charging Depreciation - Straight-line Method - Written-down-value Method - Bank Reconciliation Statement.

UNIT III

Final Accounts - Preparing Trading Account, Statement of Profit and Loss and Balance Sheet for a Sole Proprietor - Understanding contents of Financial Statements of a Joint Stock Company as per Companies Act 2013 - Understanding the contents of a Corporate Annual Report.

UNIT IV

Analyzing Financial Statements - Objectives of Financial Statement Analysis - Sources of Information - Standards of Comparison - Techniques of Financial Statement Analysis - Horizontal Analysis - Vertical Analysis - Ratio Analysis - Meaning and Usefulness of Financial Ratios - Analysis of Financial Ratios from the perspective of different Stakeholders like Investors - Lenders - Short-term Creditors - Profitability Ratio - Solvency Ratio - Liquidity Ratio - Turnover Ratio - Limitations of Ratio Analysis.

UNIT V

Partnership Accounts: Past adjustments and guarantees - Basic concepts of Admission, Retirement and death of a partner including treatment of goodwill.

Note: Distribution of marks between problems and theory shall be 80% and 20%.

SUGGESTED READINGS:

TEXT BOOKS

1. Gupta, R.L., & Gupta, V.K. (2014). *Financial Accounting*. New Delhi: Sultan Chand & Sons.
2. Jain, S.P., & Narang. (2007). *Financial Accounting*. Ludhiana: Kalyani Publishers.

REFERENCES

1. Maheshwari, S.N., Suneel, K., Maheshwari, & Sharad, K., Maheshwari. (2013). *An Introduction to Accountancy* (11th ed.). New Delhi: Vikas Publishing House Pvt., Ltd.R.
2. Narayanaswamy, R. (2011). *Financial Accounting*: *A Managerial Perspective* (4th ed.). New Delhi: PHI Learning Pvt. Ltd.
3. Charles,T., Horngren, Gart, L., Sundem, John, A., Elliott, & Donna, R., Philbrick. (2013). *Introduction to Financial Accounting*, (11th ed.). New Delhi: Pearson Prentice Hall of India.
4. Monga, J.R. (2002). *Financial Accounting*: *Concepts and Applications* (11th ed.). Second Volume. New Delhi: Mayur Paperbacks.

5. Ghosh, T.P. (2014). *Financial Accounting for Managers* (4th ed.). New Delhi: Taxmann Allied Services Pvt Ltd.
6. Vinayakam, N. (2011). *Financial Accounting*. New Delhi: S.Chand and Company Ltd.
7. Grewal, T.S. (2010). *Introduction to Accountancy*. New Delhi: S.Chand and Company Ltd.
8. Grewal, T.S., Gupta, S.C., & Shukla, M.C. (2013). *Advanced Accountancy*. New Delhi: Sultan Chand and Sons.
9. Narang, K.L. & Maheswari, S.N. (2012). *Advanced Accountancy*, Ludhiyana: Kalyani Publisher

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Department of Management

Name: **Dr.M.NANDHINI (Associate Professor)**
Department: **Management**
Course Code: **17BAU202** Semester: **II** Year: **2017-20 Batch**
Course: **Business Accounting - Lesson Plan**

SI.No	Lecture Hours	Contents	References
UNIT I			
1	1	Accounting – Meaning, Definition, Objectives, scope, Features, Advantages and Limitations	T1 : Page No : 1 – 9
2	1	Accounting Principles - Accounting concepts : Business entity, Money measurement, Going concern, Dual aspect	T1 : Page No : 10 – 17 W1
3	1	Accounting Principles – Accounting Conventions: Consistency, Full Disclosure, Conservatism	T1 : Page No : 18 – 28
4	1	Accounting standards - Objectives Accounting policies-Accounting as a measurement discipline, valuation principles, Accounting estimates and ASI.	T2 : Page No : 38 – 40
5	1	Accounting Process: Preparation of journal	T2 : Page No : 43 - 45
6	1	Passing Journal Entries – Capital, Drawing, Purchase, Sale	T2 : Page No : 46 - 50
7	1	Passing Journal Entries – Salary, Rent, Trade Discount, Cash Discount	T2: Page No : 56 - 60
8	1	Posting to Ledger	T2 : Page No : 61 - 65
9	1	Trial balance – Debit Balance, Credit Balance	T2 : Page No : 66 - 73
10	1	Subsidiary Books – Purchase Book, Sales Book	R2 : Page No : 52 – 73
11	1	Subsidiary Books – Purchase Return Book, Sales Return Book	R2 : Page No : 74 – 103
12	1	Recapitulation and discussion of important questions	
Total Number of hours planned for Unit I			**12**
UNIT II			
1	1	International Financial Reporting Standards (IFRS). Understanding Accounting Standards issued by the ICAI related to Disclosure of Accounting Policies.	W2

2	1	Depreciation – Meaning, Definition, Depreciable asset and cases of depreciation	R1: Page No : 1.242 – 1.248
3	1	Depreciation as apportionment of cost and Need for providing depreciation	R1: Page No : 1.249 – 1.258
4	1	Basis factors taken into consideration while calculating the depreciation expenses	R1: Page No : 1.259 – 1.265
5	1	Methods of recording depreciation - Straight Line Method	R1: Page No : 1.265 – 1.268
6	1	Methods of recording depreciation - Diminishing Value Method	R1: Page No : 1.269 – 1.271
7	1	Sum of Digit Method, Annuity Method, Machine Hour Rate Method	R1: Page No : 1.271 – 1.273
8	1	Depreciation Fund Method, Insurance Policy method, Revaluation and Depletion Method	R1: Page No : 1.273 – 1.2
9	1	Bank Reconciliation Statement - Procedure for preparation of Bank Reconciliation Statement	T2 : Page No : 329 - 334
10	1	Preparation of Bank Reconciliation Statement – Type I, II, III, IV, V	T2 : Page No : 335 - 344
11	1	Preparation of Bank Reconciliation Statement – Type VI, VII, VIII, IX	T2 : Page No : 345 - 359
12	1	Recapitulation and discussion of important questions	
Total Number of hours planned for Unit II			**12**
UNIT III			
1	1	Final Accounts – Meaning, Trading and Profit and Loss Account	R3 : Page No : 155 - 161
2	1	Format for preparing Final Accounts	R3 : Page No : 162 – 169 W3
3	1	Trading Account – Items to be posted to the debit side and credit side of Trading Account	R3 : Page No : 170 - 176
4	1	Profit and Loss Account – Expenses to be shown and not shown in Profit and Loss Account	R3 : Page No : 177 - 198
5	1	Balance Sheet – Classification of Assets , Classification of Liabilities	R3 : Page No : 199 - 211
6	1	Final Accounts – Adjustments: Closing stock, Prepaid expenses, Accrued Income	R3 : Page No : 211 - 258
7	1	Final Accounts – Adjustments: Income received in advance, Depreciation, Bad debts, Interest on capital, Interest on borrowing, Provision for bad debts, Managers Commission	T2 : Page No : 120 - 138
8	1	Preparation of Trading Account, Profit and Loss Account and Balance Sheet - Adjustments: Closing stock, Prepaid expenses, Accrued Income, Income received in advance, Depreciation, Bad debts	T2 : Page No : 138 - 147
9	1	Preparation of Trading Account, Profit and Loss Account and Balance Sheet - Interest on capital, Interest on borrowing, -	T2 : Page No : 147 - 168

		Provision for bad debts, Managers Commission	
10	1	Understanding contents of Financial Statements of a Joint Stock Company as per Companies Act 2013	W3
11	1	Understanding the contents of a Corporate Annual Report	W3
12	1	Recapitulation and discussion of important questions	
Total Number of hours planned for Unit III			**12**
UNIT IV			
1	1	Financial Statements – Meaning, Definition Objectives of Financial Statement, Sources of Information, Standards of Comparison	T2 : Page No : 735 - 739
2	1	Techniques of Financial Statement Analysis - Horizontal Analysis - Vertical Analysis	T2 : Page No : 739 – 743 W4
3	1	Techniques of Financial Statement Analysis – Comparative analysis, Common Size analysis, Trend Analysis	T2 : Page No : 743 - 756
4	1	Ratio Analysis – Meaning, Definition, Features, Nature, Significance and limitations	T2 : Page No : 757 - 761
5	1	Classification of Ratios – Short term solvency ratio – Current Ratio, Liquid Ratio and Cash Ratio	T2 : Page No : 761 - 766
6	1	Long Term Solvency Ratio – Debt Equity Ratio, Fixed Asset Ratio, Proprietary Ratio	T2 : Page No : 767 - 781
7	1	Activity / Turnover Ratio – Inventory Turnover Ratio, Debtors Turnover Ratio, Creditors Turnover Ratio,	T2 : Page No : 782 - 794
8	1	Turnover Ratio – Creditors Turnover Ratio, Working Capital Turnover Ratio	T2 : Page No : 795 - 802
9	1	Profitability Ratio – Gross Profit Ratio, Net Profit Ratio,	T2 : Page No : 804 - 813
10	1	Profitability Ratio – Expenses Ratio, Operating Ratio, Operating profit Ratio	T2 : Page No : 814 - 827
11	1	Capital Gearing Ratio	T2 : Page No : 827 - 846
12	1	Recapitulation and discussion of important questions	
Total Number of hours planned for Unit IV			**12**
UNIT V			
1	1	Partnership Accounts – Meaning , Definition. Features	R4 : Page No : 1479 – 1493 W5
2	1	Treatment of Goodwill, Methods of valuation of Goodwill	R4 : Page No : 1494 - 1512
3	1	Admission of a partner- Calculation of Net Profit Sharing Ratio	R4 : Page No : 1513 - 1537
4	1	Admission of a partner - Revaluation of Assets and Liabilities	R4 : Page No : 1538 - 1547
5	1	Preparation of Realization, Capital and Balance sheet	R4 : Page No : 1547 - 1559
6	1	Retirement of a partner	R4 : Page No : 1560 - 1572
7	1	Death of a partner	R4 : Page No : 1573 - 1595
8	1	Revaluation of Assets and Liabilities	R4 : Page No : 1596 - 1612

9	1	Revaluation Account, Paying a partners loan in installments Recapitulation and discussion of important questions	R4 : Page No : 1479 - 1483
		Total no. of hours planned for Unit - V	9
10	1	Discussion of previous ESE question papers	
11	1	Discussion of previous ESE question papers	
12	1	Discussion of previous ESE question papers	3
Total no. of hours planned for Unit – V and Discussion of previous ESE question papers			**12**

SUGGESTED READINGS:

TEXT BOOKS

T1 - Gupta, R.L., and Gupta, V.K. (2014). *Financial Accounting.* New Delhi: Sultan Chand & Sons.

T2 - Jain, S.P., and Narang. (2014). *Financial Accounting*. Ludhiana: Kalyani Publishers.

REFERENCES

R1 - Maheshwari, S.N., Suneel, K., Maheshwari, & Sharad, K., Maheshwari. (2013). *An Introduction to Accountancy* . New Delhi: Vikas Publishing House Pvt.,

R2 – Vinayakam, N. (2013). *Financial Accounting*. New Delhi: S.Chand and Company Ltd.

R3 - Grewal, T.S. (2016). *Introduction to Accountancy*. New Delhi: S.Chand and Company Ltd.

R4 - Grewal, T.S., Gupta, S.C., and Shukla, M.C. (2016). *Advanced Accountancy*. New Delhi: Sultan Chand and Sons.

WEBSITES

W1 - https://www.accountingcoach.com/accounting-principles/explanation

W2 - http://www.ifrs.org/issued-standards/list-of-standards/

W3 - https://sol.du.ac.in/mod/book/view.php?id=1240&chapterid=900

W4 - https://www.accountingtools.com/articles/2017/5/10/financial-statements

W5 - https://www.accountingtools.com/articles/2017/5/5/partnership-accounting

UNIT-I

SYLLABUS

Introduction to Accounting: Accounting - Meaning - Definition - Concepts - Conventions - Accounting as an Information System - Importance - Scope - Limitations - Users of Accounting Information - Generally accepted Accounting Principles - Accounting Equation - Nature of Accounts - Rules of Debit and Credit - Recording Transactions in General Journal - Ledger - Trial balance - Subsidiary Books.

ACCOUNTING

Meaning

Accounting, as an information system is the process of identifying, measuring and communicating the economic information of an organization to its users who need the information for decision making. It identifies transactions and events of a specific entity. A transaction is an exchange in which each participant receives or sacrifices value (e.g. purchase of raw material). An event (whether internal or external) is a happening of consequence to an entity (e.g. use of raw material for production). An entity means an economic unit that performs economic activities.

DEFINITION OF ACCOUNTING

American Institute of Certified Public Accountants (AICPA) which defines accounting as "the art of recording, classifying and summarizing in a significant manner and in terms of money, transactions and events, which are, in part at least, of a financial character and interpreting the results thereof".

OBJECTIVE OF ACCOUNTING

Objective of accounting may differ from business to business depending upon their specific requirements. However, the following are the general objectives of accounting.

i) To keeping systematic record:

It is very difficult to remember all the business transactions that take place. Accounting serves this purpose of record keeping by promptly recording all the business transactions in the books of account.

ii) To ascertain the results of the operation:

Accounting helps in ascertaining result i.e., profit earned or loss suffered in business during a particular period. For this purpose, a business entity prepares either a Trading and Profit and Loss account or an Income and Expenditure account which shows the profit or loss of the business by matching the items of revenue and expenditure of the some period.

iii) To ascertain the financial position of the business:

In addition to profit, a businessman must know his financial position i.e., availability of cash, position of assets and liabilities etc. This helps the businessman to know his financial strength. Financial statements are barometers of health of a business entity.

iv) To portray the liquidity position:

Financial reporting should provide information about how an enterprise obtains and spends cash, about its borrowing and repayment of borrowing, about its capital transactions, cash dividends and other distributions of resources by the enterprise to owners and about other factors that may affect an enterprise's liquidity and solvency.

v) To protect business properties:

Accounting provides up to date information about the various assets that the firm possesses and the liabilities the firm owes, so that nobody can claim a payment which is not due to him.

vi) To facilitate rational decision – making: Accounting records and financial statements provide financial information which help the business in making rational decisions about the steps to be taken in respect of various aspects of business.

vii) To satisfy the requirements of law: Entities such as companies, societies, public trusts are compulsorily required to maintain accounts as per the law governing their operations such as the Companies Act, Societies Act, and Public Trust Act etc. Maintenance of accounts is also compulsory under the Sales Tax Act and Income Tax Act.

IMPORTANCE OF ACCOUNTING (USERS OF ACCOUNTING INFORMATION)

i) Owners: The owners provide funds or capital for the organization. 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. Comparing the accounts of various years helps in getting good pieces of information.

ii) 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."

iii) Creditors: Creditors are the persons who supply goods on credit, or bankers or lenders of money. It is usual that these groups are interested to know the financial soundness before granting credit. The progress and prosperity of the firm, two which credits are extended, are largely watched by creditors from the point of view of security and further credit. Profit and Loss Account and Balance Sheet are nerve centers to know the soundness of the firm.

iv) Employees: Payment of bonus depends upon the size of profit earned by the firm. The more important point is that the workers expect regular income for the bread. The demand for wage rise, bonus, better working conditions etc. depend upon the profitability of the firm and in turn depends upon financial position. For these reasons, this group is interested in accounting.

v) 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 statements of the firm. This is to safeguard the investment. For this, this group is eager to go through the accounting which enables them to know the safety of investment.

vi) Government: Government keeps a close watch on the firms which yield good amount of profits. The state and central Governments are interested in the financial statements to know the earnings for the purpose of taxation. To compile national accounting is essential.

vii) Consumers: These groups are interested in getting the goods at reduced price. Therefore, they wish to know the establishment of a proper accounting control, which in turn will reduce to cost of production, in turn less price to be paid by the consumers. Researchers are also interested in accounting for interpretation.

viii) Research Scholars: Accounting information, being a mirror of the financial performance of a business organization, is of immense value to the research scholar who wants to make a study into the financial operations of a particular firm.

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 record maintained by the firm.

FUNCTIONS OF ACCOUNTING

i) Record Keeping Function: The primary function of accounting relates to recording, classification and summary of financial transactions- journalisation, posting, and preparation of final statements. These facilitate to know operating results and financial positions. The purpose of this function is to report regularly t the interested parties by means of financial statements. Thus accounting performs historical function i.e., attention on the past performance of a business; and this facilitates decision making programme for future activities.

ii) Managerial Function: Decision making programme is greatly assisted by accounting. The managerial function and decision making programmes, without accounting, may mislead. The day-to-day operations are compared with some predetermined standard. The variations of actual operations with pre-determined standards and their analysis is possible only with the help of accounting.

iii) 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. Accounting is a base and with its help various returns, documents, statements etc., are prepared.

iv) Language of Business: Accounting is the 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. The accounting shows a real and true position of the firm or the business.

ADVANTAGES OF ACCOUNTING

The following are the advantages of accounting to a business:

i) It helps in having complete record of business transactions.

ii) It gives information about the profit or loss made by the business at the close of a year and its financial conditions. The basic function of accounting is to supply meaningful information about the financial activities of the business to the owners and the managers.

iii) It provides useful information from making economic decisions.

iv) It facilitates comparative study of current year's profit, sales, expenses etc., with those of the previous years.

v) It supplies information useful in judging the management's ability to utilize enterprise resources effectively in achieving primary enterprise goals.

vi) It provides users with factual and interpretive information about transactions and other events which are useful for predicting, comparing and evaluation the enterprise's earning power.

vii) It helps in complying with certain legal formalities like filing of income tax and sales-tax returns. If the accounts are properly maintained, the assessment of taxes is greatly facilitated.

LIMITATIONS OF ACCOUNTING

i) Accounting is historical in nature: It does not reflect the current financial position or worth of a business.

ii) Transactions of non-monetary mature do not find place in accounting. Accounting is limited to monetary transactions only. It excludes qualitative elements like management, reputation, employee morale, labour strike etc.

iii) Facts recorded in financial statements are greatly influenced by accounting conventions and personal judgments of the Accountant or Management. Valuation of inventory, provision for doubtful debts and assumption about useful life of an asset may, therefore, differ from one

business house to another.

iv) Accounting principles are not static or unchanging-alternative accounting procedures are often equally acceptable. Therefore, accounting statements do not always present comparable data. Cost concept is found in accounting. Price changes are not considered. Money value is bound to change often from time to time. This is a strong limitation of accounting.

vi) Accounting statements do not show the impact of inflation. The accounting statements do not reflect those increases in net asset values that are not considered realized.

METHODS OF ACCOUNTING

Business transactions are recorded in two different ways.

Single Entry

Double Entry

Single Entry: Itis incomplete system of recording business transactions. The business organization maintains only cash book and personal accounts of debtors and creditors. So the complete recording of transactions cannot be made and trail balance cannot be prepared.

Double Entry: It this system every business transaction is having a two fold effect of benefits giving and benefit receiving aspects. The recording is made on the basis of both these aspects. Double Entry is an accounting system that records the effects of transactions and other events in at least two accounts with equal debits and credits.

STEPS INVOLVED IN DOUBLE ENTRY SYSTEM

(a) Preparation of Journal: Journal is called the book of original entry. It records the effect of all transactions for the first time. Here the job of recording takes place.

(b) Preparation of Ledger: Ledger is the collection of all accounts used by a business. Here the grouping of accounts is performed. Journal is posted to ledger.

(c) Trial Balance preparation: Summarizing. It is a summary of ledge balances prepared in the form of a list.

(d) Preparation of Final Account: At the end of the accounting period to know the achievements of the organization and its financial state of affairs, the final accounts are prepared.

Advantages of Double Entry System

i) Scientific system: This system is the only scientific system of recording business transactions in a set of accounting records. It helps to attain the objectives of accounting.

ii) Complete record of transactions: This system maintains a complete record of all business transactions.

iii) A check on the accuracy of accounts: By use of this system the accuracy of accounting book can be established through the device called a Trail balance.

iv) Ascertainment of profit or loss: The profit earned or loss suffered during a period can be ascertained together with details by the preparation of Profit and Loss Account.

v) Knowledge of the financial position of the business: The financial position of the firm can be ascertained at the end of each period, through the preparation of balance sheet.

vi) Full details for purposes of control: This system permits accounts to be prepared or kept in as much detail as necessary and, therefore, affords significant information for purposes of control etc.

vii) Comparative study is possible: Results of one year may be compared with those of the precious year and reasons for the change may be ascertained.

viii) Helps management in decision making: The management may be also to obtain good information for its work, specially for making decisions.

ix) No scope for fraud: The firm is saved from frauds and misappropriations since full information about all assets and liabilities will be available.

Meaning of Debit and Credit

The term ‘debit’ is supposed to have derived from ‘debit’ and the term ‘credit’ from ‘creditable’. For convenience ‘Dr’ is used for debit and ‘Cr’ is used for credit.

Recording of transactions require a thorough understanding of the rules of debit and credit relating to accounts. Both debit and credit may represent either increase or decrease, depending upon the nature of account.

MEANING AND DEFINITION OF BOOK- KEEPING

Meaning

Book- keeping includes recording of journal, posting in ledgers and balancing of accounts. All the records before the preparation of trail balance is the whole subject matter of book- keeping. Thus, book- keeping many be defined as the science and art of recording transactions in money or money’s worth so accurately and systematically, in a certain set of books, regularly that the true state of businessman’s affairs can be correctly ascertained. Here it is important to note that only those transactions related to business are recorded which can be expressed in terms of money.

DEFINITION

“Book- keeping is the art of recording business transactions in a systematic manner”. A.H.Rosenkamph.

“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”. R.N.Carter

OBJECTIVES OF BOOK- KEEPING

i) Book- keeping provides a permanent record of each transactions.

ii) Soundness of a firm can be assessed from the records of assets and abilities on a particular date.

iii) Entries related to incomes and expenditures of a concern facilitate to know the profit and loss for a given period.

iv) It enables to prepare a list of customers and suppliers to ascertain the amount to be received or paid.

v) It is a method gives opportunities to review the business policies in the light of the past records.

vi) Amendment of business laws, provision of licenses, assessment of taxes etc., are based on records.

DISTINCTION BETWEEN BOOK-KEEPING AND ACCOUNTING

Basis of difference	Book-keeping	Accounting
Transactions	Recording of transactions in books of original entry.	To examine these recorded transactions in order to find out their accuracy.
Posting	To make posting in ledger	To examine this posting in order to ascertain its accuracy.
Total and Balance	To make total of the amount in journal and accounts of ledger. To ascertain balance in all the accounts.	To prepare trial balance with the help of balances of ledger accounts.
Income Statement and Balance Sheet	Preparation of trading, Profit & loss account and balance sheet is not book keeping	Preparation of trading, profits and loss account and balance sheet is included in it.
Rectification of errors	These are not included in book-keeping	These are included in accounting.
Special skill and knowledge	It does not require any special skill and knowledge as in advanced countries this work is done by machines.	It requires special skill and knowledge.
Liability	A book-keeper is not liable for accountancy work.	An accountant is liable for the work of book-keeper.

TYPES OF ACCOUNTS

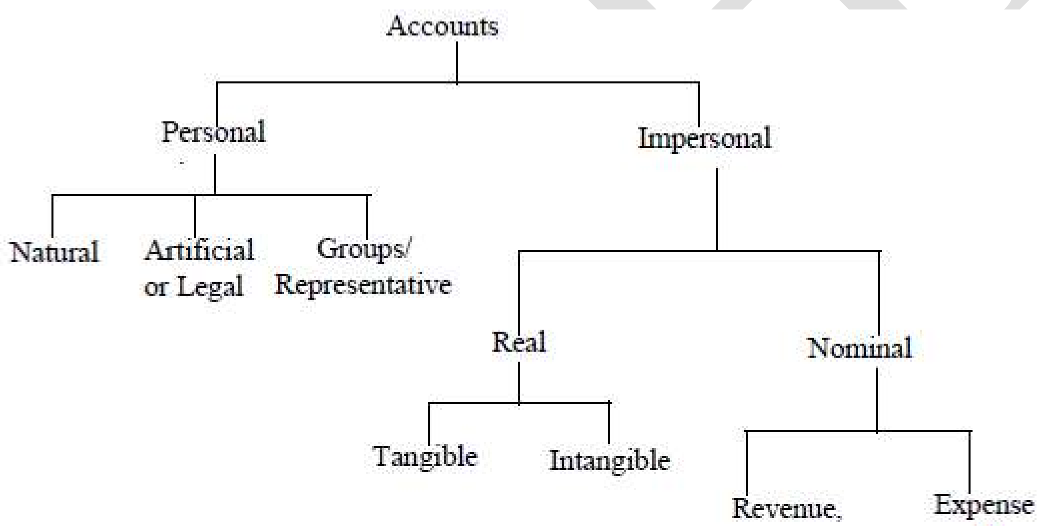
The object of book-keeping is to keep a complete record of all the transactions that place in the business. To achieve this object, business transactions have been classified into three categories:

(i) Transactions relating to persons.

(ii) Transactions relating to properties and assets

(iii) Transactions relating to incomes and expenses.

The accounts falling under the first heading are known as 'personal Accounts'. The accounts falling under the second heading are known as 'Real Accounts', The accounts falling under the third heading are called 'Nominal Accounts'. The accounts can also be classified as personal and impersonal. The following chart will show the various types of accounts:



PERSONAL ACCOUNTS: Accounts recording transactions with a person or group of persons are known as personal accounts. These accounts are necessary, in particular, to record credit transactions. Personal accounts are of the following types:

(a) Natural persons: An account recording transactions with an individual human being is termed as a natural persons' personal account. eg., Kamal's account, Mala's account, Sharma's accounts. Both males and females are included in it.

(b) Artificial or legal persons: An account recording financial transactions with an artificial person created by law or otherwise is termed as an artificial person, personal account, e.g. Firms' accounts, limited companies' accounts, educational institutions' accounts, Co-operative society account.

(c) Groups/Representative personal Accounts: An account indirectly representing a person or persons is known as representative personal account. When accounts are of a similar nature and their number is large, it is better tot group them under one head and open representative personal accounts. e.g., prepaid insurance, outstanding salaries, rent, wages etc.

When a person starts a business, he is known as proprietor. This proprietor is represented by capital account for all that he invests in business and by drawings accounts for all that which he withdraws from business. So, capital accounts and drawings account are also personal accounts.

The rule for personal accounts is: **Debit the receiver**

Credit the giver

REAL ACCOUNTS: Accounts relating to properties or assets are known as 'Real Accounts', A separate account is maintained for each asset e.g., Cash Machinery, Building, etc., Real accounts can be further classified into tangible and intangible.

(a) Tangible Real Accounts: These accounts represent assets and properties which can be seen, touched, felt, measured, purchased and sold. e.g. Machinery account Cash account, Furniture account, stock account etc.

(b) Intangible Real Accounts: These accounts represent assets and properties which cannot be seen, touched or felt but they can be measured in terms of money. e.g., Goodwill accounts, patents account, Trademarks account, Copyrights account, etc.

The rule for Real accounts is: **Debit what comes in**

Credit what goes out

NOMINAL ACCOUNTS: Accounts relating to income, revenue, gain expenses and losses are termed as nominal accounts. These accounts are also known as fictitious accounts as they do not represent any tangible asset. A separate account is maintained for each head or expense or loss and gain or income. Wages account, Rent account Commission account, Interest received account are some examples of nominal account

The rule for Nominal accounts is: **Debit all expenses and losses**

Credit all incomes and gains

BRANCHES OF ACCOUNTING

The changing business scenario over the centuries gave rise to specialized branches of accounting which could cater to the changing requirements. The branches of accounting are;

i) Financial accounting;

ii) Cost accounting; and

iii) Management accounting.

Now, let us understand these terms.

Financial Accounting

The accounting system concerned only with the financial state of affairs and financial results of operations is known as Financial Accounting. It is the original from of accounting. It is mainly concerned with the preparation of financial statements for the use of outsiders like creditors, debenture holders, investors and financial institutions. The financial statements i.e., the profit and loss account and the balance sheet, show them the manner in which operations of the business have been conducted during a specified period.

Cost Accounting

In view of the limitations of financial accounting in respect of information relating to the cost of individual products, cost accounting was developed. It is that branch of accounting which is concerned with the accumulation and assignment of historical costs to units of product and department, primarily for the purpose of valuation of stock and measurement of profits. Cost accounting seeks to ascertain the cost of unit produced and sold or the services rendered by the business unit with a view to exercising control over these costs to assess profitability and efficiency of the enterprise. It generally relates to the future and involves an estimation of future costs to be incurred. The process of cost accounting based on the data provided by the financial accounting.

Management Accounting

It is an accounting for the management i.e., accounting which provides necessary information to the management for discharging its functions. According to the Anglo-American Council on productivity, “Management accounting is the presentation of accounting information is such a way as to assist management in the creation of policy and the day-to-day operation of an undertaking.”

It covers all arrangements and combinations or adjustments of the orthodox information to provide the Chief Executive with the information from which he can control the business e.g. Information about funds, costs, profits etc. Management accounting is not only confined to the area of cost accounting but also covers other areas (such as capital expenditure decisions, capital structure decisions, and dividend decisions) as well.

ACCOUNTING PRINCIPLES

The word ‘Principle’ has been differently viewed by different schools of thought. The American Institute of Certified Public Accountants (AICPA) has viewed the word ‘principle’ as a general law of rule adopted or professed as a guide to action; a settled ground or basis of conduct of practice”

Accounting principles refer, to certain rules, procedures and conventions which represent a consensus view by those indulging in good accounting practices and procedures. Canadian Institute of Chartered Accountants defined accounting principle as “the body of doctrines commonly associated with the theory and procedure of accounting, serving as an explanation of current practices as a guide for the selection of conventions or procedures where alternatives exist. Rules governing the formation of accounting axioms and the principles derived from them have arisen from common experiences, historical precedent, statements by individuals and professional bodies and regulations of Governmental agencies”. To be more reliable, accounting

statements are prepared in conformity with these principles. If not, chaotic conditions would result. But in reality as all the businesses are not alike, each one has its own method of accounting.

However, to be more acceptable, the accounting principles should satisfy the following three basic qualities, viz., relevance, objectivity and feasibility. The accounting principle is considered to be relevant and useful to the extent that it increases the utility of the records to its readers. It is said to be objective to the extent that it is supported by the facts and free from personal bias.

It is considered to be feasible to the extent that it is practicable with the least complication or cost. Though accounting principles are denoted by various terms such as concepts, conventions, doctrines, tenets, assumptions, axioms, postulates, etc., it can be classified into two groups, viz., accounting concepts and accounting conventions.

ACCOUNTING CONCEPTS AND CONVENTIONS

Accounting concepts:

The term 'concept' is used to denote accounting postulates, i.e., basic assumptions or conditions upon the edifice of which the accounting super-structure is based. The following are the common accounting concepts adopted by many business concerns.

1. Business Entity Concept 2. Money Measurement Concept

3. Going Concern Concept 4. Dual Aspect Concept

5. Periodicity Concept 6. Historical Cost Concept

7. Matching Concept 8. Realization Concept

9. Accrual Concept 10. Objective Evidence Concept

i) Business Entity Concept: A business unit is an organization of persons established to accomplish an economic goal. Business entity concept implies that the business unit is separate and distinct from the persons who provide the required capital to it. This concept can be expressed through an accounting equation, viz.,

Assets = Liabilities + Capital. The equation clearly shows that the business itself owns the assets and in turn owes to various claimants. It is worth mentioning here that the business entity concept as applied in accounting for sole trading units is different from the legal concept. The expenses, income, assets and liabilities not related to the sole proprietorship business are excluded from accounting. However, a sole proprietor is personally liable and required to utilize non-business assets or private assets also to settle the business creditors as per law. Thus, in the case of sole proprietorship, business and non-business assets and liabilities are treated alike in the eyes of law. In the case of a partnership, firm, for paying the business liabilities the business assets are used first and it any surplus remains thereafter, it can be used for paying off the private liabilities of each partner. Similarly, the private assets are first used to pay off the private liabilities of partners and if any surplus remains, it is treated as part of the firm's property and is used for paying the firm's liabilities. In the case of a company, its existence does not depend on the life span of any shareholder.

ii) Money Measurement Concept: In accounting all events and transactions are recode in terms of money. Money is considered as a common denominator, by means of which various facts, events and transactions about a business can be expressed in terms of numbers. In other words, facts, events and transactions which cannot be expressed in monetary terms are not recorded in accounting. Hence, the accounting does not give a complete picture of all the transactions of a business unit. This concept does not also take care of the effects of inflation because it assumes a stable value for measuring.

iii) Going Concern Concept: Under this concept, the transactions are recorded assuming that the business will exist for a longer period of time, i.e., a business unit is considered to be a going concern and not a liquidated one. Keeping this in view, the suppliers and other companies enter into business transactions with the business unit. This assumption supports the concept of valuing the assets at historical cost or replacement cost. This concept also supports the treatment of prepaid expenses as assets, although they may be practically unsaleable.

iv) Dual Aspect Concept: According to this basic concept of accounting, every transaction has a two-fold aspect, Viz., 1.giving certain benefits and 2. Receiving certain benefits. The basic principle of double entry system is that every debit has a corresponding and equal amount of credit. This is the underlying assumption of this concept. The accounting equation viz.,

Assets = Capital + Liabilities or Capital = Assets – Liabilities, will further clarify this concept, i.e., at any point of time the total assets of the business unit are equal to its total liabilities. Liabilities here relate both to the outsiders and the owners. Liabilities to the owners are considered as capital.

V) Periodicity Concept: Under this concept, the life of the business is segmented into different periods and accordingly the result of each period is ascertained. Though the business is assumed to be continuing in future (as per going concern concept), the measurement of income and studying the financial position of the business for a shorter and definite period will help in taking corrective steps at the appropriate time. Each segmented period is called "accounting period" and the same is normally a year. The businessman has to analyze and evaluate the results ascertained periodically. At the end of an accounting period, an Income Statement is prepared to ascertain the profit or loss made during that accounting period and Balance Sheet is prepared which depicts the financial position of the business as on the last day of that period. During the course of preparation of these statements capital revenue items are to be necessarily distinguished.

vi) Historical Cost Concept: According to this concept, the transactions are recorded in the books of account with the respective amounts involved. For example, if an asset is purchases, it is entered in the accounting record at the price paid to acquire the same and that cost is considered to be the base for all future accounting. It means that the asset is recorded at cost at the time of purchase but it may be methodically reduced in its value by way of charging depreciation. However, in the light of inflationary conditions, the application of this concept is considered highly irrelevant for judging the financial position of the business.

vii) Matching Concept: The essence of the matching concept lies in the view that all costs which are associated to a particular period should be compared with the revenues associated to the same period to obtain the net income of the business. Under this concept, the accounting period concept is relevant and it is this concept (matching concept) which necessitated the provisions of different adjustments for recording outstanding expenses, prepaid expenses, outstanding incomes, incomes received in advance, etc., during the course of preparing the financial statements at the end of the accounting period.

viii) Realization Concept: This concept assumes or recognizes revenue when a sale is made. Sale is considered to be complete when the ownership and property are transferred from the seller to the buyer and the consideration is paid in full. However, there are two exceptions to this concept, viz., 1. Hire purchase system where the ownership is transferred to the buyer when the last installment is paid and 2. Contract accounts, in which the contractor is liable to pay only when the whole contract is completed, the profit is calculated on the basis of work certified each year.

ix) Accrual Concept: According to this concept the revenue is recognized on its realization and not on its actual receipt. Similarly the costs are recognized 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. But under cash accounting system, the revenues and costs are recognized only when they are actually received or paid. Hence, the combination of both cash and accrual system is preferable to get rid of the limitations of each system.

x) Objective Evidence Concept: This concept ensures that all accounting must be based on objective evidence, i.e., every transaction recorded in the books of account must have a verifiable document in support of its, existence. Only then, the transactions can be verified by the auditors and declared as true or otherwise. The verifiable evidence for the transactions should be free from the personal bias, *i.e.*, it should be objective in nature and not subjective.

ACCOUNTING CONVENTIONS

The following conventions are to be followed to have a clear and meaningful

information and data in accounting:

i) Consistency: The convention of consistency refers to the state of accounting rules, concepts, principles, practices and conventions being observed and applied constantly, i.e., from one year to another there should not be any change. If consistency is there, the results and performance of one period can he compared easily and meaningfully with the other. It also prevents personal bias as the persons involved have to follow the consistent rules, principles, concepts and conventions. This convention, however, does not completely ignore changes. It admits changes wherever indispensable and adds to the improved and modern techniques of accounting.

ii) Disclosure: The convention of disclosure stresses the importance of providing accurate, full and reliable information and data in the financial statements which is of material interest to the users and readers of such statements. This convention is given due legal emphasis by the Companies Act, 1956 by prescribing formats for the preparation of financial statements. However, the term disclosure does not mean all information that one desires to get should be included in accounting statements. It is enough if sufficient information, which is of material interest to the users, is included.

iii) Conservatism: In the prevailing present day uncertainties, the convention of conservatism has its own importance. This convention follows the policy of caution or playing safe. It takes into account all possible losses but not the possible profits or gains. A view opposed to this convention is that there is the possibility of creation of secret reserves when conservatism is excessively applied, which is directly opposed to the convention of full disclosure. Thus, the convention of conservatism should be applied very cautiously.

BASES OF ACCOUNTING

There are three bases of accounting in common usage. Any one of the following bases may be used to finalize accounts.

1. Cash basis

2. Accrual or Mercantile basis

3. Mixed or Hybrid basis.

Accounting on 'Cash basis

Under cash basis accounting, entries are recorded only when cash is received or paid. No entry is passed when a payment or receipt becomes due. Income under cash basis of accounting, therefore, represents excess of receipts over payments during an accounting period. Government system of accounting is mostly on cash basis.

Certain professional people record their income on cash basis, but while recording expenses they take into account the outstanding expenses also. In such a case, the financial statements prepared by them for determination of their income is termed as Receipts and Expenditure Account.

Accrual Basis of Accounting or Mercantile System

Under accrual basis of accounting, accounting entries are made on the basis of amounts having become due for payment or receipt. Incomes are credited to the period in which they are earned whether cash is received or not. Similarly, expenses and losses were detailed to the period in which, they are incurred, whether cash is paid or not. The profit or loss of any accounting period is the difference between incomes earned and expenses incurred, irrespective of cash payment or receipt. All outstanding expenses and prepaid expenses, accrued incomes and incomes received in advance are adjusted while finalizing the accounts. Under the Companies Act 1956, all companies are required to maintain the books of accounts according to accrual basis of accounting.

Mixed or Hybrid Basis of Accounting

When certain items of revenue or expenditure are recorded in the books of account on cash basis and certain items on mercantile basis, the basis of accounting so employed is called 'hybrid basis of accounting'. For example, a company may follow mercantile system of accounting in respect of its export business. However, government subsidies and duty drawbacks on exports to be received from government are recorded only when they are actually received i.e., on cash basis. Such a method could be adopted because of uncertainty with respect of quantum, amount and time of receipt of such incentives and drawbacks. Such a method of accounting followed by the company is called the hybrid basis of accounting. In practice, the profit or loss shown under this basis will not be realistic. Conservative people who prefer recognizing income when received but cautious to provide for all expenses, whether paid or not prefer this system. It is not widely practiced due to the inconsistency.

ACCOUNTING TERMINOLOGY

It is necessary to understand some basic accounting terms which are daily in business world. These terms are called accounting terminology.

Transaction

"An event the recognition of which gives rise to an entry in accounting records. It is an event which results in change in the balance sheet equation. That is, which changes the value of assets and equity. In a simple statement, transaction means the exchange of money or money's worth from one account to another account Events like purchase and sale of goods, receipt and payment of cash for services or on personal accounts, loss or profit in dealings etc., are the transactions". Cash transaction is one where cash receipt or payment is involved in the exchange. Credit transaction, on the other hand, will not have 'cash' either received or paid, for something given or received respectively, but gives rise to debtor and creditor relationship. Non-cash transaction is one where the question of receipt or payment of cash does not at all arise, e.g. Depreciation, return of goods etc.,

Debtor

A person who owes money to the firm mostly on account of credit sales of goods is called a debtor. For example, when goods are sold to a person on credit that person pays the price in future, he is called a debtor because he owes the amount to the firm.

Creditor

A person to whom money is owing by the firm is called creditor. For example, Madam is a creditor of the firm when goods are purchased on credit from him

Capital

It means the amount (in terms of money or assets having money value) which the proprietor has invested in the firm or can claim from the firm. It is also known as owner's equity or net worth. Owner's equity means owner's claim against the assets. It will always be equal to assets less liabilities, say: Capital = Assets - Liabilities.

Liability

It means the amount which the firm owes to outsiders that is, accepting the proprietors. In the words of Finny and Miller, "Liabilities are debts; they are amounts owed to creditors; thus the claims of those who ate not owners are called liabilities".

In simple terms, debts repayable to outsiders by the business are known as liabilities.

Asset

Any physical thing or right owned that has a money value is an asset. In other words, an asset is that expenditure which results in acquiring of some property or benefits of a lasting nature.

Goods

It is a general term used for the articles in which the business deals; that is, only those articles which are bought for resale for profit are known as Goods.

Revenue

It means the amount which, as a result of operations, is added to the capital. It is defined as the inflow of assets which result in an increase in the owner’s equity. It includes all incomes like sales receipts, interest, commission, brokerage etc., However, receipts of capital nature like additional capital, sale of assets etc., are not a pant of revenue.

Expense

The terms ‘expense’ refers to the amount incurred in the process of earning revenue. If the benefit of an expenditure is limited to one year, it is treated as an expense (also know is as revenue expenditure) such as payment of salaries and rent.

Expenditure

Expenditure takes place when an asset or service is acquired. The purchase of goods is expenditure, where as cost of goods sold is an expense. Similarly, if an asset is acquired during the year, it is expenditure, if it is consumed during the same year, it is also an expense of the year.

Purchases

Buying of goods by the trader for selling them to his customers is known as purchases. As the trade is buying and selling of commodities purchase is the main function of a trade. Here, the trader gets possession of the goods which are not for own use but for resale. Purchases can be of two types. viz, cash purchases and credit purchases. If cash is paid immediately for the purchase, it is cash purchases, If the payment is postponed, it is credit purchases.

Sales

When the goods purchased are sold out, it is known as sales. Here, the possession and the ownership right over the goods are transferred to the buyer. It is known as. 'Business Turnover’ or sales proceeds. It can be of two types, viz.,, cash sales and credit sales. If the sale is for immediate cash payment, it is cash sales. If payment for sales is postponed, it is credit sales.

Stock

The goods purchased are for selling, if the goods are not sold out fully, a part of the total goods purchased is kept with the trader unlit it is sold out, it is said to be a stock. If there is stock at the end of the accounting year, it is said to be a closing stock. This closing stock at the yearend will be the opening stock for the subsequent year.

Drawings

It is the amount of money or the value of goods which the proprietor takes for his domestic or personal use. It is usually subtracted from capital.

Losses

Loss really means something against which the firm receives no benefit. It represents money given up without any return. It may be noted that expense leads to revenue but losses do not. (e.g.) loss due to fire, theft and damages payable to others,

Account

It is a statement of the various dealings which occur between a customer and the firm. It can also be expressed as a clear and concise record of the transaction relating to a person or a firm or a property (or assets) or a liability or an expense or an income.

Invoice

While making a sale, the seller prepares a statement giving the particulars such as the quantity, price per unit, the total amount payable, any deductions made and shows the net amount payable by the buyer. Such a statement is called an invoice.

Voucher

A voucher is a written document in support of a transaction. It is a proof that a particular transaction has taken place for the value stated in the voucher. Voucher is necessary to audit the accounts.

Proprietor

The person who makes the investment and bears all the risks connected with the business is known as proprietor.

Discount

When customers are allowed any type of deduction in the prices of goods by the businessman that is called discount. When some discount is allowed in prices of goods on the basis of sales of the items, that is termed as trade discount, but when debtors are allowed some discount in prices of the goods for quick payment, that is termed as cash discount.

Solvent

A person who has assets with realizable values which exceeds his liabilities is insolvent.

Insolvent

A person whose liabilities are more than the realizable values of his assets is called an insolvent.

ACCOUNTING EQUATION

As indicated earlier, every business transaction has two aspects. One aspect is debited other aspect is credited. Both the aspects have to be recorded in accounts appropriately. American Accountants have derived the rules of debit and credit through a 'novel' medium, i.e., accounting equation. The equation is as follows: Assets = Equities

The equation is based on the principle that accounting deals with property and rights to property and the sum of the properties owned is equal to the sum of the rights to the properties. The properties owned by a business are called assets and the rights to properties are known as liabilities or equities of the business. Equities can be subdivided into equity of the owners which is known as capital and equity of creditors who represent the debts of the business know as liabilities. These equities may also be called internal equity and external equity. Internal equity represents the owner's equity in the assets and external represents he outsider's interest in the asset. Based on the bifurcation of equity, the accounting equation can be restated as follows:

Assets = Liabilities + Capital

(Or)

Capital = Assets – Liabilities

(Or)

Liabilities = Assets – Capital.

The equation is fundamental in the sense that it gives a foundation to the double entry book-keeping system. This equation holds good for all transaction and events and at all periods of time since every transaction and events has two aspects.

JOURNAL AND LEDGER

When the business transactions take place, the first step is to record the same in the books of original entry or subsidiary books or books of prime or journal. Thus journal is a simple book of accounts in which all the business transactions are originally recorded in chronological order and from which they are posted to the ledger accounts at any convenient time. Journalsing refers to the act of recording each transaction in the journal and the form in which it is recorded, is known as a journal entry.

ADVANTAGES OF JOURNAL

The following are the inherent advantages of using journal, though the transactions can also be directly recorded in the respective ledger accounts; 1. As all the transactions are entered in the journal chronologically, a date wise record can easily be maintained;

2. All the necessary information and the required explanations regarding all transactions can be obtained from the journal; and

3. Errors can be easily located and prevented by the use of journal or book of prime entry.

The specimen journal is as follows:

Date	Particulars		L.F.	Debit Rs.	Credit Rs.
1	2		3	4	5
				-	-

The journal has five columns, viz. (1) Date; (2) Particulars; (3) Ledger Folio;

(4) Amount (Debit); and (5) Amount (Credit) and a brief explanation of the transaction by way of narration is given after passing the journal entry.

(1) Date: In each page of the journal at the top of the date column, the year is written and in the next line, month and date of the first entry are written. The year and month need not be repeated until a new page is begun or the month or the year changes. Thus, in this column, the date on which the transaction takes place is alone written.

(2) Particulars: In this column, the details regarding account titles and description are recorded. The name of the account to be debited is entered first at the extreme left of the particulars column next to the date and the abbreviation 'Dr.' is written at the right extreme of the same column in the same line. The name of the account to be credited is entered in the next line preceded by the word "To" leaving a few spaces away from the extreme left of the particulars column. In the next line immediately to the account credited, a short about the transaction is given which is known as "Narration". "Narration" may include particulars required to identify and understand the transaction and should be adequate enough to explain the transaction.

It usually starts with the word "Being" which means what it is and is written within parentheses. The use of the word "Being" is completely dispense with, in modern parlance. To indicate the completion of the entry for a transaction, a line is usually drawn all through the particulars column.

(3) Ledger Folio: This column is meant to record the reference of the main book, i.e., ledger and is not filled in when the transactions are recorded in the journal. The page number of the ledger in which the accounts are appearing is indicated in this column, while the debits and credits are posted o the ledger accounts.

(4) Amount (Debit): The amount to be debited along with its unit of measurement at the top of this column on each page is written against the account debited.

(5) Amount (Credit): The amount to be credited along with its unit of measurement at the top of this column on each page is written against the account credited.

SUB-DIVISION OF JOURNAL

When innumerable number of transactions takes place, the journal, as the sole book of the original entry becomes inadequate. Thus, the number and the number and type of journals required are determined by the nature of operations and the volume of transactions in a particular business. There are many types of journals and the following are the important ones:

1. Sales Day Book- to record all credit sales.

2. Purchases Day Book- to record all credit purchases.

3. Cash Book- to record all cash transactions of receipts as well as payments.

4. Sales Returns Day Book- to record the return of goods sold to customers on credit.

5. Purchases Returns Day Book- to record the return of goods purchased from suppliers on credit.

6. Bills Receivable Book- to record the details of all the bills received.

7. Bills Payable Book- to record the details of all the bills accepted.

8. Journal Proper-to record all residual transactions which do not find place in any of the aforementioned books of original entry.

Illustration:

Analyse the following transactions.

(a) Ramesh started his business with cash

(b) Borrowed from Nikhil

(c) Purchased furniture

(d) Purchased furniture from Mohan on credit

(e) Purchased goods for cash

(f) Purchased goods from Ram on credit

(g) Sold goods for cash

(h) Sold goods to Hari on credit

(i) Received cash from Hari

(j) Paid cash to Ram

(k) Deposited into bank

(l) Withdrew cash for personal use

(m) Withdrew from bank for office use

(n) Withdrew from bank for personal use

(o) Received cash from a customer, Shyam

(p) Paid salary by cheque

(q) Received donation in cash

(r) Paid to Ram by cheque

(s) Paid salary

(t) Paid rent by cheque

(u) Goods withdrawn for personal use

(v) Paid an advance to suppliers of goods

(w) Received an advance from customers

(x) Paid interest on loan

(y) Paid instalment of loan

(z) Interest allowed by bank.

Solution

ANALYSIS OF TRANSACTIONS

Transaction	Accounts involved	Nature of accounts	How affected	Whether to be debited or credited
(a)	Cash A/c	Real	Cash is coming in	Debit
	Capital A/c	Personal	Ramesh is the giver	Credit
(b)	Cash A/c	Real	Cash in coming in	Debit
	Loan from Nikhil A/c	Personal	Nikhil is the giver	Credit
(c)	Furniture A/c	Real	Furniture is coming in	Debit
	Cash A/c	Real	Cash is going out	Credit
(d)	Furniture A/c	Real	Furniture is coming in	Debit
	Mohan's A/c	Personal	Mohan is the giver	Credit
(e)	Purchases A/c	Real	Goods are coming in	Debit
	Cash A/c	Real	Cash is going out	Credit
(f)	Purchases A/c	Real	Goods are coming in	Debit
	Ram's A/c	Personal	Ram is the giver	Credit
(g)	Cash A/c	Real	Cash is coming in	Debit
	Sales A/c	Real	Goods are going out	Credit
(h)	Hari's A/c	Personal	Hari is the receiver	Debit
	Sales A/c	Real	Goods are going out	Credit
(i)	Cash A/c	Real	Cash is coming in	Debit
	Hari's A/c	Personal	Hari is the giver	Credit
(j)	Ram's A/c	Personal	Ram is the receiver	Debit
	Cash A/c	Real	Cash is going out	Credit
(k)	Bank A/c	Personal	Bank is the receiver	Debit
	Cash A/c	Real	Cash is going out	Credit
(l)	Drawings A/c	Personal	Ramesh is the receiver	Debit
	Cash A/c	Real	Cash is going out	Credit

20.	Cash A/c	Dr.		1,000	
	Discount Allowed A/c	Dr.		50	
	To Pankaj A/c				1,050
	(Being cash received from Pankaj and allowed him discount Rs. 50)				
22.	Cash A/c	Dr.		3,000	
	To Bank A/c				3,000
	(Being cash withdrawn from bank)				
25.	Ram A/c	Dr.		500	
	To Bank A/c				500
	(Being paid by cheque)				
31.	Drawings A/c	Dr.		200	
	To Cash A/c				200
	(Being withdrawn for personal use)				
	Grand Total			**90,050**	**90,050**

Goods Account

Generally, the term goods include every type of property such as Land, Building, Machinery, Furniture, Cloth etc. However, in accountancy its meaning is restricted to only those articles which are purchased by a businessman with an intention to sell it. For example, if a businessman purchased typewriter, it will be goods for him if he deals in typewriter but if he deals in other business say clothes then typewriter will be asset for him and clothes will be goods.

Sub-Division of Goods Accounts

The goods account is not opened in accounting books and it is to be noted goods includes purchases, sales, sales returns, purchases return of goods. However, purchase account, sales account, sales return account and purchase return account are opened in the books of account.

Purchases Account: This is opened for goods purchased on cash and credit.

Sales Account: This account is opened for the goods sold on cash and credit.

Purchase Returns Account or Return Outward Account: This account is opened for the goods returned to suppliers.

Sales Returns Account or Return Inward Account: This account is opened for the goods returned by customers.

Opening Entry

In case of going concern at the beginning of the new year, new books of accounts are opened and the balances relating to personal and real Accounts appearing in the books at the close of the previous year are brought forward in new books. The entry for this purpose in the books is called opening entry.

The opening entry is passed by debiting all assets and crediting all liabilities including capital. If the amount of capital is not given then this can be found out with the help of the accounting equation:

Assets = Liabilities + capital

Capital = Assets- Liabilities

Illustration: On 1st April 1998, Singh's assets and liabilities stood

as follows:

Assets: Cash Rs. 6,000, Bank Rs. 17,000, Stock Rs. 3,000;

Bills receivable 7,000; Debtors 3,000; Building

70,000; Investments 30,000; Furniture 4,000

Liabilities: Bills payable 5000, Creditors 9000, Ram's loan

13,000

Pass on opening Journal entry.

Date	Particulars		L.F.	Debit Amount	Credit Amount
1998					
April 1	Cash Account	Dr.		6,000	
	Bank Account	Dr.		17,000	
	Stock Account	Dr.		3,000	
	Bills receivable Account	Dr.		7,000	
	Debtors Account	Dr.		3,000	
	Building Account	Dr.		70,000	
	Investment Account	Dr.		30,000	
	Furniture	Dr.		4,000	
	To Bills payable Account				5,000
	To Creditor's Account				9,000
	To Ram's loan Account				13,000
	To Singh's capital				1,13,000
	(Being the opening balances of assets and liabilities)				
				1,40,000	1,40,000

IMPORTANT CONSIDERATIONS FOR RECORDING THE

BUSINESS TRANSACTIONS

1. Trade Discount

Trade discount is usually allowed on the list price of the goods. It may be allowed by producer to wholesaler and by wholesaler to retailer for purchase of goods in large quantity. It is not recorded in the books of account and entry is made only with the net amount paid or received, for example, purchased goods of list price Rs. 8,000 at 15% trade discount from X. In this case the following entry will be passed:

Purchases Account Dr. 6,800

To X 6,800

(Being goods purchased at 15% trade discount Less list price)

2. Amount paid or received in full settlement or cash discount

Cash discount is a concession allowed by seller to buyer to encourage him to make early cash payment. It is a Nominal Account. The person who allows discount, treat it as an expenses and debits is his books and it is called discount allowed and the person who receives discount, treat as an income and it is called discount received and credits in his books of account "Discount Received Account." For example, X owes Rs. 6,000 to Y. He pays Rs. 5,950 in full settlement against the amount due. In the books of X the journal entry will be:

Y Dr. 6,000

To Cash Account 5,950

To Discount Received account 50

(Being Cash paid and discount received)

In the books of Y Rs. Rs.

Cash Account Dr. 5,950

Discount Allowed Account Dr. 50

To X 6,000

(Being cash received and discount allowed)

3. Goods distributed as free samples

Some times business distributes goods as free samples for the purpose of advertisement. In this case Advertisement Account is debited and Purchases Accounts is credited. For example, goods costing Rs. 8000 were distributed as free sample. to record this transactions following entry will be passed:

Advertisement Account Dr. 8,000

To Purchases Account 8,000

4. Interest on capital

Interest paid on capital is an expense. Therefore interest account should be debited. On the other hand the capital of the business is increases. So the capital account should be credited. The entry will be as follows:

Interest on Capital Account Dr.

To Capital Account

5. Interest charged on Drawings

If the interest is charged on drawings then it will be an increase in the income of business, so interest on drawings will be credited. On the other hand there will be increase in Drawings or decrease in Capital. So Drawings Account will be debited. To record this, following entry will be

passed:

Drawing Account or Dr.

Capital Account Dr.

To Interest on Drawing Account

6. Depreciation charged on Fixed Assets

Depreciation is the gradual, permanent decrease in the value of an assets due to wear and tear and many other causes. Depreciation is an expense so the following entry will be passed:

Depreciation Account Dr.

To Asset Account

7. Bad Debts

Sometimes a debtor of business fails to pay the amount due from him. Reasons may be many e.g. he may become insolvent or he may die. Such irrecoverable amount is a loss to the business. To record this following entry will be passed:

Bad Debts Account Dr. To Debtor’s Account

8. Bad Debts Recovered

When any amount becomes irrecoverable from any costumer or debtor his account is closed in the books. If in future any amount is recovered from him then his personal account will not be credited because that does not exist in the books. So the following entry is passed:

Cash Account Dr.

To Bad Debts Recovered Account

9. Purchase and Sale of investment

When business has some surplus money it may invest this amount is shares, debentures or other types of securities. When these securities are purchased, these are recorded at the purchase price paid. At the time of sale of investment the sale price of an investment is recorded in the books of accounts. The following entry is passed to record the purchase of investment:

Investment Account Dr.

To Cash Account

In case of sale of these securities the entry will be:

Cash Account Dr.

To Investment Account

10. Loss of Goods by Fire/Accident/theft

A business may suffer loss of goods on account of fire, theft or accident. It is a business loss and a nominal account. It also reduces the goods at cost price, and increases the loss/expenses of the business. The entry will be passed as:

Loss by fire/Accident/theft Account Dr (for loss)

Insurance Company Account Dr. (for insurance claim admitted)

To Purchases Account

11. Income Tax Paid

Income Tax paid should be debited to Capital Account or Drawings Account and credited to cash Account in case of sole proprietorship and partnership firms. The reason behind this is that income tax is a personal expense for the sole trader and partners because it is paid on income of proprietor. The entry will be as follows:

Capital Account Dr.

Drawing Account Dr.

To Cash Account

12. Bank Charges

Bank provide various services to their customers. Bank deducts some charges by debiting the account of customers. It is an expenses for the business. To record this following entry will be passed in the books of businessman/customer:

Bank Charges Account Dr.

To Bank Account

13. Drawings Account

It is a personal account of the proprietor. When the businessman withdraws cash or goods form the business for his personal/domestic use it is called as ‘drawings’. Drawings reduce the capital as well as goods/cash balance of the business. The journal entry is:

Drawings Account Dr.

To Cash Account

To Purchases Account

14. Personal expenses of the proprietor

When the private expenses such as life insurances premium, income tax, home telephone bill, tuition fees of the son of the proprietor etc. are paid out of the cash or bank account of business it should be debited to the Drawing Account of the proprietor. The journal entry is:

Capital/Drawings Account Dr.

To Cash/Bank

15. Sale of Asset/Property

When the asset of a business is sold, there may occur a profit or loss on its sale. It should be noted carefully that sales account is never credited on the sale of asset. The journal entry is:

(i) In case there is a profit on sale of Property/Assets

Cash/Bank Account Dr.

To Asset/Property Account

To Profit on sale of Asset Account

(ii) In case of a loss on sale of asset

Cash/Bank Account Dr.

Loss on sale of Asset Account Dr.

To Asset Account

16. Amount paid or Received on behalf of customer

(i) When the business entity pays the amount on behalf of old reputed customers such as carriage in anticipation of recovering the same later on, carriage account should not be opened because carriage is not the expense of the seller. It should be debited/charged to customer’s Personal account. The journal entry is:

Customer/Debtor's Account Dr.

To Cash/Bank Account

(ii) When the business entity receives the amount on behalf of customers from the third party as mutually settled between the third party and the customer, the account of the third party/person making the payment should not be opened in the books of the receiving entity.

The journal entry in the books of the entity is:

Cash/Bank Account Dr.

To Customer/Debtor's Account

17. Amount paid on behalf of creditors

When the creditors/supplier instructs the business entity to make payment on their behalf, the amount so paid should be debited to creditors account and liability of the business will decrease accordingly.

The journal entry is:

Suppliers/Creditors Account Dr.

To Cash/Bank Account

18. The events affecting business but they do not involve any transfer/exchange of money for the time being, they would not be recorded in the financial books. Examples of them are:

(i) On 1st January 2006 placed on order to Geeta& Sons for the supply of goods worth Rs. 1,00,000.

(ii) Babanjot, a B.Com. graduate has been appointed Sales Assistant on a salary of Rs. 5,000 p.m. on Jan., 2006.

(iii) Raman, a proprietor contracted with Bahia Builders Ltd. For the renovation of the building at an estimated cost of Rs. 5,00,000.

(iv) A shop in Adalt Bazar Patiala contracted to be taken on a rent @ Rs. 4,000 pm.

19. Paid wages/installation charges for erection of machinery

Wages and installation charges are the expenses of nominal nature. But for erection of machinery no separate account should be opened for such expenses because these expenses are of capital nature and it will be merged/debited to the cost of assets i.e. machinery. The journal entry is:

Machinery Account Dr.

To Cash/Bank Account

(Being wages/installation charges paid for the erection of machinery)

Illustration: Journalise the following transactions for the month of

January 2006:

2006

Jan.1 Invested in shares of Tata Cotton Mills Ltd. and paid for the same in cash Rs. 2,000.

2 Placed on order with Mr. Shah for goods to be received a month later Rs. 1,500.

3 Invoiced goods to Mr. Love worth Rs. 1,000 and allowed a trade discount of 2 per cent.

4 Carriage Rs. 25 and freight Rs. 70 were paid by the proprietor for the above goods but which are to be charged to Mr. Love Account. the above goods but which are to be charged to Mr. Love Account.

5 Paid rent to landlord of office premises- Rs. 150, which he spent on purchase of our goods.

6 Goods valued at Rs. 700 were delivered to Ahmedabad Merchants under instructions from Mr. Gobind. They were to be charged to the latter's Account.

7 Mr. Love paid Rs. 500 due from him, and the same was spent on purchasing goods from Mr. Deepu.

8 Sold one old motor car belonging to the proprietor for Rs. 5,000 and the amount was invested in the business.

9 The proprietor paid Rs. 180 in full settlement of Mr. Manpreet for goods worth Rs. 200 purchased by him for personal use.

10 Mr. Gobind was declared insolvent and paid Rs. 450 in full settlement. The balance Rs. 250 was written off as a bad debt.

11 Mohinder our debtors, on our advice, directly paid Narinder, our creditor Rs. 2,000.

Solution

JOURNAL

Date	Particulars		L.F.	Dr. Rs.	Cr. Rs.
2006 Jan. 1	Investment Account	Dr.		2,000	
	To Cash Account				2,000
	(Being purchase of shares of Tata Cotton Mills Ltd. paid in cash)				
2	No entry is passed as "placing of an order is not a business transaction."				
3	Mr. Love's Account	Dr.		980	
	To Sales Account				980
	(Being the entry for credit sale of goods to				
4.	Mr. Love's Account	Dr.		95	
	To Cash Account				95
	(Being payment of freight and carriage on behalf of Mr. Love)				
5	Rent Account	Dr.		150	
	To Sales Account				150
	(Being rent paid to the landlord in the form of goods, instead of in cash)				
6	Mr. Gobind Account	Dr.		700	
	To Sales account				700
	(Being goods sold to Mr. Govind but delivered to A. Merchants as per instructions)				

7	Cash Account Dr. To Love's Account (Being in amount received in cash from Love)			500	500
7	Purchases Account Dr. To Cash Account (Being entry for goods purchased from Mr. Deepu from in cash received from Love)			500	500
8	Cash Account Dr. To Proprietor's Capital Account (Being amount invested in business out of the sale process of the owner's personal car)			5,000	5,000

9	Proprietor's Capital Account/Drawing A/c Dr. To Cash Account (Being the amount paid to Manpreet for goods purchased for his personal use)		180	180

10	Cash Account Dr. Bad Debts Account Dr. To Gobind's Account (Being the amount received from Gobind in full settlement of his debts)		450 250	700
11	Narinder Dr. To Mohinder (Being cash paid by Mohinder to Narinder)		2,000	2,000

1. Mr. Ravindra's position as on 1st Jan. 1999 is follows:
   Property and Assets: Buildings Rs. 15,000

   Furniture Rs. 1,500.

   Stock of Goods Rs. 20,000

   Cash at Bank Rs. 5,000

   Cash in hand Rs. 1,000, and

   Customer's Accounts Rs. 15,000.

Liabilities: Suppliers Accounts Rs. 12,500 and

Loan Account Rs. 30,000.

Pass necessary entries to record the above.

2. Miss Twinkle Punia started a restaurant investing Rs. 5,00,000 on Jan. 1, 2000 and further submits the details of the transactions:

2006

Jan.5: She purchased furniture for Rs. 2,75,000; Crockery Rs.75,000 and cooking utensils Rs. 38,000

Jan. 10: She paid Rs. 1,00,000 as Salami for taking the shop on lease for ten years at Daryaganj, Delhi.

Jan. 15: She took a temporary loan of Rs. 75,000 from her brother Rupinder, a financier.

Jan. 25: She took a bank loan of Rs. 50,000 and repaid the loan taken from her brother, Rupinder partly.

Jan. 31: She appointed Lavina as a manager at a salary of Rs. 5000 p.m. and took from her a security deposit of Rs. 50,000.

Pass Journal entire in the books of Twinkle Punia.

LEDGER

Ledger is a main book of account in which various accounts of personal, real and nominal nature, are opened and maintained. In journal, as all the business transactions are recorded chronologically, it is very difficult to obtain all the transactions pertaining to one head of account together at one place. But, the preparation of different ledger accounts helps to get a consolidated picture of the transactions pertaining to one ledger account at a time. Thus, a ledger account may be defined as a summary statement of all the transactions relating to a person, asset, expense, or income or gain or loss which have taken place during a specified period and shows their net effect ultimately. From the above definition, it is clear that when transactions take place, they are first entered in the journal and subsequently posted to the concerned accounts in the ledger. Posting refers to the process of entering in the ledger the information given in the journal. In the past, the ledgers were kept in bound books. But with the passage of time, they became loose-leaf ones and the advantages of the same lie in the removal of completed accounts, insertion of new accounts and arrangement of accounts in any required manner.

RULING OF LEDGER ACCOUNT

The ruling of a ledger account is as follows:

Type- 1

Dr. Cr.

Date	Particulars	J.F.	Rs.	Date	Particulars	J.F.	Rs.
	To name of the account to be credited				By name of the account to be debited		

Type: 2

26

Date	Particulars	J.F.	Dr. Rs.	Cr. Rs.	Dr. / Cr.	Balance Rs.
	To name of the account to be credited				By name of the account to be debited	

Ledger Account Type 1 is followed in almost all the business concerns, whereas Type 2 is followed only in banking institutions to save space, time and clerical work involved.

SUB-DIVISION OF LEDGER

In a big business, the number of accounts is numerous and it is found necessary to maintain a separate ledger for customers, suppliers and for others. Usually, the following three types of ledgers are maintained in such big business concerns.

(i) Debtors' Ledger: It contains accounts of all customers to whom goods have been sold on credit. From the Sales Day Book, Sales Returns Book and Cash Book, the entries are made in this ledger. This ledger is also known as sales ledger.

(ii) Creditors' Ledger: It contains accounts of all suppliers from whom goods have been bought on credit. From the Purchases Day Book, Purchases Returns Book and Cash Book, the entries are made in this ledger. This ledger is also known as Purchase Ledger.

(iii) General Ledger: It contains all the residual accounts of real and nominal nature. It is also known as Nominal Ledger.

DISTINCTION BETWEEN JOURNAL AND LEDGER

(i) Journal is a book of prime entry, whereas ledger is a book of final entry.

(ii) Transactions are recorded daily in the journal, whereas posting in the ledger is made periodically.

(iii) In the journal, information about a particular account is not found at one place, whereas in the ledger information about a particular account is found at one place only.

(iv) Recording of transactions in the journal is called journalizing and recording of transactions in the ledger is called posting.

(v) A journal entry shows both the aspects debit as well as credit but each entry in the ledger shows only one aspect.

(vi) Narration is written after each entry in the journal but no narration is given in the ledger.

(vii) Vouchers, receipts, debit notes, credit notes etc., from the basic documents form journal entry, whereas journal constitutes basic record for ledger entries.

1. Journalise the following transactions in the books of Shankar & Co.

1998			Rs.
June	1	Started business with a capital of	60,000
June	2	Paid into bank	30,000

June	4	Purchased goods from Kamal on credit	10,000
June	6	Paid to Shiram	4,920
June	6	Discount allowed by him	80
June	8	Cash Sales	20,000
June	12	Sold to Hameed	5,000
June	15	Purchased goods from Bharat on credit	7,500
June	18	Paid Salaries	4,000
June	20	Received from Prem	2,480
June	20	Allowed him discount	20
June	25	Withdrew from bank for office use	5,000
June	28	Withdraw for personal use	1,000
June	30	Paid Hanif by cheque	3,000

Solution:

In the books of Shankar & Co.

Date		Particulars		L.F.	Dr. Rs.	Cr. Rs.
1998 June	1	Cash A/c To Capital A/c (Capital brought into the business)	Dr.		60,000	60,000
June	2	Bank A/c To Capital A/c (Cash paid into bank)			30,000	30,000
June	4	Purchases A/c To Kamal's A/c (Purchased goods from Kamal on credit)			10,000	10,000
June	6	Shriram's A/c To Cash A/c (Cash paid to Shriram)	Dr.		4,920	4,920
June	6	Shriram's A/c To Cash A/c (Cash allowed by Shriram)	Dr.		80	80
June	8	Cash A/c To Sales A/c (Cash sales effected)	Dr.		20,000	20,000
June	12	Hameed's A/c To Sales A/c (Goods sold to Hameed)	Dr.		5,000	5,000
June	15	Purchases A/c To Bharat's A/c (Purchased goods from Bharat)	Dr.		7,500	7,500
June	18	Salaries A/c To Cash A/c (salaries paid)	Dr.		4,000	4,000
June	20	Cash A/c	Dr.		2,480	

		To Prem's A/c (Cash received from Prem)				2,480
June	20	Discount A/c To Prem's A/c (Discount allowed to Prem)	Dr.		20	20
June	25	Cash A/c To Bank A/c (Cash withdrawn from bank)	Dr.		5,000	5,000
June	28	Drawings A/c To Cash A/c (Cash withdrawn from bank for personal use	Dr.		1,000	1,000
June	30	Hanif's A/c To Bank A/c (Paid to Hanif by cheques)	Dr.		3,000	3,000

Illusration-2

Journalise the following transactions:

1998

June 1 Purchased goods worth Rs.300 from Vimal and Rs.500 from Kamal on credit.
June 3 Sale of goods worth Rs.1,000 to Balram and Rs.700 to Dhanram.
June 5 Cash of Rs.900 received from Ramasamy and Rs.800 from Krishnasmy.
June 7 Paid Rs.800 to Pradeep and Rs.500 to kuldeep.
June 9 Withdrawn from bank Rs.600 for office use and Rs.300 for personal use.

Solution:

Journal

Date		Particulars		L.F.	Dr. Rs.	Cr. Rs.
1998 June	1	Purchases A/c To Vimal's A/ c To Kamal's A/c (Purchased goods from Vimal and Kamal on credit	Dr.		800	 300 500
June	3	Balram's A/c Dhanram A/c To Sales A/c (Sales of goods to Balram and Dhanram)	Dr. Dr.		1,000 700	 1,700
June	5	Cash A/c To Ramasamy's A/c To Krishnasamy's A/c (Cash received from Ramasamy and Krishnasamy)	Dr.		1,700	 900 800
June	7	Pradeep's A/c Kuldeep's A/c To Cash A/c (Paid Pradeep and Kuldeep)	Dr. Dr.		800 500	 1,300
June	9	Cash A/c Drawings A/c To Bank A/c	Dr. Dr.		600 300	 900

		(Withdrawn from bank for office use and personal use)			

Illustration - 3

Journalise the following transactions, post the same in relevant ledger account and balance the same.

1998

June	1	Karthik commenced business with Rs.20,000.
June	2	Paid into bank Rs.5,000.
June	3	Purchased Plant worth Rs.10,000 from Modi & Co.
June	4	Purchased goods worth Rs. 5,000 form Anwar.
June	6	Goods worth Rs.4,000 sold to Anbu
June	8	Sold goods worth Rs.2,000 for cash.
June	10	Goods returned by Anbu Rs.50.
June	15	Paid rent Rs.250.
June	18	Withdrawn from bank for office use Rs. 2,500.
June	20	Paid Salaries Rs.1,800.
June	25	Withdrawn for personal use Rs.250.
June	26	Goods returned to Anwar Rs.100.
June	27	Paid for office furniture Rs.1,500 by cheque.
June	28	Received Rs.3,900 cash from Anbu and discount allowed Rs.50.
June	29	Paid Anwar on account Rs.4,800 and discount allowed by him Rs.100.

Solution:

Journal

Date	Particular		L.F.	Dr. Rs.	Cr. Rs.
1998 June 1	Cash A/c To Karthik's Capital A/c (Capital brought into the business by Karthik)	Dr		20,000	20,000
June 2	Bank A/c To Cash A/c (Cash Paid in to bank)	Dr		5,000	5,000

June 3	Plant A/c To Modi & Co's. A/c (Plant purchased from Modi & Co.)	Dr	10,000	10,000
June 4	Purchase A/c To Answar's A/c (Goods purchased from Anwar)	Dr	5,000	5,000
June 6	Anbu's A/c To Sales A/c (Goods sold to Anbu)	Dr	4,000	4,000
June 8	Cash A/c To Sales A/c (Goods sold for cash)	Dr	2,000	2,000
June 10	Sales Returns A/c To Anbu's A/c (Goods returned by Anbu)	Dr	50	50
June 15	Rent A/c To Cash A/c (Rent paid)	Dr	250	250
June 18	Cash A/c To Bank A/c (Withdrawn from bank for office use)	Dr	2,500	2,500
June 20	Salaries A/c To Cash A/c (Salaries paid)	Dr	1,800	1,800
June 25	Drawing A/c To Cash A/c (Withdrawn for personal use)	Dr	250	250
June 26	Anwar's A/c To Purchases Returns A/c (Goods returned to Anwar)	Dr	100	100
June 27	Furniture A/c To Bank A/c (Payment by cheque for office furniture)	Dr	1,500	1,500
June 28	Cash A/c Discount A/c To Anbu's A/c (Cash received from Anbu and discount allowed Rs.50)	Dr Dr	3,900 50	 3,950
June 29	Anwar's A/c To Cash A/c To Discount A/c (Cash paid to Anwar and discount allowed by him)	Dr	4,900	 4,800 100

Ledger
Cash A/c

Dr. Cr.

Date	Particulars	J.F.	Rs.	Date	Particulars	J.F.	Rs.
1998				1998			

June	1	To Karthik's Capital A/c		20,000	June	2	By Bank A/c		5,000
June	8	To Sales A/c		2,000.	June	15	By Rent A/c		250
June	18	To Bank A/ c		2,500	June	20	By Salaries A/c		1,800
June	28	To Anbu's A/c		3,900	June	25	By Drawings A/c		250
					June	29	By Anwar's A/c		4,800
					June	30	By Balance c/d		16,300
				28,400					28,400
July	1	To Balance b/d		16,300					

Bank

Dr. Cr.

Date		Particulars	J.F.	Rs.	Date		Particulars	J.F.	Rs.
1998					1998				
June	2	To Cash A/c		5,000	June	18	By Cash A/c		2,500
					June	27	By Furniture A/c		1,500
					June	30	By Balance c/d		1,000
				5,000					5,000
July	1	To Balance b/d		1,000					

Karthik's Capital A/c

Dr. Cr.

Date		Particulars	J.F.	Rs.	Date		Particulars	J.F.	Rs.
1998					1998				
June	30	To Balance c/d		20,000	June	1	By Cash A/c		20,000
				20,000					20,000
					July	1	By Balance b/d		20,000

Plant A/c

Dr. Cr.

Date		Particulars	J.F.	Rs.	Date		Particulars	J.F.	Rs.
1998					1998				
June	3	To Modi & Co's. A/c		10,000	June	30	By Balance c/d		10,000
				10,000					10,000
July	1	To Balance c/d		10,000					

Modi & Co's. A/c

Dr. Cr.

Date		Particulars	J.F.	Rs.	Date		Particulars	J.F.	Rs.
1998					1998				
June	30	To Balance c/d		10,000	June	3	By Plant A/c		10,000
				10,000					10,000
					July	1	By Balance b/d		10,000

Purchase A/c

Dr. Cr.

Date		Particulars	J.F.	Rs.	Date		Particulars	J.F.	Rs.
1998					1998				
June	4	To Anwar's A/c		5,000	June	30	By Balance C/d		5,000
				5,000					5,000
July	1	To Balance b/d		5,000					

Anwar's A/c

Dr. Cr.

Date		Particulars	J.F.	Rs.	Date		Particulars	J.F.	Rs.
1998					1998				
June	26	To Purchases Returns A/c		100	June	4	By Purchases A/c		5,000
June	29	To Cash A/c		4,800					
June	29	To Discount A/c		100					
				5,000					5,000

Sales A/c

Dr. Cr.

Date		Particulars	J.F.	Rs.	Date		Particulars	J.F.	Rs.
1998					1998				
June	30	To Balance c/d		6,000	June	6	By Anbu's A/c		4,000
					June	8	By Cash A/c		2,000
				6,000					6,000
					July	1	To Balance b/d		6,000

Anbu's A/c

Dr. Cr.

Date		Particulars	J.F.	Rs.	Date		Particulars	J.F.	Rs.
1998					1998				
June	6	To Sales A/c		4,000	June	10	By Sales Returns A/c		50
					June	28	By Cash A/c		3,900
					June	28	By Discount A/c		50
				4,000					4,000

Purchases Returns A/c

Dr. Cr.

Date		Particulars	J.F.	Rs.	Date		Particulars	J.F.	Rs.
1998					1998				
June	30	To Balance c/d		100	June	26	By Anwar's A/c		100
				100					100
					July	1	By Balance b/d		100

Sales Returns A/c

Dr. Cr.

Date		Particulars	J.F.	Rs.	Date		Particulars	J.F.	Rs.
1998					1998				
June	10	To Anbu's A/c		50	June	30	By Balance c/d		50
				50					50
July	1	To Balance b/d		50					

Furniture A/c

Dr. Cr.

Date		Particulars	J.F.	Rs.	Date		Particulars	J.F.	Rs.
1998					1998				
June	27	To Bank A/c		1,500	June	30	By Balance c/d		1,500
				1,500					1,500
July	1	To Balance b/d		1,500					

Discount A/c

Dr. Cr.

Date		Particulars	J.F.	Rs.	Date		Particulars	J.F.	Rs.
1998					1998				
June	28	To Anbu's A/c		50	June	29	By Anwar's A/c		100
June	30	To Balance c/d		50					10,000
				100	July	1	By Balance b/d		100
									50

Drawings A/c

Dr. Cr.

Date		Particulars	J.F.	Rs.	Date		Particulars	J.F.	Rs.
1998					1998				
June	25	To Cash A/c		250	June	30	By Balance c/d		250
				250					250
July	1	To Balance b/d		250					

Rent A/c

Dr.									Cr.
Date		Particulars	J.F.	Rs.	Date		Particulars	J.F.	Rs.
1998 June	15	To Cash A/c		250	1998 June	30	By Balance c/d		250
				250					250
July	1	To Balance b/d		250					

Salaries A/c

Dr.									Cr.
Date		Particulars	J.F.	Rs.	Date		Particulars	J.F.	Rs.
1998 June	20	To Cash A/c		1,800	1998 June	30	By Balance c/d		1,800
				1,800					1,800
July	1	To Balance b/d		1,800					1,800

TRIAL BALANCE

In case, the various debit balances and the credit balances of the different accounts are taken down in a statement, the statement so prepared is termed as a 'Trial Balance'. In other words, Trial Balance is a statement containing the various ledger balances on a particular date. For example, with the balances of the ledger accounts prepared in Illustration 1. The Trial Balance can be prepared as follows:

Thus, the two sides of the Trial Balance tally. It means the books of

accounts are arithmetically accurate.

Objectives of Preparing a Trial Balance

(i) Checking of the arithmetical accuracy of the accounting entries

Trial Balance helps in knowing the arithmetical accuracy of the accounting entries. This is because according to the dual aspect concept for every debit, there must be an equivalent credit. Trial Balance represents a summary of all ledger balances and, therefore, if the two sides of the Trial Balance tally, it is an indication of this fact that the books of accounts are arithmetically accurate. Of course, there may be certain errors in the books of accounts in spite of an agreed Trial Balance. For example, if a transaction has been completely omitted, from the books of accounts, the two sides of the Trial Balance will tally, in spite of the books of accounts being wrong.

(ii) Basis for financial statements

Trial Balance forms the basis for preparing financial statements such as the Income Statement and the Balance Sheet. The Trial Balance represents all transactions relating to different accounts in a summarized form for a particular period. In case, the Trial Balance is not prepared, it will be almost impossible to prepare the financial statements as stated above to know the profit or loss made by the business during a particular period or its financial position on a particular date.

(iii) Summarized ledger

It has already been stated that a Trial Balance contains the ledger balances on a particular date. Thus, the entire ledger is summarized in the form of a Trial Balance. The position of a particular account can be judged simply by looking at the Trial Balance. The Ledger may be seen only when details regarding the accounts are required.

Illustration 2: Journalise the following transactions in the books of trade. Also make their Ledger Postings and prepare a Trial Balance.

Debit Balances as on Jan. 1, 2006: Cash in hand Rs. 8,000; Cash at Bank Rs. 25,000; Stock of goods Rs. 20,000; Furniture Rs. 2,000; Building Rs. 10,000; Sundry Debtors-Vijay Rs. 2,000, Anil Rs. 1,000 and MadhuRs. 2,000.

Credit Balances on Jan. 1, 2006: Sundry Creditors- AnandRs. 5,000; Loan from BabluRs. 10,000. The following were further transactions in the month of Jan, 2006:

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

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

Jan. 6: Purchased goods from Bharat Rs. 5,000.

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

Jan. 12: Sold goods to Rahim on credit Rs. 600.

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

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

Jan. 20: Paid salary to RatanRs. 2,000

Jan. 21: Paid AnandRs. 4,800 in full settlement.

Jan. 26: Interest received from MadhuRs. 200

Jan. 28: Paid to Bablu interest on Loan Rs. 500

Jan. 31: Sold goods for cash Rs. 500

Jan. 31: Withdraw goods from business for personal use Rs. 200

Solution:

JOURNAL

Date	Particulars		L.F.	Debit (Rs.)	Credit (Rs.)
2006					
Jan. 1	Cash A/c	Dr.		8,000	
	Bank A/c	Dr.		25,000	
	Stock A/c	Dr.		20,000	
	Furniture A/c	Dr.		2,000	
	Building A/c	Dr.		10,000	
	Vijay	Dr.		2,000	
	Anil	Dr.		1,000	
	Madhu	Dr.		2,000	
	To Anand				5,000
	To Bablu's Loan A/c				10,000
	To Capital A/c				55,000
	(Being balances brought forward from last year)				
Jan.1	Purchase A/c	Dr.		4,000	
	To Cash A/c				3,800
	To Discount A/c				200
	(Being purchase of goods on discount)				
Jan. 4	Cash A/c	Dr.		1,980	
	Discount A/c	Dr.		20	
	To Vijay				2,000
	(Being cash received from Vijay, allowed discount Rs. 20)				
	Total carried forward (C/F)			76,000	76,000

	Total brought forward (B/F)			76,000	76,000
Jan. 6	Purchase A/c	Dr.		5,000	
	To Bharat				5,000
	(Being goods purchased)				
Jan. 8	Plant A/c	Dr.		5,300	
	To Mukesh				5,000
	To Cash A/c				300
	(Being plant purchased and payment of charges of Rs. 300)				
Jan. 12	Rahim		Dr.	600	
	To Sales A/c				600
	(Being sale of goods to Rahim)				
Jan. 15	Cash A/c	Dr.		300	
	Bad Debts A/c	Dr.		300	
	To Rahim				600
	(Being cash received from Rahim) 50 paise in a rupee				

Jan. 18	Cash A/c	Dr.		1,000	
	To Sales A/c				1,000
	(Being cash sale)				
Jan. 20	Salary A/c	Dr.		2,000	
	To Cash A/c				2,000
	(Being salary paid)				
Jan. 21	Anand	Dr.		5,000	
	To Cash A/c				4800
	To Discount A/c				200
	(Being cash paid to Anand and discount received Rs. 200)				
Jan. 26	Cash A/c	Dr.		200	
	To interest A/c				200
	(Being receipt of interest)				
	Total carried forward (C/F)			95,700	95,700

	Total brought forward (B/F)			95,700	95,700
Jan. 28	Interest on Loan	Dr.		500	
	To cash A/c				500
	(Being payment of interest on loan)				
Jan. 31	Cash A/c	Dr.		500	
	To Sales A/c				500
	(Being cash sale)				
Jan. 31	Drawings A/c	Dr.		200	
	To Purchase A/c				200
	(Being goods withdrawn for personal use)				
	Total			96,900	96,900

Ledger Posting

CASH ACCOUNT

Dr. Cr.

Date	Particulars	L.F.	Amount (Rs.)	Date	Particular	L.F.	Amount (Rs.)
2006				2006			
Jan.1	To Balance b/d		8,000	Jan.1	By Purchase A/c		3,800
Jan.4	To Vijay		1,980	Jan. 8	By Plant A/c		300
Jan.15	To Rahim		300	Jan.20	By Salary A/c		2,000
Jan.18	To Sales A/c		1,000	Jan.21	By Anand		4,800
Jan. 26	To Interest A/c		200	Jan. 28	By Interest on loan A/c		500
Jan. 31	To Sales A/c		500	Jan. 31	By Balance c/d		580
			11,980				11,980
Feb. 1	To Balance b/d		580				

INTEREST ACCOUNT

Dr. Cr.

Jan. 31	To Balance c/d	200	Jan. 26	By Cash A/c	200
		200			200
			Feb. 1	By Balance b/d	200

BANK ACCOUNT

Dr. Cr.

Jan. 1	To Balance b/d	25,000	Jan. 31	By Balance c/d	25,000
		25,000			25,000
Feb. 1.	To Balance b/d	25,000			

STOCK ACCOUNT

Dr. Cr.

Jan.1	To Balance b/d	20,000	Jan. 31	By Balance c/d	20,000
		20,000			20,000
Feb. 1	To Balance b/d	20,000			

FURNITURE ACCOUNT

Dr. Cr.

Jan. 1	To Balance b/d	2,000	Jan. 31	By Balance c/d	2,000
		2,000			2,000
Feb. 1	To Balance b/d	2,000			

BUILDING ACCOUNT

Dr. Cr.

Jan. 1	To Balance b/d	10,000	Jan. 31	By Balance c/d	10,000
		10,000			10,000
Feb. 1	To Balance b/d	10,000			

VIJAY ACCOUNT

Dr. Cr.

Jan. 1.	To Balance b/d	2,000	Jan. 4	By Cash A/c	1,980
				By Discount A/c	20
		2,000			2,000

ANIL ACCOUNT

Dr. Cr.

Jan. 1.	To Balance b/d	1,000	Jan. 31	By Balance	1,000
		1,000			1,000
Feb. 1	To Balance b/d	1,000			

MADHU ACCOUNT

Dr. Cr.

Jan. 1.	To Balance b/d	2,000	Jan. 31	By Balance c/d	2,000
		2,000			2,000
Feb. 1	To balance b/d	2,000			

ANAND ACCOUNT

Dr. Cr.

Jan. 21	To Cash A/c	4,800	Jan. 1	By Balance b/d	5,000
Jan. 21	To Discount A/c	200			
		5,000			5,000

CAPITAL ACCOUNT

Dr. Cr.

Jan. 31.	To Balance c/d	55,000	Jan. 1	By Balance b/d	55,000
		55,000			55,000
			Feb. 1	By Balance b/d	55,000

BABU'S LOAN ACCOUNT

Dr. Cr.

Jan. 31.	To Balance c/d	10,000	Jan. 1	By Balance b/d	10,000
		10,000			10,000
			Feb. 1	By Balance b/d	10,000

PURCHASE ACCOUNT

Dr. Cr.

Jan. 1.	To Cash A/c	3,800	Jan. 31	By Drawings A/c	200
Jan. 1	To Discount A/c	200	Jan. 31	By Balance c/d	8,800
Jan. 6	To Bharat	5,000			
		9,000			9,000
Feb. 1.	To Balance b/d	8,800			

DISCOUNT ACCOUNT

Dr. Cr.

Jan. 4.	To Vijay	20	Jan. 1	By Purchases A/c	200
Jan. 31	To Balance c/d	380	Jan. 21	By Anand	200
		400			400
			Feb. 1	By Balance	380

BHARAT ACCOUNT

Dr. Cr.

Jan. 31.	To Balance c/d	5,000	Jan. 6	By Purchases A/c	5,000
		5,000			5,000
			Feb. 1	By Balance b/d	5,000

PLANT ACCOUNT

Dr. Cr.

Jan. 8.	To Mukesh	5,000	Jan. 31	By Balance c/d	5,300
Jan. 8	To Cash A/c	300			
		5,300			5,300
Feb. 1	To Balance b/d	5,300			

INTEREST ON LOAN ACCOUNT

Dr. Cr.

Jan. 28.	To Cash A/c	500	Jan. 31	By Balance	500
		500			500
Feb. 1	To Balance b/d	500			

MUKESH

Dr. Cr.

Jan. 31.	To Balance c/d	5,000	Jan. 8	By Plant A/c	5,000
		5,000			5,000
			Feb. 1	By Balance b/d	5,000

SALES ACCOUNT

Dr. Cr.

Jan. 31.	To Balance c/d	2,100	Jan. 21	By Rahim	600
			Jan. 18	By Cash A/c	1,000
			Jan. 31	By Cash A/c	500
		2,100			2,100
			Feb. 1	By Balance b/d	2,100

RAHIM

Dr. Cr.

Jan. 12.	To Sales A/c	600	Jan. 15	By Cash A/c	300
			Jan. 15	By Bad Debts A/c	300
		600			600

BAD DEBTS ACCOUNT

Dr. Cr.

Jan. 15	To Rahim	300	Jan. 31	By Balance c/d	300
		300			300
Feb. 1	To Balance b/d	300			

SALARY ACCOUNT

Dr. Cr.

Jan. 20.	To Cash A/c	2,000	Jan. 31	By Balance b/d	2,000
		2,000			2,000
Feb. 1	To Balance b/d	2,000			

DRAWING ACCOUNT

Dr. Cr.

Jan. 31.	To Purchases A/c	200	Jan. 31	By Balance c/d	200
		200			200
Feb. 1	To Balance	200			

TRIAL BALANCE

(AS ON 31^{ST} JANUARY, 2006)

Particular	Debit Amount	Credit Amount
Cash Account	580	
Interest Account		200
Bank Account	25,000	

Stock Account	20,000	
Furniture Account	2,000	
Building Account	10,000	
Anil	1,000	
Madhu	2,000	
Capital Account		55,000
Babu's Loan Account		10,000
Purchases Account	8,800	
Discount Account		380
Bharat		5,000
Plant Account	5,300	
Interest on Loan Account	500	
Mukesh		5,000
Sales Account		2,100
Bad Debts Account	300	
Salary Account	2,000	
Drawings Account	200	
	77,680	77,680

SUBSIDIARY BOOKS

All business transactions, at the first stage, are recorded in the book of original entry i.e. Journal and then posted into the ledger under the double entry system of book-keeping. This procedure is easy and practicable in small business houses where the number of business transactions are less and when a single person can handle the business transactions. But it is practically very difficult, rather impossible, to record all the business transactions of a day in the Journal of a large business house where the number of business transactions are varied and enormous because of the following reasons:

(a) The system of recording all transactions in a journal requires

(i) writing down of the name of the account involved as many times as the transactions occur; and (ii) an individual posting of each account debited and credited and hence, involves the repetitive journalising and posting labour.

(b) Such a system does not provide the information on a prompt basis.

(c) The journal becomes bulky and voluminous.

(d) Such a system does not facilitate the installation of an internal check system since the journal can be handled by only one person.

Therefore, to overcome the shortcomings of the use of the journal as the only book of original entry, the journal is subdivided into special journals. It is divided in such a way that a separate book is used for each category of business transactions which are repetitive in nature, similar and are sufficiently large in number. Special journals refer to the journals meant for recording specific business transactions of similar nature. These special journals are also known as "Subsidiary Books" or "Day Books". The main types of special journals are as follows:

(i) Cash Book: It records all those transactions which are in cash or by cheques.

(ii) Purchases Book: It records all transactions relating to goods purchased on credit.

(iii) Sales Book: It records all transactions relating to goods sold on credit.

(iv) Purchases Return Book: It records return of goods to suppliers.

(v) Sales Return Book: It records return of goods by the customers.

(vi) Bills Receivable Book: It records entries regarding bills receivables. The details of

bills are given in this book.

(vi) Bills Payable Book: All bills which are accepted and payable by a business house are

recorded in this book.

(viii) Journal Proper: Those transactions which are not recorded in any of the above mentioned books are recorded in the Journal Proper.

Before recording transactions in these day books, it is necessary to explain the special meaning given in business to the words 'Goods', 'Purchases' and 'Sales'.

Goods: It refers to items forming part of the stock-in-trade of a business house which are purchased and are to be resold at a profit. A business house may purchase fixed assets or stationery for use in business, but they are not purchases of goods.

Purchases: It refers to the purchase of goods for resale, and not the purchase of assets or stationery. The Purchases Account, therefore, only contains purchases of goods for resale.

Sales: It refers to the sale of goods which form part of the stock-in-

trade of the business.

ADVANTAGES

The advantages of using Special Journals are as under:

(a) Facilitates division of work: The accounting work can be divided among many persons.

(b) Time and labour saving in journalising and posting: For instance, when a Sales Book is kept, the name of the Sales Account will not be required to be written down in the Journal as many times as the sales transactions occur and at the same time, Sales Account will not be required to be posted again and again since, only a periodic total of Sales Book is posted to the Sales Account.

(c) Permits the use of specialised skill: The accounting work requiring specialised skill may be assigned to a person possessing the required skill. With the use of a specialised skill, prompt, economical and more accurate supply of accounting information may be obtained.

(d) Permits the installation of internal check system: The accounting work can be divided in such a manner that the work of one person is automatically checked by another person. With the use of internal check, the possibility of occurrence of error/fraud may be avoided.

CASH BOOK

A Cash Book is a special journal which is used for recording all cash receipts and cash payments. If a cash book is maintained, there is no need for preparing a cash account in the ledger. However, the other aspects of the transactions will be recorded in the ledger. Cash Book

serves dual role of journal as well ledger. Cash Book is the book of original entry (Journal) since transactions are recorded for the first time from the source documents. It is a ledger in the sense that it is designed in the form of Cash Account and records cash receipts on the debit side and cash payments on the credit side.

Features

- Only cash transactions are recorded in the Cash Book.
- It performs the functions of both journal and the ledger at the same time.
- All cash receipts are recorded on the debit side and all cash payments are recorded on the credit side.
- The Cash Book, recording only cash transactions can never show a credit balance.

KINDS OF CASH BOOK

Cash Book can be of several kinds:

(a) Single Column Cash Book- For recording cash transactions only.

(b) Double(Two) Column Cash Book- For recording cash transactions involving gain

or loss on account of discount.

(c) Triple (Three) Column Cash Book- For recording cash and bank transactions

involving gain or loss on account of discount.

(d) Petty Cash Book- For recording petty expenses.

Single Column Cash Book

The Single Column Cash Book has one column of amount on each side. All cash receipts are recorded on the debit (left-hand) side and all cash payments are recorded on credit (right-hand) side. In fact, it is nothing but a Cash Account. Hence, there is no need to open Cash Account in the ledger. Posting from the debit (receipt) side of the Cash Book is done to the credit side of concerned accounts and from the credit (payment) side of the Cash Book to the debit side of concerned accounts.

Balancing the Cash Book: The Cash Book is balanced in the same manner as a ledger account. To verify the accuracy of the entries made and to confirm the authenticity of cash balance, it should be balanced daily. The balance as per Cash Book must tally with the actual cash in hand. In the Cash Book, the total of amount column of the debit side always exceeds the total of credit side. As such, the Cash Book always shows a debit balance, since we cannot pay more than we have with us. At the end of the period, the balance of the Cash Book is placed on the credit side by writing “By Balance c/d” and then the totals are shown on both side in one straight line. The total of each side should be the same.

Illustration I. Enter the following transactions in the Cash Book of Mr. Nikhil.

Illustration I. Enter the following transactions in the Cash Book of Mr. Nikhil.

2006		Rs.
March 1	Mr. Nikhil commenced business with Cash	6,500
March 3	Bought goods for cash	685
March 4	Paid to Mohan	95
March 6	Deposited in the bank	4,000
March 6	Purchased office furniture on cash	465
March 9	Sold goods for cash	3,000
March 12	Paid wages in cash	120
March 13	Paid for stationary	40
March 15	Sold goods for cash	2,500
March 17	Paid for miscellaneous expenses	45
March 19	Received cash from Tarlok	485
March 21	Withdrew for domestic use	250
March 22	Paid salary	400
March 25	Paid rent	90
March 28	Paid electricity bill	35
March 29	Paid for advertising	40
March 31	Paid into bank	2,500

Solution

CASH BOOK

Dr. Cr.

Date	Particulars (Receipts)	LF	Amount (Rs.)	Date	Particular (payments)	LF	Amount (Rs.)
2006				2006			
March 1	To Capital A/c		6,500	March 3	By Purchases A/c		685
March 9	To Sales A/c		3,000	March 4	By Mohan's A/c		95
March 15	To Sales A/c		2,500	March 6	By Bank A/c		4,000
March 19	To Tarlok's A/c		485	March 6	By Furniture A/c		465
				March 12	By Wages A/c		120
				March 13	By Stationery A/c		40
				March 17	By Misc. Expenses A/c		45
				March 21	By Drawings A/c		250
				March 22	By Salaries A/c		400
				March 25	By Rent A/c		90
				March 28	By Electricity A/c		35
				March 29	By Advertisement A/c		40
				March 31	By Bank A/c		2,500
				March 31	By Balance c/d		3,720
			12,485				12,485

Double Column Cash Book

This Cash Book has two amount columns one for cash and another for discount on each side. It is customary in business to allow discount when payment is received from a customer promptly and before due date. It is equally so when payment is made to a creditor before due date. All cash receipts and discount allowed are recorded on the debit side and all cash payments and discount received are recorded on the credit side of Cash Book.

The posting from the cash columns is done in the same manner as it is done in Single Column Cash Book. Entries from discount column of the debit side of the Cash Book are posted on the credit side of every individual debtor's account to whom the business has allowed the discount. The total of the debit side of the discount column is shown on the debit side of the "Discount Allowed Account" by writing "To Sundries" in the particulars column. Entries from the discount column of the credit side of the Cash Book are posted on the debit side of every individual creditor's account by whom the discount is allowed to the business. The total of the credit side of the discount column is shown on the credit side of the "Discount Received Account" by writing "By Sundries" in the particulars column.

The cash column of the Double Column Cash Book is balanced exactly in the same manner as in case of the Single Column Cash Book. But, the discount columns are not balanced but merely totalled. These totals are posted to the respective Discount Allowed Account and Discount Received Account.

Illustration 2: From the following transactions, prepare the Two Column Cash Book and also post them in the Ledger.

2006		Rs.
Aug. 1	Cash in hand	25,500
Aug. 2	Received from Rakesh and	2,900
	discount allowed to him	100
Aug. 5	Cash sales	6,000
Aug. 6	Purchased goods for cash	7,800
Aug. 8	Received from Neelam and	1,350
	allowed her discount	50
Aug. 12	Paid to Ravinder and	3,400
	received discount	200
Aug. 20	Paid rent	1,000
Aug. 25	Interest received in cash	500
Aug. 26	Paid to Kamal and	1,760
	received discount	40
Aug. 28	Machinery purchased	5,200

Solution

CASH BOOK

Dr. Cr.

Date	Particulars	L.F.	Discount (Rs.)	Cash (Rs.)	Date	Particulars	L.F.	Discount (Rs.)	Cash (Rs.)
2006					2006				
Aug. 1	To Bal. b/d			25,500	Aug. 6	By Purchases A/c			7,800
Aug. 2	To Rakesh's A/c		100	2,900	Aug. 12	By Ravinder's A/c		200	3,400
Aug. 5	To Sales A/c			6,000	Aug. 20	By Rent A/c			1,000
Aug. 8	To Neelam's A/c		50	1,350	Aug. 26	By Kamal's A/c		40	1,760
Aug. 25	To Interest A/c			500	Aug. 28	By Machinery A/c			5,200
					Aug. 30	By Salaries A/c			3,000
					Aug. 31	By Bal. c/d			14,090
			150	36,250				240	36,250
Sep 1	To Bal b/d			14,090					

Note: The discount columns are not balanced but these are totalled in respective column and posted in the ledger.

RAKESH'S ACCOUNT

Dr. Cr.

Date	Particulars	L.F.	Amount	Date	Particulars	L.F.	Amount
				2006			
				Aug. 2	By Cash A/c		2,900
				Aug. 2	By Discount A/c		100

SALES ACCOUNT

Dr. Cr.

Date	Particulars	L.F.	Amount	Date	Particulars	L.F.	Amount
				2006			
				Aug. 5	By Cash A/c		6,000

PURCHASES ACCOUNT

Dr. Cr.

Date	Particulars	L.F.	Amount	Date	Particulars	L.F.	Amount
2006							
Aug.6	To Cash A/c		7,800				

NEELAM'S ACCOUNT

Dr. Cr.

Date	Particulars	L.F.	Amount	Date	Particulars	L.F.	Amount
				2006			
				Aug. 8	By Cash A/c		1,350

RAVINDER'S ACCOUNT

Dr. Cr.

Date	Particulars	L.F.	Amount	Date	Particulars	L.F.	Amount
2006							
Aug. 12	To Cash A/c		3,400				
Aug.12	To Discount A/c		200				

RENT ACCOUNT

Dr. Cr.

Date	Particulars	L.F.	Amount	Date	Particulars	L.F.	Amount
2006							
Aug. 20	To Cash		1,000				

INTEREST ACCOUNT

Dr. Cr.

Date	Particulars	L.F.	Amount	Date	Particulars	L.F.	Amount
				2006			
				Aug. 25	By Cash		500

KAMAL'S ACCOUNT

Dr. Cr.

Date	Particulars	L.F.	Amount	Date	Particulars	L.F.	Amount
2006							
Aug.26	To Cash A/c		1,760				
Aug.26	To Discount A/c		40				

MACHINERY ACCOUNT

Dr. Cr.

Date	Particulars	L.F.	Amount	Date	Particulars	L.F.	Amount
2006							
Aug. 28	To Cash A/c		5,200				

SALARIES ACCOUNT

Dr. Cr.

Date	Particulars	L.F.	Amount	Date	Particulars	L.F.	Amount
2006							
Aug. 30	To Cash A/c		3,000				

DISCOUNT ALLOWED ACCOUNT

Dr. Cr.

Date	Particulars	L.F.	Amount	Date	Particulars	L.F.	Amount
2006							
Aug.31	To Sundries A/c		150				

DISCOUNT RECEIVED ACCOUNT

Dr. Cr.

Date	Particulars	L.F.	Amount	Date	Particulars	L.F.	Amount
				2006			
				Aug.31	By Sundries A/c		240

TRIPLE COLUMN CASH BOOK

This type of Cash Book is an improvement over the Double Column Cash Book. In modern times, it is virtually impossible to imagine any business without having dealings with a bank. Most of the transactions relating to receipts and payments of money are made through cheques. So transactions through bank are also recorded in the cash book by adding one more column i.e. bank column on both sides of the cash book. Therefore there are three columns on both sides of the cash book i.e. cash, bank and discount columns. That is why this type of cash book is known as Triple Column Cash Book. Receipt side (Dr side) of the Triple Column Cash Book is used to record all receipts both in cash and by cheques as also to record the discount allowed to our debtors while receiving the payment. Cash receipts are entered in the cash column whereas amounts received by cheques are entered in the bank column and discount allowed in the discount column. Posting from the debit side of the cash book is made to

the credit side of each account in the ledger- in case of personal accounts credit is to be given for cash or cheques received plus discount allowed.

Payment side (Cr. side) of the Cash Book is used to record all payments both in cash and through cheques as also to record the discount received or availed by us from over creditors while making payment to them. Cash payments are recorded in the cash column, payments through cheques are entered in the bank column and discount received in the discount column. Posting from the credit side of the cash book is made on the debit side of respective accounts- in case of personal accounts debit is to be given for the total of the payments made and discount received.

After recording all the relevant transactions in the Cash Book, all the columns of the Cash Book are totalled. The difference in the cash columns is put on the credit side of Cash Book in the column by writing “By Balance c/d”. The bank balance may have a debit balance or a credit balance. If the total of the debit side of the bank column is more than the total of the credit side of the bank column, it has a debit balance and if the total of the credit side is more than that of the debit side, then it has a credit balance (overdraft). However, the difference is put on the lesser side. There is no need to balance the discount columns. The discount columns of both the sides are totalled.

In the Triple Column Cash Book there will be some cross or contra entries i.e., transfer of money from cash to bank (amount deposited) and vice-versa (amount withdrawn from bank for office use). In all such cases both entries occur in the cash book and no ledger entry is required. This is indicated by a contra sign (C) in the folio column indicating thereby that the double entry aspect of this transaction is complete and it requires no posting to the ledger.

Illustration 3: Prepare a Triple Column Cash Book from the following particulars: 2006

Jan. 1. Cash in hand Rs. 50,000.

2. Paid into bank Rs. 10,000.

3. Bought goods from Hari for Rs. 200 for cash.

4. Bought goods for Rs. 2,000 paid cheque for them, discount allowed 1%

5. Sold goods to Mohan for cash Rs. 250.

6. Received a cheque from Shyam to whom goods were sold for Rs. 800. Discount allowed 12.5%

7. Purchased an old typewriter for Rs. 200. Spent Rs. 50 on its repairs.

8. Bank notified that Shyam'scheque has been returned dishonoured and debited to the account in respect of charges Rs. 10.

9. Received a money order for Rs. 25 from Hari.

10. Shyam settled his account by means of a cheque for Rs. 820, Rs. 20 being for interest charged.

11. Withdrew from bank Rs. 10,000.

12. Discounted a bill of exchange for Rs.1,000 at 1% through bank.

13. Honoured our own acceptance by chequeRs. 5,000.

14. Withdrew for personal use Rs. 1,000.

15. Paid trade expenses Rs. 2,000.
16. Withdrew from bank for private expenses Rs. 1,500.
17. Purchased machinery from Rajiv for Rs. 5,000 and paid him by means of a bank draft purchased for Rs. 5,005.
18. Issued cheque to Ram Saran for cash purchase of furniture 1,575.
19. Received a cheque for commission Rs. 500 from R. & Co. and deposited into bank.
20. Ramesh who owned us Rs. 500 became bankrupt and paid us 50 paisa in a rupee.
21. Received payment of a loan of Rs. 5,000 and deposited Rs. 3,000 out of it into bank.
22. Paid rent to landlord 'Mohan' by a cheque of Rs. 500.
23. Interest allowed by bank Rs. 30.
24. Half-yearly bank charges Rs. 50.

Solution

TRIPLE COLUMN CASH BOOK

Dr. Cr.

Date	Particulars (Receipts)	L.F.	Discount (Rs.)	Cash (Rs.)	Bank (Rs.)	Date	Particulars (Payments)	L.F.	Discount (Rs.)	Cash (Rs.)	Bank (Rs.)
2006						2006					
Jan 1	To Balance b/d			50,000		Jan 2	By Bank A/c	C		10,000	
Jan 2	To Cash A/c	C			10,000	Jan 3	By Purchases A/c			200	
Jan 5	To Sales A/c			250		Jan 4	By Purchases A/c		20		1,980
Jan 6	To Shyam's A/c		100		700						
						Jan 8	By Typewriter A/c			200	
Jan 10	To Hari's A/c			25		Jan 8	By Typewriter A/c			50	
Jan 11	To Shyam's A/c				800	Jan 9	By Shyam's A/c		100		700
"	To Interest A/c				20	Jan 9	By Bank charges A/c				10
						Jan 12	By Cash A/c	C			10,000
Jan12	To Bank A/c	C		10,000		Jan 20	By B/P A/c				5,000
Jan 18	To B/R A/c		10		990	Jan 22	By Drawings A/c			1,000	
Jan 28	To Commission A/c				500	Jan 24	By Trade Expenses A/c			2,000	
Jan 29	To Ramesh's A/c			250		Jan 25	By Drawings A/c				1,500
Jan 30	To Loans A/c			5,000		Jan 26	By Machinery A/c				5,000
Jan 30	To Cash A/c	C			3,000	Jan 26	By Bank charges A/c				5
Jan 31	To Interest A/c				30	Jan 27	By Furniture A/c				1,575
Jan 31	To Balance c/d				10,280	Jan 30	By Bank A/c			3,000	
	(Bank overdraft)					Jan 31	By Rent A/c				500
						Jan 31	By Bank charges A/c				50
						Jan 31	By Balance c/d			49,075	
			110	65,525	26,320				120	65,525	26,320

Petty Cash Book

In every business organisation, there are a number of payments which involve small amounts e.g. payments for postage, telegrams, carriage, cartage etc. If all these transactions are recorded in the Cash Book, it will increase the head cashier's work manifold and it will make the Cash Book unnecessarily bulky and uneasy. Normally, one person is handed over a small amount to meet the petty expenses of a given period (say, week, fortnight or month) and is authorised to make such payments and to record them in a separate Cash Book. Such person, amount and Cash Books are called as "Petty Cashier", 'Imprest' and 'Petty Cash Book' respectively. The Petty Cash Book may or may not be maintained on 'Imprest System'. Under both the systems (i.e. Imprest and Non-imprest), the petty cashier submits the Petty Cash Book to the Head Cashier who examines the Petty

Cash Book. Under the Imprest system, the Head Cashier makes the reimbursement of the amount spent by the Petty Cashier but under Non-imprest system, the Head Cashier may handover the Cash to the Petty Cashier equal to/more than/less than the amount spent. Usually, the Petty Cash Book is maintained on the basis of imprest system.

Advantage of the Imprest System: The system of petty cash payments along with the imprest system offers the following advantages:

(1) The money in the hands of the petty cashier is limited to the imprest amount.

(2) As the periodical reimbursements are the actual expenses paid and not mere advances on account only, they are as such brought prominently to the notice of Chief Cashier.

(3) The Chief Cashier, by handing over a fixed sum, is relieved of the cumbersome work of petty disbursements.

(4) The main cash book is not unnecessarily clogged with the large number of small items. Even in the ledger, only the totals are posted.

(5) At all time, the amount of cash in hand plus expenses not reimbursed must equal the imprest amount, thus, facilitating a simple check.

(6) The maximum liability of the petty cashier can never exceed the imprest amount.

(7) The regular check of the petty cash book creates a sense of responsibility in the petty cashier.

All the heads of expenses are totalled periodically and such periodic totals are individually posted to the debit side of the concerned ledger accounts in the ledger by writing ‘To Petty Cash A/c’ in the particulars column. The Petty Cash Account in the ledger is credited with the total expenditure incurred during the period by writing ‘By Sundries as per Petty Cash Book’ in the particulars column. The ledger folio number is written under every total amount of expense to indicate that the entry has been posted in the ledger. In the folio column of the ledger account, the page number of the petty cash book is written.

Illustration 4: From the following particulars, prepare Petty Cash Book on imprest system of K.P. Singh & Co. for the month of January, 2006.

Jan. 2006		Rs.
1	Opening Balance (on imprest system)	100
2	Paid for stamps	12
3	Paid cleaner's wages	15
4	Paid for fare	16
5	Paid for office tea	15
6	Paid to proprietor for personal use	10
7	Paid for advertisement	30
8	Drew imprest from head cashier	
9	Paid for cartage	10
10	Paid for travelling expenses	25
11	Paid for telegram sent	15
12	Paid for entertainment to travelling salesmen	20
13	Advance to peon	10
14	Paid for printing bill	5
15	Paid for stationery	3
16	Drew imprest from head cashier	

PURCHASE BOOK

Purchases Book (also known as Invoice Journal/Bought Journal/Purchases Journal) is used for recording only the credit purchases of goods and merchandise in which the business is dealing in, i.e. goods purchased for resale purpose for earning revenue. It records neither the cash purchases of goods nor the purchase of any asset other than the goods or merchandise.

When we purchase goods on credit we receive a statement from the supplier giving the particulars of the goods supplied by him. The statement is known as an Invoice. The invoice states the quality, price and the value of goods supplied. It also states the discount allowable

(trade and cash) and the condition under which payment is expected. The entries in the purchase book are made on the basis of invoices received from the supplies with the amounts net of trade discount/quantity discount. Trade discount is a reduction granted by the supplier from the

list price of goods and services on business consideration such as quantity bought, trade practices other than for prompt payment. The object of allowing trade discount is to enable the retailer to sell the goods to the customer at list price and still leaving margin for meeting business expenses and his profit. Entries in the books of both supplier as well as retailer are made on the basis of net amount i.e. invoice price less trade discount.

Posting

After recording transactions in the Purchases Book, the posting in ledger accounts will be made. The posting from the Purchases Book is made as follows:

a) Debit the Purchases Account with the periodical totals of the Purchases Book. On the debit side of the Purchases Account, write “To total as per Purchase Book” or “To Sundries” in the particulars column.

b) Personal accounts of each individual supplier is credited with the net amount of Inward Invoice recorded in Purchases Book by writing “By Purchases”.

Illustration 5: Prepare the Purchases Book for the month of Feb, 2006 from the following particulars of M/s Sharma & Co. and also post them into Ledger.

2006	
Feb. 4	Purchased on credit from Rajesh Bros. & Co.
	10 Bags of Tea @ Rs. 1000 per bag
	5 Bags of Coffee @ Rs. 3000 per bag
	Trade discount @ 10%
Feb. 16	Purchased from Shiva Enterprises on credit
	20 bags of Rice @ Rs. 800 per bag 2
	bags of Wheat @ Rs. 500 per bag
	Trade discount @ 5%
Feb. 20	Purchased Furniture on Credit from Universal Furniture House
	for Rs. 3000
Feb 24	Bought on credit from Ashwani & Co.
	30 tin Ghee @ Rs. 400 per tin
	10 tin Oil @ Rs. 300 per tin
	Trade Discount 20%

Solution

PURCHASE BOOK OF M/S SHARMA & CO.

Date	Particulars	Invoice No.	L.F.	Details	Rs.
2006	Rajesh Bros. & Co.				
Feb. 4	10 bags of Tea @ Rs. 1,000 per bag			10,000	
	5 bags of Coffee @ Rs. 3,000 per bag			15,000	
				25,000	
	Less Trade discount @ 10%			2,500	22,500
Feb 16	Shiva Enterprises				
	20 bags of Rice @ Rs. 800 per bag			16,000	
	2 bags Wheat @ Rs. 500 per bag			1,000	
				17,000	
	Less Trade discount @ 5%			850	16,150
Feb 24	Ashwani & Co.				
	30 tin Ghee @ Rs.400 per tin			12,000	
	10 tin Oil @ Rs. 300 per tin			3,000	
				15,000	
	Less Trade discount @ 20%			3000	12,000
	Total				50,650

Note: Purchase of furniture being an asset is not to be recorded in purchase book, however, it will be recorded in Journal.

PURCHASES A/C

Dr. Cr.

Date	Particulars	L.F.	Rs.	Date	Particulars	L.F.	Rs.
2006							
Feb.28	To Sundries		50,650				

RAJESH BORS. & CO.

Dr. Cr.

Date	Particulars	L.F.	Rs.	Date	Particulars	L.F.	Rs.
				2006			
				Feb. 4	By Purchases		22,500

SHIVA ENTERPRISES

Dr. Cr.

Date	Particulars	L.F.	Rs.	Date	Particulars	L.F	Rs.
				2006			
				Feb. 16	By Purchases		16,150

ASHWANI & CO.

Dr. Cr.

Date	Particulars	L.F	Rs.	Date	Particulars	L.F.	Rs.
				1999			
				Feb. 24	By Purchases		12,000

SALES BOOK

Sales Book or Sales Journal is written up to record all the credit sales. Sales Book records only those goods which are sold on credit and the goods in question must be those, which the firm generally deals in. If there are cash sales they are recorded in Cash Book and sale of assets are recorded in the Journal proper.

The entries in the Sales Book are made from the copies of the invoice which have been sent to customers along with the goods. Such copies of the invoices may be termed as Outward Invoice. Each such outward invoice should be numbered consecutively and the reference be given in the Sales Book along with the entry.

The Sales book is totalled periodically. The net amount of the invoices in Sales Book is posted to the ledger as follows:

(a) Debit the personal accounts of the customers with the value of sales to them.

(b) Credit Sales Account with the periodical total.

Illustration 6: Enter the following transactions in the Sales Book and post them into the ledger:

2006	
Nov. 1	Sold to M/s Rana and Co. 1,000 metres of Terrycot B type @ Rs. 13 per metre.
	2,000 metres of cotton cloth Type A-6 @ Rs. 10 per metre. Trade discount 10%.
Nov. 16	Sold to Cloth Emporium, 1,000 pieces of Jeans @ Rs. 50 each.
	500 pieces of woollen Pullovers @ Rs. 150 each. Trade discount 10%
Nov. 25	Sold to Pandit Bros. 10 Rolls of Curtains ordinary type @ Rs. 1,500 per roll (Net).
	150 Blankets @ Rs. 80 each (Net).
	100 Blankets @ Rs. 120 each (Net).

Solution

SALES BOOK

Date	Inv. No.	Particulars	L.F.	Details	Amount
2006		M/s Rana and Co.			
		1,000 Metres of Terry cot B-type			
Nov. 1		@ 13 per metre		13,000	
		2,000 Metres of cotton type A-6 @ Rs. 10 per metre		20,000	
				33,000	
		Less: Trade discount 10%		3,300	29,700
		Cloth Emporium			
		1,000 Jeans Pieces @ Rs. 50 each		50,000	
Nov. 16		500 pieces of Wollen Pullovers @ Rs. 150 each		75,000	
				1,25,000	
		Less: Trade discount 10%		12,500	1,12,500
		Pandit Brors.			
		10 Rolls of curtains ordinary			
Nov. 25		@ Rs. 1,500 each		15,000	
		150 Blankets @ Rs. 80 each		12,000	
		100 Blankets @ Rs. 120 each		12,000	39,000
					1,81,200

LEDGER

SALES ACCOUNT

Dr. Cr.

Date	Particulars	L.F.	Amount (Rs.)	Date	Particulars	L.F.	Amount (Rs.)
				2006 Nov. 30	By Total Sales as per Sales Book		1,81,200

M/S RANA & CO.

Dr. Cr.

Date	Particulars	L.F.	Amount (Rs.)	Date	Particulars	L.F.	Amount (Rs.)
2006 Nov. 1	To Sales Account		29,700				

CLOTH EMPORIUM

Dr. Cr.

Date	Particulars	L.F.	Amount	Date	Particulars	L.F.	Amount
2006 Nov16	To Sales Account		Rs. 1,12,500				Rs.

PANDIT BROS.

Dr. Cr.

Date	Particulars	L.F.	Amount	Date	Particulars	L.F.	Amount
2006 Nov. 25	To Sales Account		Rs. 39,000				Rs.

PURCHASE RETURN BOOK

In every business, it is not uncommon to find that the goods are returned by a business enterprise to the suppliers because of many reasons such as goods are defective, goods are not according to order. If the returns are frequent in a business, in that case a separate book may be maintained to record this type of transactions which is known as Purchases Returns Book or Returns Outward Book.

The entries in the Purchases Returns Book are usually made on the basis of debit notes issued to the suppliers. When a firm returns some goods to it suppliers, it prepares a debit note in duplicate. The original copy is sent to the supplier to whom the goods are returned. The Debit Note is so called because the supplier's account is debited with the amount of the goods returned. The standard form of a debit note is given below:

DEBIT NOTE

INDIA BOOK HOUSE
DARYA GANJ, NEW DELHI-110002

Grams: Books
No.10
Oct. 11, 1999
Your Reference: Invoice No. 119 dated Sept. 20, 1999

To
M/s National Publishing House,
Jaipur (Rajasthan)

Qty.	Particulars	Amount (Rs.)
	To Purchase Returns	
	(Account of damage-in-transit)	
5	Management Accounting by Gupta G.S. @ 20 each	100.00
10	Hindi Social Philosophy by Gopalan @ Rs. 16 each	160.00
		260.00
	Less: 20% Trade Discount	52.00
		208.00

After recording the transaction in Purchases Returns Book, posting to the ledger involves the following:

(a) The periodical total of the Purchases Return Book is posted to the credit of the Purchases Return Account in the ledger.

(b) The personal account of each individual suppliers is debited with the amount of Debit Note.

Illustration 7: From the following transactions prepare Purchases Returns Book and also post them into Ledger.

2006

Aug.1 Returned to Varinder

10 Tables @ Rs. 100 per Table

Aug. 12 Returned to Subash

5 Chairs @ 50 per Chairs

Aug. 25 Returned to Balwinder goods values Rs. 600

Solution

PURCHASE RETURN BOOK OR RETURNS OUTWARD BOOK

Date	Particulars	Debit Note No.	L.F.	Details Rs.	Rs.
2006					
Aug 1	Varinder				
	10 Tables @ Rs. 100 per table			1,000	
Aug 12	Subash				
	5 Chairs @ Rs. 50 per chair			250	
Aug 25	Balwinder				600
	Total for the month				1,850

VARINDER'S ACCOUNT

Dr. Cr.

Date	Particulars	L.F.	Rs.	Date	Particulars	L.F.	Rs.
2006							
Aug 1	To Purchases Return		1,000				

SUBASH'S ACCOUNT

Dr. Cr.

Date	Particulars	L.F.	Rs.	Date	Particulars	L.F.	Rs.
2006							
Aug. 12	To Purchases Return		250				

BALWINDER'S ACCOUNT

Dr. Cr.

Date	Particulars	L.F.	Rs.	Date	Particulars	L.F.	Rs.
1999							
Aug. 25	To Purchases Return		600				

PURCHASES RETURNS ACCOUNT

Dr. Cr.

Date	Particulars	L.F.	Rs.	Date	Particulars	L.F.	Rs.
				2006 Aug.31	By Total per Purchases Returns Book		1,850

SALES RETURN BOOK

Sales Return Book or Returns Inwards Book is meant for recording return of goods sold on credit. The goods which are sold for cash if returned are either exchanged for new goods or parties are paid in cash do not find a place in the Sales Return Journal. The columns used in this book are similar to Sales Book except that in place of Invoice No. the Credit Note number is recorded. Credit Note is just reverse of Debit Note and is sent by the seller to the buyer. It is an acknowledgment of the goods returned as well as information to the debtor that his account is being credited with the amount mentioned in it. Thus, the party to whom a Credit Note is sent become a creditor.

The posting from the Sales Return Book will be done periodically to the debit side of the Sales Returns Account in the ledger and the individual accounts of the customers will be credited with their respective amounts.

Illustration 8: From the following transactions, prepare the Sales Returns Book of Jindal & Co. and post them to the Ledger:

Date	Credit Note No	Particulars
5.1.06	201	Goyal & Co., Rohtak, returned to us - 2 polyster sarees @ Rs. 125 per saree
10.1.06	202	Accepted return of goods (which were sold for cash) from Garg & Co., Bhiwani, 2 Kota sarees @ Rs. 50 per saree
17.1.06	203	Mittal & Co. Hisar returned to us - 2 silk sarees @ Rs. 325 per saree.
31.1.06		Mohan returned to us one old typewriter worth Rs. 500

Solution

SALES RETURNS BOOKS

Date	Credit Note	Name of Customer	L.F.	Amount Rs.
2006				
Jan 5	201	Goyal & Co., Rohtak		250.00
Jan 17	203	Mittal & Co., Hisar		650.00
				900.00

Note: Return of Kota sarees will be recorded in the Cash Book and return of typewriter will be recorded in the Journal Proper since the Sales Returns Book records only the returns of merchandise purchased on credit.

LEDGER OF JINDAL & CO.

GOYAL & CO., ROHTAK ACCOUNT

Dr. Cr.

Date	Particulars	Folio	Amount (Rs.)	Date	Particulars	Folio	Amount (Rs.)
				2006 Jan 5	By Sales Returns A/c		250.00

MITTAL & CO., HISAR

Dr. Cr.

Date	Particulars	Folio	Amount (Rs.)	Date	Particulars	Folio	Amount (Rs.)
				2006 Jan. 17	By Sales Returns A/c		650.00

SALES RETURNS ACCOUNT

Dr. Cr.

Date	Particulars	Folio	Amount (Rs.)	Date	Particulars	Folio	Amount (Rs.)
2006							
Jan 10	To Cash A/c		100.00				
31	To Sundries as per Sales Returns Book		900.00				

KARPAGAM ACADEMY OF HIGHER EDUCATION

DEPARTMENT OF MANAGEMENT

I BBA - (2017 - 2020 BATCH)

II SEMESTER

BUSINESS ACCOUNTING (17BAU202)

UNIT I

POSSIBLE QUESTIONS

PART B

1. Journalize the following transactions:

2014 April

a. Arun Commenced business with cash Rs. 25,000
b. Bought goods for cash Rs. 9,200
c. Paid rent by cheque Rs. 1,500
d. Furniture purchased for cash Rs. 15, 000

2. Pass necessary journal entries:

Commenced business with a capital Rs. 60,000

Salary paid Rs. 5000

Sold goods for cash 5,000

Purchase from GanesanRs. 2,500

3. Give journal entries for the following transactions

Kumar started business with cash Rs. 1,000

Paid Salary Rs. 500

Sold goods to Krishna for cash Rs. 5,000

Purchase goods for cash Rs. 4,000

4. Explain the Going Concern Concept?

5. Post the following transaction in the ledger:

May 2014

04 Purchased goods from rajeshRs. 2, 500

05 Paid rent Rs. 200

10 Sold goods for cash Rs. 25, 500

6. Prepare the Trial Balance from the following information's:

	Rs.		Rs.
Cash in hand	2,000	Sales Returns	8,000
Purchases Returns	4,000	Capital	42,000
Wages	8,000	Carriage Outwards	5,000
Establishment Expenses	22,000	Machinery	1,000

7. Enter the following transactions in proper subsidiary books of Harini:

3 Purchased goods from Induja	6, 500
4 Returned goods to Manesh	1,500
5 Sold goods to Saran	1, 000
6 Sold goods to Gunasekar	5, 500
7 Bought goods from Rajuwith trade discount of 10%	8, 500

8. Write a short note on importance of accounting?

9. Distinguish between bookkeeping and accounting?

10. List out the three branches in accounting?

11. Mention the types of subsidiary book?

12. Bring out the importance of maintain cash book?

***CIA - 3 X 2 = 6 (ANSWER ALL THE QUESTIONS)**

****ESE - 5 X 2 = 10 (ANSWER ALL THE QUESTIONS)**

PART C

1. Elaborate the accounting principles with suitable examples?
2. Journalize the following transaction of Manisha& Co.:

July 2015	Rs.
1 Commenced business with cash	15, 00, 000
2 Purchased goods for cash	10, 000
4 Sold goods for cash	25, 000
6 Purchased goods from Mohan	5, 000
7 Sold goods to Rahul	35, 000
8 Rent paid	6, 500
9 Received cash from Rahul in full settlement	34, 950
and discount allowed	50
13 Paid cash to Mohan in full settlement	4, 950
and discount received	50
15 Commission paid	200
25 Interest received	500

3. Post the following transaction in the Ledger:

March 2015	Rs.
1 Anil Started business with cash	2, 00, 000
2 Deposited into bank	50, 000
3 Purchased Machinery	45, 000
4 Sold goods to Manisha	65,000

5	Salary Paid	15, 000
6	Received cash from Manisha	65, 000
8	Purchased goods for nithish	20, 500
10	Retuned goods to nithish	5, 000

4. Journalize the following transaction ofArun&co.,

Jan 2015

1 Arun started business by investing Rs. 5, 00, 000

2 Purchase building for Rs. 1, 00, 000

3 Purchased goods for cash Rs. 30, 000

4 Purchased goods from rajeshRs. 2, 500

5 Paid rent Rs. 200

10 Sold goods for cash Rs. 25, 500

15 Sold goods for cash to avathar 2, 400

18 Sold goods to mahendra on credit Rs. 4, 650

25 Paid commission Rs. 120

28 Withdraw from bank for personal use Rs. 5, 000

30 Deposited into bank Rs. 8, 000

5. Prepare Trail balance from the following information as on 31st December, 2013

Particulars	**Rs.**
Cash in hand	540
Cash at Bank	2,630
Purchases Account	40,675
Sales Account	98,780
Returns Inwards Account	680
Returns Outwards Account	500

Wages Account	10,480
Fuel and Power Account	4,730
Carriage Inward	3,200
Rent	2,040
Opening Stock	5,760
Buildings	30,000
Land	10,000
Machinery	20,000
Electricity charges	7,500
Salaries Account	15,000
General Expenses Account	3,000
Insurance Account	600
Commission	5,245

Capital	71,000
Sundry Debtors	14,500
Sundry Creditors	6,300

6. Prepare Trail balance from the following information as on 31st March 2015

Particulars	Rs.
Capital	16, 800
Wages	5, 000
Stock	21, 000
Purchases	36, 000
Sales	72, 000
Purchase Return	2, 000
Sales Return	3, 000
Debtors	4, 500
Creditors	2, 500
Furniture	900
Bills receivable	2, 300
Bills payable	4, 200

Rent	1, 300
Expenses on advertising	600
Commission received	600
Machinery	20, 000
Cash	3,500

7. Enter the following transactions in proper subsidiary books of Ram:

2015		Rs.
March 1	Sold goods to Ramesh	5, 250
2	Ramesh retuned goods	1, 500
3	Purchased goods from Mangal	3, 500
4	Returned goods to Mangal	500
5	Sold goods to Ramsaran	1, 000
6	Sold goods to Guna	1, 500
7	Bought goods from Devilal with trade discount of 10%	2, 500
8	Sold to Rajaram at a trade discount of 5%	3, 500

8. From the following transactions you are asked to prepare the subsidiary books.

2011 January	Rs.
1. Bought goods from Das	3,500
2. Sold goods to Saran	950
3. Sold goods to Ramesh	750
4. Bought goods from Suresh	1,200

6.	Received goods returned by Saran	350
8.	Sold goods to Arun for cash	900
9.	Purchased goods from Shyam	1,200
10.	Returned goods to Suresh	150
11.	Sold goods to Roy	900
12.	Roy returned us goods	100
21.	Purchased furniture from Vijay steel & Co for cash	4,000
30.	Sold goods to Dinesh	260

9. Enter the following transactions in a cash book with cash, bank and discount columns

2015 July		Rs.
1	Cash in hand	10,000
2	Cash at bank	9,000
6	Paid to kannan by chequeRs. 4, 000 and was allowed discount Rs. 100	
10	Cash sales	4, 000
11	Paid into bank	3, 000
15	Received cheques in our bank account	1, 000
19	Issued a cheque for furniture purchase	2, 000
25	Received from nithinRs. 500 Discount allowed Rs. 50	
28	Cash purchase paid by cheque	800
29	Paid salary by cheque	1, 200

10. Elaborate the importance of subsidiary books with suitable examples?

11.Journalize the following transactions in the books of Mr.Chandran**:** 2001

Apr. 1 Started business with cash Rs.40,000 and furniture Rs.10,000.

5 Paid tuition fee of the son Rs.1,000

8 Paid household expenses Rs.1,400.

10 Sold personal car for Rs.18,000 and the amount is brought into the business.

15 Withdrew goods for personal use Rs.2,000.

16 Sold goods to Navin on credit Rs.8,000.

18 Sold old typewriter Rs.1,000.

19 Purchase goods on credit from Ramesh Rs.20,000

20 Received interest on investment Rs.6,000.

22 Received commission from Manohar Rs.2,000.

23 Receive a cheque from Navin Rs.5,000.

25 Issued a cheque to Ramesh Rs.12,000

26 Received cash from Anand on account Rs.4,000

27 Paid cash to Bhagwan on account Rs.1,000.

28 Returned goods to Ramesh Rs.1,000.

29 Navin returned goods Rs.500.

30 Paid rent Rs.1,000.

30 Paid salaries Rs.12,000.

12.Journalise the following transactions in the books of Sabitha and post them in the Ledger:

2000

Apr.1 Bought goods for cash Rs. 15,000

3 Sold goods for cash Rs. 19,000

5 Bought goods on credit from PeraraRs. 12,000

6 Sold goods on credit to RavindarRs. 16,000

8 Received from RavindarRs. 12,000

10 Paid to PeraraRs. 7,500

25 Bought furniture for cash Rs. 4,500

13. Enter the following transactions in the journal and ledger of Murali of New Delhi:

2001

Mar. 1 Murali commenced business with cash 90,000

4 Purchased goods for cash 6,000

5 Deposited into bank 40,000

6 Withdrew from bank for office use 4,500

8 Sold goods to Raja 4,800

12 Purchased goods on credit from Kathar 1,380

15 Received from Raj Rs.4,650 and allowed him discount 150

20 Cash sales 7,200

28 Paid to Kathar in full settlement 1,300

30 Paid rent 300

Paid salary 1,600

Accounts are closed on 31st March 2001.

14. Journalise the following transactions and Post them in relevant ledger accounts: 1991

Jan. 1. Bought from Das 1,000

Jan. 2. Sold to Sen 400

Jan. 3. Sold to Ramesh 250

Jan. 4. Purchased from Suresh 200

Jan. 5. Sales returns by Sen 50

Jan. 10. Bought from Shyam 600

Jan. 12. Returned to Suresh 100

Jan. 15. Sold to Roy 800

Jan. 16. Roy returned goods 200

Jan. 17. Sold goods to Ram 300

Jan. 19. Bough from Naresh 650

Jan. 21. Sold to Bhatanger 750

Jan. 22. Returned to Naresh 50

Jan. 25. Bought from Khatju 850

Jan. 27. Sold to Dheeran 260

Jan. 29. Returns from Bhatanger 100

Jan. 30. Dheeran Returned 60

Jan. 31. Returns to Khatju 150

***CIA - 3 X 8 = 24 (EITHER OR TYPE)**

****ESE - 5 X6 = 30 (EITHER OR TYPE)**

UNIT-II

SYLLABUS

Depreciation Accounting: International Financial Reporting Standards (IFRS) - Understanding Accounting Standards issued by the ICAI related to Disclosure of Accounting Policies. Depreciation Accounting - Revenue Recognition - Methods of charging Depreciation - Straight-line Method - Written-down-value Method - Bank Reconciliation Statement

INTERNATIONAL FINANCIAL REPORTING STANDARDS:

International Financial Reporting Standards (IFRS) are designed as a common global language for business affairs so that company accounts are understandable and comparable across international boundaries. ... IAS were issued between 1973 and 2001 by the Board of the International Accounting Standards Committee (IASC).

According to The Hundred Group of Finance Directors, UK 2006, "Financial reporting is a practical exercise in communication not a theoretical or academic construct. We should not lose sight of the importance of financial statements as a tool for communication; currently we are losing the audience as they are becoming too complex." Consequently, there arises a need of a common set of high quality accounting and financial reporting procedures and standards to facilitate investment and other economic decisions across borders, increase market efficiency and reduce the cost of capital. This has resulted in the development of International Financial Reporting Standards (IFRS) by International Accounting Standards Board (IASB) in the year 2001.These standards are based on sound and clearly stated principles. It is much refined system of financial reporting which would benefit all stakeholders in the years to come, together with improved corporate governance and increased free flow of capital across the globe.

UNDERSTANDING ACCOUNTING STANDARDS

Assumptions in IFRS

IFRS are principle based while Indian Generally Accepted Accounting Principles (GAAP) are rule based. Unlike Indian Accounting Standards, IFRS do not prescribe any form for preparing the financial statements. Fair value is considered for showing assets and liabilities in the Balance Sheet under IFRS unlike Indian GAAP which is based on the historical cost concept. The underlying assumptions in IFRS are:

1.Accrual assumption: The transactions are recorded in the books of accounts on accrual basis, i.e., as and when they occur and not when the settlement of transactions takes place.

2.Going Concern assumption: It is assumed that life of business is infinite, i.e., the entity will continue its operations for an indefinite period.

3.Fair Value: Assets should be reflected at current i.e., fair value.

4.Constant Purchasing Power Assumption: It means value of capital be adjusted to inflation in the economy at the end of the financial year.

India and IFRS

With the emergence of IFRS by IASB in 2001 as global reporting norms, India had two options: either to adopt IFRS as they are, or to converge the Indian Accounting standards in line with the IFRS. It decided to converge its existing accounting standards with IFRS. According to ICAI, 'convergence' means to achieve harmony with IFRS; in precise terms convergence can be considered 'to design and maintain national accounting standards in a way that financial statements prepared in accordance with national accounting standards draw unreserved statement of compliance with IFRS'. The converged accounting standards titled Ind-AS have been issued and notified. These standards do not resemble IFRS. Both by presentation and measurement principles, they are new set of accounting standards developed in the line of IFRS.

The Finance Minister had said in his budget speech that from April 2016, all listed companies with a net worth of Rs. 500 crore or more would have to switch to the new norms except banks, Non Bank Financial Corporation (NBFCs) and insurance companies. Under the new Ind-AS, companies would have to enhance the quality of financial reporting to be in sync with the IFRS and make India's capital markets attractive globally. Companies' Balance Sheets are likely to get hit since the new accounting norms require firms to be more transparent and disclose more stakeholder-related data.

The advantages of achieving convergence with IFRS are numerous. It benefits the economy by increasing the growth of its international business. By encouraging the international investors to invest, it leads to more foreign capital flows to the country. Financial statements prepared using a common set of accounting standards help investors better understand investment opportunities as opposed to financial statements prepared using a different set of national accounting standards. The industry is able to raise capital from foreign markets at lower cost if it can create confidence in the minds of foreign investors that their financial statements comply with globally accepted accounting standards. It offers accounting professionals more opportunities in any part of the world if same accounting practices prevail throughout the world.

Thus, it can be summed up that India's convergence with IFRS is an intellectual decision, also the Companies Act, 2013 has prescribed certain modifications in the preparation of financial statements, making the information provided by business entities more reliable, transparent and stakeholder friendly, thus, corroborating with international financial reporting standards on many fronts. However, one of the challenges which arise is to understand the problems that will be faced on the way of IFRS convergence. The level of understanding of these problems would pave the way for success or otherwise of this paradigm shift in financial reporting. Thus, lack of training facilities and academic courses on IFRS will pose a challenge in India. Since, 2016 – 17 has been marked as the financial year for mandatory adoption of these standards for Indian companies, the need of the hour is to be educated on IFRS and its application. It must be a business imperative for Indian companies.

An attempt has been made here to call the attention of the concerned academicians, pracademics, higher education institution, Institute of Chartered Accountants of India and various regulatory bodies including Ministry of Corporate Affairs and Ministry of Finance, National Financial Reporting Authority and Securities Exchange Board of India towards enlightening employees, potential investors, and students about this development in corporate financial reporting. Dr. N.A. Gilkar, in his write-up entitled "Accounting : A fully – fledged academic discipline" published in Greater Kashmir (July 11, 2016) informed that Central university of Kashmir intends to take a lead by introducing Integrated Accounting and Finance Programme. My submission here would also be that this varsity should also consider an academic course on IFRS as part of the proposed programmes. Given the developments in corporate financial reporting in India, there would be an increasing demand from the industry for such accounting professionals who are well versed and honed with the knowledge of international norms of communicating business information.

In addition, the unprecedented growth in the technology driven economic transactions would also increase the demand for people well equipped with accounting knowledge. It would be a boost to job oriented programme in accounting discipline and at the same time would save a number of students from those who lure them by promoting online courses of fake, money minting institutes. As Socrates said, "I am not going to teach you, I am trying to make you think".

DEPRECIATION:

The term depreciation refers to the reduction in or loss of quality or value of a fixed asset through wear or tear in or tear, in use, effusion of time, obsolescence through technology and market changes or from any other cause. Depreciation take place in case of all fixed assets with certain possible exceptions e.g. land and antiques etc, although the process may be invisible or gradual. Depreciation does take place irrespective of regular repairs and proper maintenance of assets. The word 'depreciation' is closely related to the concept of business income. Unless it is charged against revenues, we cannot say that the business income has been ascertained properly. This is because of the fact that the use of long term assets tend to consume their economic value and at some point of time these assets become useless. The economic value so consumed must be recovered from the revenue of the firm to have a proper measure of its income. Hence, the reader's must understand that the process of charging depreciation is the technique used by accountants for recovering the cost of fixed assets over a period.

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

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

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

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

Depreciation, Depletion and Amortization: The terms depreciation, depletion and amortization are used often interchangeably. However, these different terms have been developed in accounting usage for describing this process for different types of assets. These terms have been described as follows:

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

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

Amortisation: The process of writing off intangible assets is termed as amortisation. The intangible assets like patents, copyrights, leaseholds and goodwill are recorded at cost in the books of account.

Many of these assets have a limited useful life and are, therefore, written off.

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

CAUSES OF DEPRECIATION

The depreciation occurs because of the following:

1. Constant use: The constant use of assets results into their wear and tear, which in turn reduces their working capacity. Hence, a decrease in the value of assets may be seen due to reduced capacity. The value of assets like, machinery, furniture, etc., declines with the constant use of them.
2. Passage of Time: Many fixed assets lose their value with the passage of time. This holds true in case of intangible fixed assets such as patents, copy rights, lease hold properties, etc. The term "amortisation"is generally used to indicate the reduction in the value of such assets.
3. Depletion: Depletion also causes decline in the value of certain assets. This is true in case of wasting assets such as mines, oil wells and forest-stands. On account of continuous extraction of

minerals or oils, these assets go on declining in their value and finally they gets completely exhausted.

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

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

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

NEED FOR PROVIDING DEPRECIATION

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

1. To Ascertain the Profits or Losses: The true profits or losses could be ascertained when all costs of earning revenues have been properly charged against them. Fixed assets like building, plant and machinery, furniture, motor vehicles etc are important tool in earning business income. But the cost of the fixed asset is not charged to profit and loss of the accounting period in which the asset is purchased. Therefore, the cost of the fixed asset less its salvage value must be allocated rationally to the periods that receive benefit from the use of the asset. Thus, depreciation is an item of business expense and must be provided for a proper matching of costs with the revenue.

2. To show the Asset as its Reasonable Value: The assets get decrease in their value over a period of time on account of various such as passage of time, constant use, accidents, etc. Therefore, if the depreciation is not charged then the asset will appear in the balance sheet at the over stated value. This practice is unfair as the balance sheet fail to present the true financial position.

3. Replacement of assets: Business assets become useless at the expiry of their life and, therefore, need replacement. The cash resources of the concern are saved from being distributed

by way of dividend by providing for depreciation. The resources so saved, if set aside in each year, may be adequate to replace it at the end of life of the asset.

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

BASIC ELEMENTS OF DEPRECIATION

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

1. Cost of the asset: The knowledge about the cost of the asset is very essential for determining the amount of depreciation to be charged to the profit and loss account. The cost of the asset includes the invoice price of the asset less any trade discount plus all costs essential to make the asset usable. Cost of transportation and transit insurance are included in acquisition cost. However, the financial charges such as interest on money borrowed for the purchase for the purchase of the asset should no be included in the cost of the asset.

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

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

METHODS OF RECORDING DEPRECIATION

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

When a provision for depreciation account is maintained

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

i) Depreciation account Dr.

To provision for Depreciation Account

(for providing depreciation)

ii) Profit and loss Account Dr.

To Depreciation account

(for closing depreciation account)

iii) Provision for Depreciation account Dr.

To Asset Account

(entry on sale of an asset)

iv) Any amount realised on account of sale of the asset is credited to the Asset Account. The balance, if any, in the Asset Account is transferred to the profit and loss Account.

When a provision for depreciation account is not maintained

The following journal entries are passed in this method:

i) Depreciation account Dr.

To Asset Account

(Entry for providing depreciation)

ii) Profit and loss Account Dr.

To Depreciation Account

(Entry for closing Depreciation Account)

iii) In case the asset is sold, the amount realized is credited to the Asset Amount. Any profit or loss on sale of the asset is transferred to the Profit and loss account.

METHODS OF CALCULATING DEPRECIATION

The following are various methods of depreciation in use:

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

8. Depletion Method.

Straight Line Method

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

$$\text{Amount of annual Depreciation} = \frac{\text{Original cost of the fixed assets} - \text{Residual value}}{\text{Estimated Life in years}}$$

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

$$\text{Depreciation} = \frac{\text{Rs. } 50{,}000 - 2000}{10 \text{ Years}} = \text{Rs. } 4800$$

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

Illustration:1 H. Ltd. purchased a machinery on 1st January 1990 for Rs. 29000 and spent Rs. 2000 on its carriage and Rs. 1,000 on its erection. Machinery is estimated to have a scrap value of Rs. 5000 at the end of its useful life of 5 year. The accounts are closed every year on 31stDecember. Prepare the machinery account for five years charging depreciation according to straight line method

Solution

MACHINERY ACCOUNT

Date	Particulars	Rs.	Date	Particulars	Rs.
1990	To Bank	22000	Dec. 31	By Depreciation	4000
Jan. 1	To Bank	2000	"	By Balance C/d	21000
	To Bank	1000			
		25000			25000
1991	To Balance b/d	21000	1991	By Depreciation	4000
Jan.1			Dec.31	Balance c/d	17000
		21000			21000
1992	To Balance/b/c	17000	1992	By Depreciation	4000
Jan.1			Dec. 31	By Balance c/d	13000
		17000			17000
1993	To Balance b/c	13000	1993	By Depreciation	4000
Jan.1			Dec.31	By Balance	9000
		13000			13000
1994	To Balance b/d	9000	1994	By Depreciation	4000
Jan.1			Dec.31	By Balance c/d	5000
		9000			9000

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

Machine Hour Rate Method

In case of this method, the running time of the asset is taken into account for the purpose of calculating the amount of depreciation. It is suitable for charging depreciation on plant and machinery, air-crafts, gliders, etc. The amount of depreciation is calculated as follows:

$$= \frac{\text{Acquisition cost of the assets} - \text{Scrap value}}{\text{Life of the Asset in hours}}$$

For example, if machinery has been purchased for Rs. 20000 and it will have a scrap value of Rs. 1000 at the end of its useful life of 1900 hours, the amount of depreciation per hour will be computed as follows:

$$\text{Depreciation} = \frac{\text{Acquisition cost of the assets} - \text{Scrap value}}{\text{Life of the Asset in hours}}$$

$$= \frac{\text{Rs. } 20{,}000 - 1{,}000}{1900 \text{ hours}}$$

$$= \text{Rs. } 10 \text{ per hour}$$

If in a particular year, the machine runs for 490 hours, the amount of depreciation will be Rs. 4900 (i.e., Rs. 10x490). It is obvious from this example that under machine hour rate method the amount of depreciation is closely related with the frequency of use of an asset. The simplicity in calculations and under standing is the main advantage of this methods. However, it can be used only in case of those assets whose life can be measured in terms of working time.

Diminishing Balance Method

This is also known as Written down value method [WDV]. Under the diminishing balance method depreciation is charged at fixed rate on the reducing balance (i.e., cost less depreciation) every year. Thus, the amount of depreciation goes on decreasing every year. Under this method also the amount of depreciation is transferred to profit and loss account in each of the year and in the balance sheet the asset is shown at book value after reducing depreciation from it.

For example, if an asset is purchased for Rs. 10,000 and depreciation is to be charged at 20% p.a. on reducing balance system then the depreciation for the first year will be Rs. 2000. In the second year, it will Rs. 1600 (i.e. 20% of 8000), in the third year Rs. 1280 (i.e. 20% of 6400) and so on. The rate of depreciation under this method can be computed by using the following formula:

$$\text{Depreciation rate} = -1 \sqrt{\frac{\text{Net scrap value}}{\text{Acquisition cost}}}$$

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

$$\text{Depreciation Rate} = 1 - 3\sqrt{\frac{3375}{27000}}$$

Merits of Diminishing Balance Method

(i) It is very easy to understand and calculate the amount of depreciation despite the early variation in the book value after depreciation

(ii) This method put an equal burden for use of the asset on each subsequent year since the amount of depreciation goes on decreasing for each subsequent year while the charge for repairs goes on increasing for each subsequent year.

(iii) This method has also been approved by the income tax act applicable in India

(iv) Asset is never reduced to zero because if the rate of depreciation is (say) 20%. Then even when asset is reduced to very small value, there must remain the 80% of that small value as on written off balance.

Demerit

(i) It ignores the interest on the capital committed to purchase that asset.

(ii) It does not provide adequately for replacing the asset at the end of its life.

(iii) The calculation of rate of depreciation is not so simple.

(iv) The formula for calculating the rate of depreciation can be applied only when there is some residual of the asset.

Suitability

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

Illustration 2: A company purchases Machinery on 1st April 1990 for Rs. 20,000. Prepare the machinery account for three years charging depreciation @ 25% p.a. according to the written Down value Method.

MACHINERY ACCOUNT

Date	Particulars	Rs.	Date	Particulars	Rs.
1990 Apr. 1	To Bank	20000	1991 Mar. 31	By Depreciation By Balance C/d	5000 15000
		20000			20000
1991 Apr.1	To Balance b/d	15000	1992 Mar.31	By Depreciation By Balance c/d	3750 11250
		15000			15000
1992 Apr 1	To Balance b/d	11250	1993 Mar.31	By Depreciation By Balance c/d	2812.5 8437.5
		11250			11250

Sum of Years digits (SYD) Method

Under this method also the amount of depreciation goes on diminishing in the future years similar to that under diminishing Balance method.

For calculating the amount of depreciation to be charged to the profit and loss account this method takes into account cost, scrape value, and life of the asset. The following formula is used for determining depreciation:

$$= \frac{\text{Remaining life of the Assets at the end of the year} + 1}{\text{Sum of the digits representing the life of the asset}} \times \text{Acquisition Cost}$$

For example, an asset having an effective life of 5 years is purchased at a cost of Rs. 20,000. It is estimated that its scrap value at the end of its effective life will be Rs. 2000. The depreciation on this asset, if SYD method is followed, will be calculated as follows from one to five years:

Year		Depreciation Amount
1	=	$\frac{5}{15} \times 18000 = \text{Rs. } 6000$
2	=	$\frac{4}{15} \times 18000 = \text{Rs. } 4800$
3	=	$\frac{3}{15} \times 18000 = \text{Rs. } 3600$
4	=	$\frac{2}{15} \times 18000 = \text{Rs. } 2400$
5	=	$\frac{1}{15} \times 18000 = \text{Rs. } 1200$

Annuity Method

Sofar we have described such methods of charging depreciation which ignore the interest factor. Also, some times it becomes inconvenient for a company to follow any of the methods discussed earlier. Under such circumstances the company may use some special depreciation systems. Annuity method is one of these special systems of depreciation. Under this system, the depreciation is charged on the basis that besides losing the acquisition cost of the asset the business also loses interest on the amount used for purchasing the asset. Here, interest refers to that income which the business would have earned otherwise if the money used in buying the asset would have been committed in some other profitable investment. Therefore, under the annuity method the amount of total depreciation is determined by adding the cost and interest thereon at an expected rate. The annuity table is used to help in the determination of the amount of depreciation. A specimen of Annuity Table is as follows:

ANNUITY TABLE

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

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

(i) Purchase of an assetAsset Account Dr.

ToBank

(ii) For Charging interestAsset Account Dr.

To Interest Account

(iii) For Charging depreciation:

Depreciation Account Dr.

To Asset Account

Evaluation of Annuity Method

Merits

(i) This method keep into account interest on money spent on the purchase of the asset.

(ii) The value of the asset become zero at the end of life.

Demerits

(i) This method is comparatively more difficult than the methods discussed so far.

(ii) It makes no arrangement of money to replace the old asset with the new one at the expiry of its life.

(iii) Under this method the burden on the profit and loss account is no similar in each year because the depreciation remains constant year after year but the interest goes on decreasing.

Illustration: On 1st January, 1990 a firm purchased a leasehold property for 4 year at a cost of Rs. 24000. It decides to depreciate the lease by Annuity Method by charging interest at 5% per annum. The Annuity Table shows that the annual necessary to write off Rs. 1 at 5% Rs. 0.282012. You are required to prepare the lease Hold Property Account for four years and show the net amount to be charged to the profit and loss account for these four years.

LEASE HOLD PROPERTY ACCOUNT

Date	Particulars	Rs.	Date	Particulars	Rs.
1990 Jan. 1	To Bank	24000.00	1990 Dec. 31	By Depreciation	6768.29
	To interest	1200.00	Dec.31	By balance c/d	18431.71
		25200.00			25200.00
1991 Jan.1	To balance b/d	18431.71	1991 Dec.31	By Depreciation	6768.29
Dec.31	To Interest	921.59	Dec.31	By Balance c/d	12585.01
		19353.30			19353.30
1992 Jan.1	To balance b/d	12585.01	1992 Dec.31	By Depreciation	6768.29
Dec. 31	To Interest	629.25	Dec.31	By Balance c/d	6445.97
		13214.26			13214.26
1993 Jan.1	To balance b/d	6445.97	1993 Dec.31	By Depreciation	6768.29
				By Balance c/d	9000
Dec.31	To Interest	322.30			13000
		6768.27			6768.27

NET AMOUNT CHARGEABLE TO THE PROFIT AND LOSS ACCOUNT

Year	Depreciation debited	Interest Credited	Net Charge against Profit
1990	6768.29	1200.00	5568.29
1991	6768.29	921.59	5846.70
1992	6768.29	629.25	6139.04
1993	6768.29	322.30	6445.99
Rs.	27073.16	3073.14	24000.02

Depreciation Fund Method

Business assets become useless at the expiry of their life and therefore, need replacement. However, all the methods of depreciation discussed above do not help in accumulating the amount which can be readily available for the replacement of the asset its useful life comes to an end Depreciation fund method takes care of such a contingency as it incorporates the benefits of depreciating the asset as well as accumulating the necessary amount for its replacement. Under this method, the amount of depreciation charged from the profit and loss account is invested in certain securities carrying a particular rate of interest. The interest received on the investment in such securities is also invested every year together with the amount of annual depreciation. In the last of the life of asset the depreciation amount is set aside interest is received as usual. But the amount is not invested because the amount is immediately needed for the purchase of new asset. Rather all the investments so far accumulated are sold away. Cash realized on the sale of investments is utilized for the purchase of new asset. The following accounting entries are generally made in order to work out this system of depreciation.

1. At the end of the first year

(i) for setting aside the amount of depreciation: The amount to be charge by way of depreciation is determined on the basis of sinking Fund Table given as an Appendix at the end of every book of accountancy.

Depreciation Account Dr.

To Depreciation Fund Account (or Sinking Fund A/c)

(ii) For investing the amount charged by way of depreciation:

Depreciation Fund Investment A/c Dr.

To Bank A/c

2. In the second and subsequent years

(i) For receiving interest. The interest on the balance of Depreciation Fund Investment outstanding in the beginning of each year will be received by the end of the year. This entry is:

Bank Account Dr.

To Depreciation Fund Account

(ii) For setting aside the amount of depreciation

Profit and Loss A/c Dr.

To Depreciation Fund A/c

(iii) For investing the amount

Depreciation Fund Investment A/c Dr.

To Bank A/c

(Annual instalment of depreciation and interest received invested)

3. In the last year

(i) For receiving interest:

Bank A/c Dr.

To Depreciation Fund A/c

(ii) For setting aside the amount of depreciation

Profit and loss A/c Dr.

To depreciation Fund A/c

Note: In the last year no investment will be made, because the amount is immediately required for the purchase of new asset.

(iii) For the sale of investment:

Bank A/c Dr.

To Depreciation Fund Investment A/c

(iv) For the transfer of profit or loss on sale on investments: The profit or loss on the sale of these investments is transferred to the Depreciation Fund Account.

The entry for loss:

Depreciation Fund A/c Dr.

To Depreciation Fund Investment A/c

The entry for profit

Depreciation Fund Investment A/c

To Depreciation Fund A/c

(v) For the sale of old asset:

Bank A/c Dr.

To asset A/c

(vi) The depreciation fund is transferred to asset account and any balance left in the asset account is transferred to profit and loss account. The entry is:

Depreciation Fund A/c. Dr.

To asset A/c

(vii) The balance in Asset Account represents profit or loss. Therefore it will be transferred to the profit and loss account.

(viii) The cash realised on the sale of investments and the old asset is utilized for the purchase of new asset.

Insurance Policy Method

Under this method, instead of investing the money in securities an insurance policy for the required amount is taken. The amount of the policy is such that it is adequate to replace the asset when it is worn out.

A fixed sum equal to the amount do depreciation is paid as premium every year. Company receiving premium allows a small rate of interest on compound basis. At the maturity of the policy, the insurance company pays the agreed amount with which the new asset can be purchased.

Accounting entries will be made as follows.

1. First and every subsequent years

(a) Depreciation Insurance policy A/c Dr.

To Bank

(Entry in the beginning of the year for payment of insurance premium)

(b) Profit and loss Account Dr.

To Depreciation fund A/c

(Entry at the end of the year for providing depreciation)

2. Last year

(a) Bank A/c Dr.

To Depreciation Policy A/c

(Entry for the amount of policy received)

(b) For transfer of profit on insurance policy:

Depreciation Insurance Policy A/c Dr.

To Depreciation Fund A/c

(c) For transfer of accumulated depreciation to the asset account:

Depreciation Fund A/c Dr.

To Asset A/c

(d) On purchase of new asset:

On purchase of new asset:

New Asset A/c Dr.

To Bank

Depletion Method

This is also known as productive output method. In this method it is essential to make an estimate of the units of output the asset will produce in its life time. This method is suitable in case of mines, queries, etc., where it is possible to make an estimate of the total output likely to be available. Depreciation is calculated per unit of output. Formula for calculating the depreciation rate is as under:

$$r = \frac{\text{Acquisition cost} - \text{Scrap value}}{\text{Units of output}}$$

Example: If a mine is purchased for 50,000 and it is estimated that the total quantity of mineral in the mine is 1,00,000 tonnes, the rate of depreciation would be:

$$r = \frac{50{,}000}{1{,}00{,}000} = \text{Rs. } 0.5$$

Hence, the rate of depreciation is 50 paise per tonne. In case output in a year is 20,000 tonnes, the amount of depreciation to be charged to the profit and loss account would be Rs.

10,000 (i.e., 20,000 tonnes × Rs. 0.50).This method is useful where the output can be measured effectively, and the utility of the asset is directly related to its production use.

Thus, the method provides the benefit of correlating the amount of depreciation withthe productive use of asset.

SALE OF AN ASSET

An enterprise may sell an asset either because of obsolescence or inadequacy or even for other reasons. In case an asset is sold during the course of the year, the amount realized should be credited to the Asset Account. The amount of depreciation for the period of which the asset has been used should be written off in the usual manner. Any balance in the Asset Account will represent profit or loss on disposal of the asset. This balance in the Asset Account should be transferred to the profit andloss account.

DEPRECIATION ONAN ASSET PURCHASED IN THE COURSE OF A YEAR

Two alternatives are available regarding charging of depreciation on assets which have been bought during the course of an accounting year.

These are as follows:

1. Depreciation may be charged only for the part of the year for which the asset could have been made available for use after purchase of it.
2. Depreciation may be charged for the full year irrespective of the date of purchase. It will be ascertained at the given rate of depreciation. The Income tax authorities also permit this.

Important Note: If there is no specific instruction in the question about depreciation, the students should give the assumption made by them in this regard. But, in case rate of depreciation has been given as a certain percentage per annum and the purchasing date has been given, it is suggested to calculate depreciation only for the part of the year for which the asset has been made available for its use.

CHANGE OF DEPRECIATION METHOD

To ensure comparability of results from year to year, it is essential that once a method of depreciation is selected by the management it should be followed consistently. However, sometimes a change in the method of depreciation may be required. The change may be required either because of statutory compulsion or required by an accounting standard or change would result in more appropriate presentational the financial statements.

The change in the method of depreciation may be desired from the current year onwards. In such a case, depreciation will be charged according to the new method from the current year.

PROBLEMS:1

A firm purchases a plant for a sum of Rs. 10,000 on 1st January 1990. Installation charges are Rs. 2,000. Plant is estimated to have a scrap value of Rs. 1,000 at the end of its useful life of five years. You are required to prepare the plant account for five years charging depreciation according to Straight Line Method .

PROBLEMS:2

A plant is purchased for Rs. 20,000. It is depreciated at 5% per annum on reducing balance for five years when it becomes obsolete due to new method of production and is scrapped. The scrap produces Rs. 5,385. Show the plant account in the ledger.

PROBLEMS:3

The machinery account of a factory showed a balance of Rs. 1,90,000 on 1st January 1998. 1st accounts were made up on 31st December each year and depreciation is written off at 10% p.a. under the Diministing Balance Method.

On 1st June 1998, New Machinery is acquired at a cost of Rs. 28,000 and installation charges incurred in erecting the machines works out to Rs. 892 on the same date. On 1st June 1998 a machine which had cost Rs. 6,000 on 1st January 1993 was sold for Rs. 750, another machine which had cost Rs. 600 on 1st January 1994, was scrapped on the same date and it realised nothing.

Write up plant and Machinery Account for the year 1998, allowing the same rate of Depreciation as in the past calculating Depreciation to the nearest multiple of a Rupee. (Ans. Loss on Sale Rs. 2,645, Loss on scrapping Rs. 377, Closing Balance Rs. 1,94,665).

PROBLEMS:4

A company purchased a four years lease on January, 1, 1985 for Rs. 20,150. It is decided to provide for the replacement of the lease at the end of four years by setting up a Depreciation Fund. It is expected that investments will fetch interest at 4per cent. Sinking Fund tables show that to provide the requisite sum at 4percent at the end of four years, an investment of Rs. 4,745.02 is required. Investments are made to the nearest rupee.

On December 31, 1988, the investments are sold for Rs. 14,830 On 1st January, 1989, the same lease is renewed for a further period of 4 years by payment of Rs. 22,000.Show journal entries and give the important ledger account to record the above.

BANK RECONCILIATION STATEMENT

In modern business world, the major part of the business transactions is settled by cheques. For the purpose of business transactions through cheques, every businessman maintains current accounts with banks. He keeps money in his account and deposits cheques, etc. received from customers and draws cheques in favour of his creditors for making the payments. Current account facilitates business transactions in a smoother way than cash. For instance, no substantial cash is to be kept in the business, payments of cheques are themselves records of payments made, the payee is also relieved of the risk of carrying cash.

When a businessman opens a current account in a bank, the bank issues him a cheque book and pass book. At the same time, the businessman also keeps its records relating to bank transactions either through the bank columns of the cash book or through a separate bank account in the books of accounts. When the cash is deposited or a cheque is deposited in the bank, the bank account is debited in the cash book. But when the businessman withdraws cash from the bank, the same account is credited. Similarly, when cash is deposited into bank it increases the liability of the bank and bank gives credit to the account of the client in the pass book. The bank maintains the businessman’s account in its ledgers and its copy is recorded in the pass book and given to the customers.

In other words, all entries appearing in the debit side of the bank column of the cash book will be appearing in the credit side of the businessman’s account in the ledger of the bank. Conversely, all entries appearing in the credit side of the bank column of the cash book will be appearing in the debit side of the businessman’s account in the ledger of the bank.

Sometimes it happens that balance of the bank column of the cash book does not show the same balance as that shown by the pass book. Both there balances may be correct, yet may show a difference. In order to reconcile the balance of the bank column of the cash book with that of the pass book, this statement is prepared.

The statement that is prepared for reconciling the balances of cash book and pass book is called a Bank Reconciliation Statement. Bank Reconciliation Statement is a statement which contains a complete and satisfactory explanation of the differences in the balances as per the cash book and the pass book.

FEATURES OR CHARACTERISTICS OF BANK RECONCILIATION STATEMENT

From the above, the following features of the statement emerge:

a) It is merely a statement not an account.

b) This is a periodical statement.

c) It is prepared on a particular day or this statement is valid for the day it is prepared.

d) The preparation of bank reconciliation statement is not a part of the double entry book-keeping.

e) The causes which are responsible for the disagreement of the two balances can easily be found out.

CAUSES/REASONS FOR DIFFERENCE IN TWO BALANCES

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

Cheques issued but not yet presented for payment: When a cheque is issued to a third party, it is entered in the cash book by crediting the bank account esulting in reducing the bank balance in the depositor's books. But bank debits the customer's account when the cheque is presented by that third party to the bank for payment. This means that if the cheque is not presented for payment upto the date of preparation of the bank reconciliation statement, the balance as per pass book will be higher than the balance shown by the cash book by the amount of cheque not presented for payment.

Cheques paid into bank but not yet collected by the bank: Whereas a cheque is received by a businessman from a third party and he deposits it in a bank, he will debit bank account and credit the account of third party in his own books. His bank balance in cash book is therefore increased.

But bank will credit that cheque not when it is deposited but only when that amount has been realised. Until the cheque has been collected, the balance appearing in the pass book would be less than the balance in the bank column of cash book.

Bank Charges: The bank usually debits the account of the customer with interest on bank overdraft, collection charges, incidental charges for the various services rendered by the bank. These adjustments are shown in the pass book as and when they occur and hence the balance in the pass book decreases. Customer comes to know about it when he collects his pass book and verifies it. Until then, the bankbalance as per the pass book would be less than the bank balance as per the cash book.

Interest credited by bank but not entered in cash book:

Some scheduled banks give interest on current accounts to their customers if they maintain certain minimum credit balance in their current accounts. When a bank allows interest to a customer it will credit his account and his bank balance will be increased. But the customer will know about when he will receive the pass book or bank statement and then he would pass an appropriate entry in the cash book. Until then, the bank balance as per pass book would be more than the bank balance as per cash book.

Interest or dividend on investments etc. collected by the The businessman may entrust the task of collection of interest or dividend on investments, rent on property etc. to the banker. After the collection of this income, the bank will give credit to the account of the businessman and will increase his balance whereas there may be no entry for this income in the cash book of the businessman for want of information. The relevant entry in the cash book is made only when communicated and hence cash and pass book balances vary in the mean time.

Amount directly deposited into the bank by customers:

When any amount is directly deposited into the bank account of a businessman by customers then the bank gives credit to the account of that businessman immediately. This results in an increase in the bank balance by that amount. The businessman would come to know about the deposit on receiving advice from the bank or intimation from the customer. Until then the bank balance would show more balance as compared to the balance as per cash book.

Payments made by the bank on behalf of clients: The businessman may give standing instructions to his bank to make the payment of insurance, rent, licence fee and other payments on his behalf when they fall due. On the instructions of the customers, the bank makes the payment on due dates and debits the client's account. But the businessman enters the same in his books only when he receives the intimation from the bank. Till it is done, the two balances show a difference.

Bills Collected by the bank on behalf of Customers: The customers may authorise his banker to collect the amount against certain bills receivable from the acceptor or a draweeas and when they become due. If the acceptor of a bill receivables honours the bill on its due date, the bank will give a credit to the customer's account for the amount so collected. As a result, the bank balance will be higher by that amount than the balance as per cash book until the necessary entry in this respect is recorded in cash book.

Dishonour of Bills or cheques: When the businessman sends the bills or cheques to the bank for realisation, he enters them on the debit side of his cash book and thus increases the bank balance. But the bank does not make any entry in the customer's account if these are dishonoured. This is another cause of difference between the two balances. Rebate on retiring of Bills: When the businessman makes payment of his bills payable through bank or to bank before maturity he is allowed a rebate on such payments by the bank. The bank credits the businessman's account with this rebate. Thus, there will be a difference in the balances of cash book and pass book to the extent of amount of rebate.

- Cheques paid into bank but omitted to be entered in cash book:Sometimes the businessman deposits a cheque into the bank but forgets to enter the same in cash book. This also causes a difference between the two balances.
- Wrong debit or credit given by the banks: If there is a wrong debit or credit in the books of account of the bank it also causes a difference in the balances of books of the customer and the bank. A wrong debit or credit may be given by the bank in the following ways:

a)Other account holders' cheque wrongly debited or credited in the customer account
by the bank.

b)Recording of entry on the wrong side of the pass book by the bank.

PROCEDURE FOR PREPARATION OF BANK RECONCILIATION STATEMENT

The bank reconciliation statement is prepared usually at the end of period, i.e. a month, a quarter, a half year or year as may be found convenient and necessary by the businessman taking into account the number of transactions involved. The following are the steps to be taken for preparing a bank reconciliation statement:

a) Tick off all the items in the pass book with the entries in the bank column of the cash book and make a list of the entries as are found not ticked either in the cash book or the pass book. The unticked items are responsible for the difference in the balances shown by the cash book and the pass book.

b) The balance shown by any book (i.e. cash book or pass book) should be taken as the base . This is as a matter of fact the starting point for determining the balance as shown by the other book after making suitable adjustments taking into account the causes of difference.

c) The effect of the particular cause of difference should be studied on the balance shown by the other book.

d) In case, the cause has resulted in an increase in the balance shown by the other book, the amount of such increase should be added to the balance as per the former book which has been taken as the base.

e) In case, the cause has resulted in decrease in the balance shown by the other book, the amount of such decrease should be substracted from the balance as per the former book which has been taken as the base.

f) In case, the books show an adverse balance (i.e. an overdraft the amount of the overdraft should be put in the minus column. Bank Reconciliation Statement should then be prepared on the same pattern as if there is a favourable balance instead of their being an overdraft.

The following table will help to learn the preparation of the bank reconciliation statement

Dr. balance as per Cr. Balance as per

Cash Book or pass Book or

Overdraft as per Overdraft as per

Pass Book Cash Book

I. Those items which affect the debit side of Cash Book: - +

i) Cheques deposited but not collected by bank

ii)Cheque though entered in Cash Book but omitted to be sent to the Bank.

II. Those items which affect the credit side of Cash Book: + -

i) Cheques issued but not presented for payment.

III. Those items which affect the Credit side of pass Book: + -

i) Interest/Dividend credited by bank.

ii) Amount deposited direct by a customer into bank account.

iii) Cheques sent to the bank but omitted to be entered into the Cash Book.

IV. Those items which affect the debit side of Pass Book: - +

i) Bank charges charged by bank.

ii) Interest on overdraft.

iii) Payment made by bank on standing instructions of customer.

The above technique will be clear with it help of the illustrations given in the following pages.

Where causes of differences are given

Illustration: From the following particulars prepare a Bank Reconciliation Statement as on 31st December, 2006.

i)Balance as per Cash Book Rs.5,800.

ii)Cheques issued but not presented for payment Rs. 2,000.

iii)Cheques sent for collection but not collected upto 31stDecember, 2005 Rs. 1,500.

iv) The Bank had wrongly debited the account of the firm by Rs. 200 which was rectified by them after 31st December.

Balance as per Pass Book is Rs. 6,100.

Solution : There is a difference of Rs.300 between the balance as shown by the Cash Book and the balance as shown by the Pass Book. A reconciliation statement can be prepared to reconcile on the following basis the balances shown by the two books.

i)The balance as shown by the Cash Book will be taken as thestarting point.

ii) The cheques issued but not presented for payment have not been recorded in the Pass Book. The balance as per Pass Book has to be found out. The Bank has not yet passed the entry for the payment of these cheques since they have not been presented for payment. The balance, therefore, in the Pass Book should be more. The amount of Rs.2,000 should, therefore, be added to the balance as shown by the Cash Book.

iii)Cheques sent for collection but not yet collected must have been entered in the Cash Book, but must not have been credited by the Bank to the firm's account since they have not yet been collected. The balance in the Pass Book should, therefore, be less as compared to the Cash Book. The amount of Rs. 2,000 should, therefore, be deducted out of the balance as shown by the Cash Book.

iv) The Bank has wrongly debited the firm's account. This must have resulted in reducing balance as per the Bank Pass Book. The amount should, therefore, be deducted out of the balance shown as per the Cash Book.

The Bank Reconciliation Statement will now appear as follows:

BANK RECONCILIATION STATEMENT

	Particulars	**+(Rs.)**	**- (Rs.)**
i)	Balance as per Cash Book	5,800	
ii)	Add Cheques issued but not presented for payment	2,000	
iii)	Less Cheques sent for collection but not yet collected		1,500
iv)	Less Amount wrongly debited by the Bank.		200
Balance as per Bank Pass Book			6,100

Bank Reconciliation Statement can be prepared as per the balance shown by Pass Book as the starting point.

BANK RECONCILIATION STATEMENT

Particulars	**+(Rs.)**	**- (Rs.)**
i) Balance as per Pass Book	6,100	
ii) Less Cheques issued but not presented for payment		2,000
iii) Add Cheques sent for collection but not yet collected	1,500	
iv) Add Amount wrongly debited by the Bank.	200	

Balance as per Bank Cash Book 5,800

Where cash book balance/pass book balance has to be adjusted

Illustration II: On 31st December, 1997, the Cash Book of a firm showed a bank balance of Rs.3,000. From the following information, prepare a Bank Reconciliation Statement, showing the balance as per Pass Book.

i) Cheques have been issued for Rs.2,500 out of which cheques worth Rs.2,000 only were presented for payment.

ii) Cheques worth Rs.700 were paid on 28th December but had not been credited by the Bank. One cheque for Rs.250 was entered in the Cash Book on 30th December but was banked on 3rd January, 1998.

iii) A cheque from Mohan for Rs.200 was paid in on 26th December but was dishonoured and the advise was received on 2nd January, 1998.

iv) Pass Book showed bank charges Rs.10 debited by the bank. It also showed Rs. 400 collected by the bank as interest.

v) One of the debtors deposited a sum of Rs.250 in the account of the firm on 20th December. Intimation in this respect was received from the bank on 2nd January, 1998.

Solution

BANK RECONCILIATION STATEMENT AS ON 31ST DECEMBER, 2006

Particulars	+(Rs.)	- (Rs.)
i) Dr. Balance as per Cash Book	3000	

ii) Add Cheques issued but not yet presented for 500payment (Rs.2,500-Rs.2,000).

iii) Add Interest collected by the bank not recorded in 400the Cash Book

iv) Add Amount deposited by the Customer direct 250into the bank not recorded in the Cash Book.

v) Less Cheques paid into bank but not yet credited 700by the bank

vi) LessCheque entered in the Cash Book but was 250omitted to be banked upto 31st December.

vii) Less Cheque from Mohan paid into bank 200dishonoured but not yet recorded in the Cash Book.

viii) Less Bank charges as per Pass Book 104

Balance as per Pass Book 2,990

Where abstracts from the cash book and the pass book are given

Illustration III: From the following entries in the Bank column of Cash Book and the corresponding Pass Book, prepare Bank Reconciliation Statement as on 30th June, 2006.

CASH BOOK (BANK COLUMN ONLY)

Dr. Cr.

Date Particulars Rs. Date Particualrs Rs.

2006 2006

June 1 To Balance b/d 4,600 June 3 By Cash (Self 800

June 4 ToManinder 3,200 Cheque)

June 8 ToDevinder 500 June 5 By Drawings 1,000

June 18 ToNarinder 3,700 June 10 By Kailsash 2,200

June 21 ToDayal 1,400 June 15 By ShyamLal 1,300

June 28 ToAmrinder 100 June 28 By Salaries 1,800

June 30 To Kashmiri Lal 450 June 29 By Mohanto 1,900

June 30 By Des Raj 1,700

June 30 By Commission 20

June 30 By Balance b/d 3,230

BANK PASS BOOK

Date Particulars Dr. Cr. Balance

withdrawals Deposits Dr./Cr. Amount

2006

June 1 By Bal. b\d - - Cr. 4,600

June 3 To Cash (Self) 800 - Cr. 3,800

June 5 To Self (Drawings) 1,000 - Cr. 2,800

June 6 ByManinder - 3,200 Cr. 6,000

June 10 ByDevinder - 500 Cr. 6,500

June 14 ToKailash 2,200 - Cr. 4,300

June 16 ByNarinder - 3,700 Cr. 8,000

June 20	ToShyamLal	1,300	-	Cr.	6,700
June 25	By Dividend on shares	-	700	Cr.	7,400
June 28	To Salaries	1,800	-	Cr.	5,600
June 30	To Collection charges	4	-	Cr.	5,596
June 30	To Commission	20	-	Cr.	5,576
June 30	To Electricity Board	80	-	Cr.	5,496

Solution

BANK RECONCILIATION STATEMENT AS ON 30TH JUNE, 2006

Particulars	+(Rs.)	- (Rs.)
i) Dr. Balance as per Cash Book	3,230	
ii) Add Cheques issued but not yet presented(Mohanto Rs.1,900 +Des Raj Rs.1,700 +Dividend Rs.700).	4,300	
iii) Less Cheques paid but not yet credited by Bank (Dayal Rs.1,400 + Amrinder Rs.100 + Kashmiri Lal Rs.450)		1,950
iv) Less Collection charges charged by Bank		4
v) Less Payment to Electricity Board		80
Cr. Balance as per Pass Book.		5,496

When overdraft balance is given

Illustration IV: From the following particulars, prepare the Bank Reconciliation Statement:

Rs.

(i) Bank overdraft as per the Cash Book. 16,200

(ii) A cheque deposited as per Bank Statement but not 700recorded in the Cash Book.

(iii) Debit side of the Bank Column cast short. 100

(iv) A cheque for Rs.5,000 deposited but collection as per the 4,996Bank Statement only.

(v) A party's cheque returned dishonoured as per the Bank 530Statement only.

(vi) Billscollected directly by the bank. 3,500

(vii) Bank charges recorded twice in the Cash Book.25

(viii) A bill for Rs.8,000 discounted for Rs.7,960 returned15dishonoured by the bank, noting charges being

(ix) Cheques deposited but not yet collected by the bank. 2,320

(x) Cheques issued but not yet presented for encashment. 1,250

Solution

BANK RECONCILIATION STATEMENT

Particulars + Rs. -Rs.

(i) Bank Overdraft per the Cash Book 16,200

(ii)Add Cheque for Rs.5,000 deposited but collection 4as per Bank statement Rs.4,996.

(iii) Add Chequereturned dishonoured as per the 530Bank statement only.

(iv) Bill for Rs.8,000 discounted for Rs.7,960 Rs. 8,015returned dishonoured by the bank noting chargesbeing Rs.15.

(v) Add Cheque deposited but not collected. 2,320

(vi) LessCheque deposited but not recorded in the 700Cash Book.

(vii) Less Debit side of the bank column cast short. 100

(viii) Less Bills collected directly by the bank. 3,500

(ix) Less Bank charges recorded twice in the Cash 25Book.

(x) Less Cheques issued but not yet presented for 1,250encashment.

Bank overdraft as per the Pass Book (Dr.) 21,494

yet collected by the bank;

(iii) bank charges;

(iv) interest credited by bank but not entered in cash book;

(v) interest or dividend on investments etc. collected by the bank;

(vi) amount directly deposited into the bank by customers;

(vii) payment made by the bank on behalf of client;

(viii) bills collected by the bank on behalf of customers;

(ix) dishonour of cheques;

(x) rebate on retiring of bills;

(xi) cheques paid into bank but omitted to the entered in cash book; (xii) wrong debit or credit given by the banks.

Bank reconciliation statement can be prepared with the

(i) debit balance of cash book;

(ii) credit balance of cash book;

(iii) debit balance of pass book;

(iv) credit balance of pass book.

KARPAGAM ACADEMY OF HIGHER EDUCATION
DEPARTMENT OF MANAGEMENT
I BBA - (2017 - 2020 BATCH)
II SEMESTER
BUSINESS ACCOUNTING (17BAU202)
UNIT Ii

POSSIBLE QUESTIONS
PART B

1. Define Depreciation?

2. Distinguish between the straight line method and diminishing balance method?

3. Bring out the different methods of depreciation?

4. Write a short note on Bank Reconciliation Statement?

5. List out the limitation in Bank Reconciliation Statement?

6. A machine was purchased on 1st April 2000 for Rs. 75, 000 and its installation charges are Rs. 10,000. Depreciation is to be charged @ 10% p.a. Prepare Machinery Account for three years under Straight Line Method and Diminishing Balance Method.

7. On 31st March 2013, the Pass Book of Mr. X showed a credit balance Rs. 10,500. A Comparision of pass book and cash book revealed the following:
   a. Cheques deposited but not yet cleared by 31st March 2013, Rs. 2,500
   b. Cheques issued by X but not presented for payment before 31st March 2013. Rs. 1,500. From the above particulars prepare a bank reconciliation statement as on 31st March 2013.

8. From the following particulars prepare a Bank Reconciliation statement as on 31.12.2014
   i) Balance as per cash book Rs. 2,28,800
   ii) Three cheques for Rs. 22,500, Rs. 3,740 and Rs. 2,700 issues in December were presented for payment in Jan 2014.
   iii) Two cheques of Rs. 23,000 and Rs. 3,700 were sent for collection but no collection was made during the year.

9. From the following particulars, prepare a Bank Reconciliation Statement as on 31.03.2013
   i) Balance as per Pass book Rs. 2,400
   ii) Cheques issued to creditors amounting to Rs. 1,340 were not presented to the bank before 31.03.2013

iii) Cheques amounting to Rs. 1,900 deposited into bank were not collected and credited before 31.03.2013

***CIA- 3 X 2 = 6 (ANSWER ALL THE QUESTIONS)**

****ESE - 5 X 2 = 10 (ANSWER ALL THE QUESTIONS)**

PART C

1. Elaborate the importance of International Financial Reporting Standards?
2. Elaborate the various methods of depreciation with suitable example?
3. On 1st January 2000 Nithin& co., Mumbai, purchase, machinery for Rs. 50, 000. On 1st July 2000, additional machinery was purchased for Rs. 20, 000. On 30th June 2002, the company sold the first machine for Rs. 6000.

   Company closes the accounts on 31st December every year and decided to charge 10% p.a. depreciation on original cost of the machinery. Prepare machinery a/c.
4. Seema Automobile Ltd., purchased machine for Rs. 60, 000 on 1stJuly 2000.

   On 1st January 2001 company purchased an additional machine costing Rs. 20, 000

   On 31st December 2002 the machine purchased on 1st July 2000 became obsolete and was sold for Rs. 40, 000.

   Depreciation was provided annually on 31st December at the rate of 10% per annum on the Diminishing Balance Method. Prepare Machinery Account for 3 years.

5. Briefly describe the needs of preparing Bank Reconciliation Statement and explain the method of preparation with suitable examples?

6. Elaborate the importance of preparing Bank Reconciliation Statement?

7. On 31st March 2015 the cash book of Paramu showed a bank balance of Rs. 4,850. While verifying with the pass book, the following facts were noted. Prepare a Bank Reconciliation Statement:

   a) Cheques deposited for collection before March 31st, 2013, but the amount not yet credited by the bank of Rs. 845

   b) Cheques issued before March 31st, 2013 but not presented for payment amounted to Rs. 885

   c) The bank charges has debited a sum of Rs. 100

   d) Interest credited by the bank Rs. 250

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

   f) A customer paid into bank directly a sum of Rs. 300 on March 28, 2013 which has not been entered in cash book

   g) A cheque for Rs. 200 sent for collection, but it’s not yet credited by the bank

8. From the under-mentioned particulars of Mr. M. Mohan, Prepare a Bank Reconciliation Statement as on 31st July 2014.

i) Cheques paid into Bank on the 28th July 1994 but credited to Mohan's account in the first week of August 2014
K. KalyanRs. 1,000; j. joy Rs. 800, R. RaghulRs. 1,200,
ii) The following cheques were issued by Mohan on 30th July 2014 but presented to bank for payment after the close of the year. D. David Rs. 1,200; H. HariRs. 1,000; L. LalRs. 800
iii) A cheque for Rs. 300 was credited direct to the account and was not passed through the cash book.
iv) The bank balance as per cash book on 31st July 2014 amounted to Rs. 30,000.

9. The cash book shows a balance of Rs. 12,500. On comparing the cash book with the

pass book, the following discrepancies were noted:

i) Cheques issued but not presented for payment Rs. 600
ii) Cheques deposited in bank but not collected Rs. 90o
iii) Bank paid insurance premium Rs. 500
iv) Directly deposited cash by a customer in bank of Rs. 800
v) Interest on investment collected by bank Rs. 200
vi) Bank Charges Rs. 30

Prepare a Bank Reconciliation statement showing balance as per pass book

10. On 31st December, 2015 the Pass book of Mr. Murali's shows a credit balance of Rs. 10, 000. Prepare a Bank Reconciliation Statement with the following information.

a) Mr. Murali issued cheques of Rs. 300 on 25th December 2015 but this was not presented for payment till 31.12.2015
b) A cheque of Rs. 200 issued to Avinash has not been presented for payment
c) A cheque of Rs. 285 deposited on 28th December 2015 entered in cash book but not entered by the banker
d) A customer directly deposited of Rs. 800 in the bank but not entered in the cash book until 30th Jan 2015
e) The debit side of the cash book has been undercast by Rs. 300
f) **"**Depreciation accounting is a process of allocation and not of valuation" Comment?

***CIA- 3 X 8 = 24 (EITHER OR TYPE)**

***ESE- 5 X6 = 30 (EITHER OR TYPE)**

UNIT-III

SYLLABUS

Final Accounts: Final Accounts - Preparing Trading Account, Statement of Profit and Loss and Balance Sheet for a Sole Proprietor - Understanding contents of Financial Statements of a Joint Stock Company as per Companies Act 2013 - Understanding the contents of a Corporate Annual Report

FINAL ACCOUNTS

INTRODUCTION

The transactions of a business enterprise for the accounting periodare first recorded in the books of original entry, then posted therefrominto the ledger and lastly tested as to their arithmetical accuracy with thehelp of trial balance. After the preparation of the trial balance, everybusinessman is interested in knowing about two more facts. They are: (i)Whether he has earned a profit or suffered a loss during the periodcovered by the trial balance, and (ii) Where does he stand now? In otherwords, what is his financial position?

For the above said purposes, the businessman prepares financialstatements for his business i.e. he prepares the Trading and Profit and LossAccount and Balance Sheet at the end of the accounting period. Thesefinancial statements are popularly known as final accounts. The preparationof financial statements depends upon whether the business concern is atrading concern or manufacturing concern. If the business concern is atrading concern, it has to prepare the following accounts along with theBalance Sheet: (i) Trading Account; and (ii) Profit and Loss Account.

But, if the business concern is a manufacturing concern, it has toprepare the following accounts along with the Balance Sheet:

(i) Manufacturing Account;
(ii) Trading Account; and
(iii) Profit and Loss Account.

Trading Account is prepared to know the Gross Profit or GrossLoss. Profit and Loss Account discloses net profit or net loss of thebusiness. Balance sheet shows the financial position of the business on agiven date. For preparing final accounts, certain accounts representingincomes or expenses are closed either by transferring to Trading Accountor Profit and Loss Account. Any Account which cannot find a place in anyof these two accounts goes to the Balance Sheet.

TRADING ACCOUNT

After the preparation of trial balance, the next step is to prepareTrading Account. Trading Account is one of the financial statementswhich shows the result of buying and selling of goods and/or servicesduring an accounting period. The main objective of preparing the TradingAccount is to ascertain gross profit or gross loss during the accountingperiod. Gross Profit is said to have made when the sale proceeds exceedthe cost of goods sold. Conversely, when sale proceeds are less than thecost of goods sold, gross loss is incurred. For the purpose of calculatingcost of goods sold, we have take into consideration opening stock,purchases, direct expenses on purchasing or manufacturing the goodsand closing stock. The balance of this account i.e. gross profit or grossloss is transferred to the Profit and Loss Account. The specimen of aTrading Account is given below:

TRADING ACCOUNT
FOR THE YEAR ENDED 31ST MARCH, 2006

Particulars	Amount Rs.	Particulars	Amount Rs.
To Opening Stock		By Sales	
To Purchases		*Less* Sales Returns	
Less Purchases Returns		By Closing Stock	
To Direct Expenses:		By Gross Loss transferred to P & L A/c	
Carriage Inward			
Wages			
Fuel, Power and Lighting Expenses			
Manufacturing Expenses			
Coal, Water and Gas			
Motive Power			
Octroi			
Import Duty			
Custom Duty			
Consumable Stores			
Freight and Insurance			
Royalty on manufactured Goods			
Packing charges			

Gross Profit transferred to P& L A/c

IMPORTANT POINTS REGARDING TRADING ACCOUNT

1. Stock

The term 'stock' includes goods lying unsold on a particular date.

The stock may be of two types:

(a) Opening stock

(b) Closing stock

Opening stock refers to the closing stock of unsold goods at theend of previous accounting period which has been brought forward in thecurrent accounting period. This is shown on the debit side of the TradingAccount.

Closing stock refers to the stock of unsold goods at the end of thecurrent accounting period. Closing stock is valued either at cost price orat market price whichever is less. Such valuation of stock is based on theprinciple of conservatism which lays down that the expected profit should not be taken into account but all possible losses should be duly providedfor.

Closing stock is an item which is not generally available in the trialbalance. If it is given in Trial Balance, it is not to be shown on the creditside of Trading Account but appears only in the Balance Sheet as anasset. But if it is given outside the trial balance, it is to be shown on thecredit side of the Trading Account as well as on the asset side of theBalance Sheet.

2. Purchases

Purchases refer to those goods which have been bought for resale.It includes both cash and credit purchases of goods. The following itemsare shown by way of deduction from the amount of purchases:

(a) Purchases Returns or Return Outwards.

(b) Goods withdrawn by proprietor for his personal use.

(c) Goods received on consignment basis or on approval basis or on hire purchase.

(d) Goods distributed by way of free samples.

(e) Goods given as charity.

3. Direct Expenses

Direct expenses are those expenses which are directly attributableto the purchase of goods or to bring the goods in saleable condition.Some examples of direct expenses are as under:

(a) Carriage Inward: Carriage paid for bringing the goods to thegodown is treated as carriage inward and it is debited to TradingAccount.

(b) Freight and insurance: Freight and insurance paid foracquiring goods or making them saleable is debited to Trading Account. Ifit is paid for the sale of goods, then it is to be charged (debited) to Profitand Loss Account.

(c) Wages: Wages incurred in a business is direct, when it isincurred on manufacturing or merchandise or on making it saleable.Other wages are indirect wages. Only direct wages are debited to theTrading Account. Other wages are debited to the Profit and Loss Account.If it is not mentioned whether wages are direct or indirect, it should beassumed as direct and should appear in the Trading Account.

(d) Fuel, Power and Lighting Expenses: Fuel and powerexpenses are incurred for running the machines. Being directly related toproduction, these are considered as direct expenses and debited toTrading Account. Lighting expenses of factory is also charged to TradingAccount, but lighting expenses of administrative office or sales office arecharged to Profit and Loss Account.

(e) Octroi: When goods are purchased within municipalitylimits, generally octroi duty has to be paid on it. It is debited to TradingAccount.

(f) Packing Charges: There are certain types of goods whichcannot be sold without a container or proper packing. These form a partof the finished product. One example is ink, which cannot be soldwithout a bottle. These type of packing charges are debited to TradingAccount. But if the goods are packed for their safe dispatch tocustomers, i.e. packing meant for transportation or fancy packing meantfor advertisement will appear in the Profit and Loss Account.

(g) Manufacturing Expenses: All expenses incurred inmanufacturing the goods in the factory such in factory rent, factoryinsurance etc. are debited to Trading Account.

(h) Royalties: These are the payments made to a patentee,author or landlord for the right to use his patent, copyright or land. Ifroyalty is paid on the basis of production, it is debited to Trading Accountand if it is paid on the basis of sales, it is debited to Profit and LossAccount.

4. Sales

Sales include both cash and credit sales of those goods which werepurchased for resale purposes. Some customers might return the goodssold to them (called sales return) which are deducted from the sales inthe inner column and net amount is shown in the outer column. While
ascertaining the amount of sales, the following points need attention:

(a) If a fixed asset such as furniture, machinery etc. is sold, itshould not be included in sales.

(b) Goods sold on consignment or on hire purchase or on sale orreturn basis should be recorded separately.

(c) If goods have been sold but not yet dispatched, these shouldnot be shown under sales but are to be included in closingstock.

(d) Sales of goods on behalf of others and forward sales shouldalso be excluded from sales.

CLOSING ENTRIES FOR TRADING ACCOUNT

The journal entries necessary to transfer opening stock, purchases,sales and returns to the Trading Account are called closing entries, asthey serve to close these accounts. These are as follows:

1. For transfer of opening stock, net purchases and directexpenses to Trading A/c.

 Trading A/c Dr.

 To Stock (Opening) A/c

 To Purchases A/c

 To Direct Expenses A/c

(Being opening stock, purchases and direct expensestransferred to Trading Account)

2. For transfer of net sales and closing stock to Trading A/c

 Sales A/c Dr.

 Stock (Closing) A/c Dr.

 To Trading A/c

(Being sales, closing stock transferred to Trading Account)

3. (a) For Gross Profit

 Trading A/c Dr.

 To Profit & Loss A/c

(Being gross profit transferred to Profit and Loss Account)

(b) For Gross Loss

 Profit & Loss A/c Dr.

 To Trading A/c

(Being gross loss transferred to Profit and Loss Account)

Illustration I: From the following balances extracted from thebooks of Mr. BansiLal, prepare the Trading Account for the year ending31st March, 2006.

Purchases	42,500	Wages	5,000
Mfg. expenses	1,950	Op. Stock	10,000
Sales	67,500	Sales returns	50
Carriage inwards	100	Purchases returns	200
Freight and duty	5,000		
Stores consumed	200		
Power	300		

The value of stock unsold is Rs. 12,000.

Solution

TRADING ACCOUNT

FOR THE YEAR ENDED 31ST MARCH, 2006

To Opening stock		10,000	By Sales	67,500	
To Purchases	42,500		*Less* returns	50	67,450
Less returns	200	42,300	By Closing Stock		12,000
To Manufacturing exp.		1,950			
To Carriage inwards		100			
To Freight and duty		5,000			
To Stores consumed		200			
To Power		300			
To Wages		5,000			
To Gross Profit transferred to Profit & Loss A/c		14,600			
		79,450			79,450

MANUFACTURING ACCOUNT

The concern which are engaged in the conversion of raw materialsinto finished goods, are interested to knowing the cost of production ofthe goods produced. The cost of the goods produced cannot be obtainedfrom the Trading Account. So, it is desirable to prepare a ManufacturingAccount prior to be preparation of the Trading account with the object ofascertaining the cost of goods produced during the accounting period.

The proforma of Manufacturing Account is given as under:

MANUFACTURING ACCOUNT

FOR THE YEAR ENDING...................

Dr. Cr.

	Rs.		Rs.
To Work-in process (Opening)		By Work-in-process (Closing)	
To Raw Materials consumed:		By Sale of Scrap	
Opening Stock		By Cost of Production of finished goods during the period transferred to the Trading Account	
Add Purchases of Raw Materials			
Less Closing Stock of Raw Materials			
To Direct or Productive Wages			
To Factory Overheads:			
Power & Fuel			
Repairs of Plant			
Depreciation on Plant			
Factory Rent			

The Trading Account in case of manufacturers will appear asfollows:

TRADING ACCOUNT

FOR THE YEAR ENDING..............

Dr. Cr.

	Rs.		Rs.
To Opening Stock of Finished Goods		By Sales *less* Returns	
To Cost of Production of finished goods transferred from Manufacturing Account		By Closing Stock of Finished goods	
To Purchases of Finished Goods *less* Returns		By Gross Loss transferred to Profit and Loss A/c	
To Carriage Charges on goods purchased			
To Gross Profit transferred to Profit and Loss A/c			

The gross profit or loss shown by the Trading Account will be takento the Profit and Loss Account which will be prepared in the usual way asexplained in the following pages.

IMPORTANT POINTS REGARDING MANUFACTURING ACCOUNT

1. Raw Materials Consumed

The cost of raw materials consumed to be included in the debit sideof the Manufacturing Account shall be calculated as follows:

Rs.

Opening Stock of raw materials..........

Add Purchases of raw materials........... ....

Less Purchase return of raw materials ....

Less Closing stock of raw materials ....

Cost of raw material consumed

2. Direct Expenses

The expenses and wages that are directly incurred in the process ofmanufacturing of goods are included under this head..

3. Factory Overheads

The term "overheads" includes indirect material, indirect labourand indirect expenses. Therefore, the term "factory overheads" stands forall factory indirect material, indirect labour and indirect expenses. Examples of factory overheads are: rent for the factory, depreciation ofthe factory machines and insurance of the factory, etc.

4. Cost of Production

Cost of production is computed by deducting from the total of thedebit side of the Manufacturing Account, the total of the various itemsappearing on the credit side of the Manufacturing Account.

DIFFERENCE BETWEEN TRADING ACCOUNT AND MANUFACTURING ACCOUNT

	Manufacturing Account	Trading Account
1.	Manufacturing account is prepared to find out the cost of goods produced.	Trading Account is prepared to find out the Gross Profit/Gross Loss.
2.	The balance of the manufacturing Account is transferred to the Trading Account.	The balance of the Trading account is transferred to the Profit and Loss Account.
3.	Sale of crap is shown in the Manufacturing Account.	Sale of scrap is not shown in the Trading Account.
4.	Stocks of raw materials and work-in-progress are shown in the Manufacturing Account.	Stocks of finished goods are shown in the Trading Account.
5.	Manufacturing Account is a part of the Trading account.	Trading Account is a part of the Profit and Loss Account.

PROFIT AND LOSS ACCOUNT

Trading Account results in the gross profit/loss made by abusinessman on purchasing andselling of goods. It does not take intoconsideration the other operating expenses incurred by him during thecourse of running the business. Besides this, a businessman may haveother sources of income. In order to ascertain the true profit or losswhich the business has made during a particular period, it is necessarythat all such expenses and incomes should be considered. Profit andLoss Account considers all such expenses and incomes and gives the netprofit made or net loss suffered by a business during a particular period.

All the indirect revenue expenses and losses are shown on the debit sideof the Profit and Loss Account, where as all indirect revenue incomes areshown on the credit side of the Profit and Loss Account.

Profit and Loss Account measures net income by matchingrevenues and expenses according to the accounting principles. Netincome is the difference between total revenues and total expenses. Inthis connection, we must remember that all the expenses, for the periodare to be debited to this account - whether paid or not. If it is paid inadvance or outstanding, proper adjustments are to be made (Discussedlater). Likewise all revenues, whether received or not are to be credited.

Revenue if received in advance or accrued but not received, properadjustment is required.

A proforma of the Profit and Loss Account showing probable itemstherein is as follows:

PROFIT AND LOSS A/C FOR THE YEAR ENDED ....

	Rs.		Rs.
To Gross Loss b/d		By Gross Profit b/d	
To *Selling and Distribution Expenses:*		By *Other Income:*	
Advertisement		Discount received	
Travellers' Salaries		Commission received	
Expenses & Commission		By Non-trading Interest:	
Godown Rent		Bank Interest	
Export Expenses		Rent of property let-out	
Carriage Outwards		Dividend from shares	
Bank Charges		By *Abnormal Gains:*	
Agent's Commission		Profit on sale of machinery	
Upkeep of Motor Lorries		Profit on sale of investment	
To *Management Expenses:*		By Net Loss transferred to Capital Account	
Rent, Rates and Taxes			
Heating and Lighting			
Office Salaries			
Printing & Stationary			
Postage & Telegrams			
Telephone Charges			
Legal Charges			
Audit Fees			
Insurance			
General Expenses			
To *Depreciation and Maintenance:*			
Depreciation			
Repairs & Maintenance			
To *Financial Expenses:*			
Discount Allowed			
Interest on Loans			
Discount on Bills			
To *Abnormal Losses:*			
Loss by fire (not covered by Insurance)			
Loss on Sale of Fixed Assets			
Loss on Sale of Investments			
To Net profit transferred to Capital A/c			

IMPORTANT POINTS IN PROFIT AND LOSS ACCOUNT

1. Selling and Distribution Expenses

These expenses are incurred for promoting sales and distributionof sold goods. Example of such expenses are go down rent, carriageoutwards, advertisement, cost of after sales service, selling agentscommission, etc.

2. Management Expenses

These are the expenses incurred for carrying out the day-to-dayadministration of a business. Expenses, under this head, include officesalaries, office rent and lighting, printing and stationery and telegrams,telephone charges, etc.

3. Maintenance Expenses

These expenses are incurred for maintaining the fixed assets of theadministrative office in a good condition. They include repairs andrenewals, etc.

4. Financial Expenses

These expenses are incurred for arranging finance necessary forrunning the business. These include interest on loans, discount on bills,etc.

5. Abnormal Losses

There are some abnormal losses that may occur during theaccounting period. All types of abnormal losses are treated as extraordinary expenses and debited to Profit and Loss Account. Examples arestock lost by fire and not covered by insurance, loss on sale of fixedassets, etc.

Following are the expenses not to appear in the Profit and LossAccount:

(i) Domestic and household expenses of proprietor or partners.

(ii) Drawings in the form of cash, goods by the proprietor orpartners.

(iii) Personal income tax and life insurance premium paid by thefirm on behalf of proprietor or partners.

6. Gross Profit

This is the balance of the Trading Account transferred to the Profitand Loss Account. If the Trading Account shows a gross loss, it willappear on the debit side.

7. Other Income

During the course of the business, other than income from the saleof goods, the business may have some other income of financial nature.The examples are discount or commission received.

8. Non-trading Income

Such incomes include interest on bank deposits, loans toemployees and investment indebentures of companies. Similarly,dividend on investment in shares of companies and units of mutualfunds are also known as non-trading incomes and shown in Profit andLoss Account.

9. Abnormal Gains

There may be capital gains arising during the course of the year,e.g., profit arising out of sale of a fixed asset. Such profit is shown as aseparate income on the credit side of the Profit and Loss Account.

Closing entries for Profit and Loss account

(i) For transfer of various expenses to Profit & Loss A/c

Profit and Loss A/c Dr.

To Various Expenses A/c

(Being various indirect expenses transferred to Profit andLoss Account)

(ii) For transfer of various incomes and gains to Profit & LossA/c

Various Incomes & Gains A/c Dr.

To Profit & Loss A/c

(Being various incomes & gains transferred to Profit and Loss Account)

(iii) (a) For Net Profit

Profit & Loss A/c Dr.

To Capital A/c

(Being Net Profit transferred to capital)

(b) For Net Loss

Capital A/c Dr

To Profit & Loss A/c

(Being Net Loss transferred to Capital Account)

Illustration II: From the following balances extracted at the close of year ended 31 March, 2006, prepare Profit and Loss Account as at that date:

	Rs.		Rs.
Gross Profit	51,000	Discount (Dr.)	500
Carriage Outward	2,500	Apprentice Premium (Cr.)	1,500

Salaries	5,500	Printing & Stationary	250
Rent	1,100	Rates & Taxes	350
Fire Insurance Premium	900	Travelling Expenses	200
Bad Debts	2,100	Sundry Trade Expenses	300
Commission Received	1,000	Discount allowed by Creditors	800

Solution

PROFIT & LOSS ACCOUNT OF M/S...............................

FOR THE YEAR ENDED 31ST MARCH, 2006

Dr. Cr.

Particular	Rs.	Particular	Rs.
To Carriage Outward	2,500	By Gross Profit b/d	51,000
To Salaries	5,500	By Apprentice Premium	1,500
To Rent	1,100	By Discount by Creditors	800
To Fire Insurance Premium	900	By Commission	1,000
To Bad Debts	2,100		
To Discount	500		
To Printing & Stationary	250		
To Rent & Taxes	350		
To Travelling Expenses	200		
To Sundry Trade Expenses	300		
To Net Profit transferred to Capital A/c	40,600		
	54,300		54,300

Distinction between trading account and Profit and LossAccount

	Profit and Loss Account	Trading Account
1.	Profit and Loss Account is	Trading Account is prepared as a

	Profit and Loss Account	Trading Account
	prepared as a main account.	part or section of the Profit and Loss Account.
2.	Indirect expenses are taken in Profit and Loss Account.	Direct Expenses are taken in Trading Account.
3.	Net Profit or Net Loss is ascertained from the Profit and Loss Account.	Gross Profit or Gross Loss is ascertained from Trading Account.
4.	The balance of the Profit and Loss Account i.e. Net Profit or Net Loss is transferred to proprietor's Capital Account.	The Balance of the Trading Account i.e. Gross Profit or Gross Loss is transferred to the Profit and Loss Account.
5.	Items of accounts written in the Profit and Loss Account are much more as compared to the Trading Account.	Items of account written in the Trading Account are few as compared the Profit and Loss Account.

BALANCE SHEET

A Balance Sheet is a statement of financial position of a businessconcern at a given date. It is called a Balance Sheet because it is a sheetof balances of those ledger accounts which have not been closed till thepreparation of Trading and Profit and Loss Account. After the preparationof Trading and Profit and Loss Account the balances left in the trialbalance represent either personal or real accounts. In other words, theyeither represent assets or liabilities existing on a particular date. Excessof assets over liabilities represent the capital and is indicative of thefinancial soundness of a company.

A Balance Sheet is also described as a "Statement showing theSources and Application of Capital". It is a statement and not an accountand prepared from real and personal accounts. The left hand side of theBalance Sheet may be viewed as description of the sources from whichthe business has obtained the capital with which it currently operatesand the right hand side as a description of the form in which that capitalis invested on a specified date.

CHARACTERISTICS

The characteristics of a Balance Sheet are summarised as under:

(a) A Balance Sheet is only a statement and not an account. Ithas no debit side or credit side. The headings of the two sidesare 'Assets' and 'Liabilities'.

(b) A Balance Sheet is prepared at a particular point of time andnot for a particular period. The information contained in theBalance Sheet is true only at that particular point of time atwhich it is prepared.

(c) A Balance Sheet is a summary of balances of those ledgeraccounts which have not been closed by transfer to Tradingand Profit and Loss Account.

(d) A Balance Sheet shows the nature and value of assets andthe nature and the amount of liabilities at a given date.

Classification of assets and liabilities

Assets

Assets are the properties possessed by a business and the amountdue to it from others. The various types of assets are:

(a) Fixed Assets

All assets that are acquired for the purpose of using them in theconduct of business operations and not for reselling to earn profit arecalled fixed assets. These assets are not readily convertible into cash inthe normal course of business operations. Examples are land andbuilding, furniture, machinery, etc.

(b) Current Assets

All assets which are acquired for reselling during the course ofbusiness are to be treated as current assets. Examples are cash andbank balances, inventory, accounts receivables, etc.

(c) Tangible Assets

There are definite assets which can be seen, touched and havevolume such as machinery, cash, stock, etc.

(d) Intangible Assets

Those assets which cannot be seen, touched and have no volumebut have value are called intangible assets. Goodwill, patents and trademarks are examples of such assets.

(e) Fictitious Assets

Fictitious assets are not assets at all since they are not representedby any tangible possession. They appear on the asset side simply becauseof a debit balance in a particular account not yet written off e.g. provisionfor discount on creditors, discount on issue of shares etc.

(f) Wasting Assets

Such assets as mines, quarries etc. that become exhausted orreduce in value by their working are called wasting assets.

(g) Contingent Assets

Contingent assets come into existence upon the happening of acertain event or the expiry of a certain time. If that event happens, theasset becomes available otherwise not, for example, sale agreement toacquire some property, hire purchase contracts etc.

In practical no reference is made to contingent assets in theBalance Sheet. At the most, they may form part of notes to the BalanceSheet.

Liabilities

A liability is an amount which a business is legally bound to pay. Itis a claim by an outsider on the assets of a business. The liabilities of abusiness concern may be classified as:

(a) Long Term Liabilities

The liabilities or obligations of a business which are not payablewithin the next accounting period but will be payable within next five toten years are known as long term liabilities. Public deposits, debentures,bank loan are the examples of long term liabilities.

(b) Current Liabilities

All short term obligations generally due and payable within oneyear are current liabilities. This includes trade creditors, bills payable etc.

(c) Contingent Liabilities

A contingent liability is one which is not an actual liability. Theybecome actual on the happenings of some event which is uncertain. Inother words, they would become liabilities in the future provided thecontemplated event occurs. Since such a liability is not actual liability it
is not shown in the Balance Sheet. Usually it is mentioned in the form ofa footnote below the Balance Sheet.

Marshalling of assets and liabilities

The arrangement of assets and liabilities in a particular order iscalled marshalling of the Balance Sheet. Assets and liabilities can bearranged in the Balance Sheet into two ways:

(a) In order of liquidity.

(b) In order of permanence.

When assets and liabilities are arranged according to theirreliability and payment preferences, such an order is called liquidityorder. Such arrangement is given below in Balance Sheet (a). When theorder is reversed from that what is followed in liquidity, it is called orderof permanence. In other words, assets and liabilities are listed in order ofpermanence. This order of Balance Sheet is given below in BalanceSheet (B).

BALANCE SHEET (A)
(IN ORDER OF LIQUIDITY)

Liabilities	Rs.	Assets	Rs.
Bills payable		Cash in hand	
Loans		Cash at bank	
Sundry creditors		Investments	
Outstanding expenses		Sundry debtors	
Reserves		Bills receivable	
Capital		Stock-in-trade	
Add Net Profit		Loose tools	
Add Interest		Fixtures and fittings	
Less Drawings		Plant and machinery	
		Building	
		Land	
		Goodwill	

BALANCE SHEET (B)
(IN ORDER OF PERMANENCE)

Liabilities	Rs.	Assets	Rs.
Capital		Goodwill	
Add Net Profit		Land	
Add Interest		Building	
Less Drawings		Plant and machinery	
Reserves		Fixtures and fittings	
Outstanding expenses		Loose tools	
Sundry creditors		Stock-in-trade	
Loans		Bills receivable	
Bills payable		Sundry debtors	
		Investments	
		Cash at bank	
		Cash in hand	

Illustration III: The following balances are extracted from the booksof Kautilya& Co. on 31st March, 2006. You are required prepare theTrading and Profit and Loss Account and a Balance Sheet as on that date.

	Rs.		Rs.
Stock on April, 1	500	Commission (Cr.)	200
B/R	2,250	Returns Outwards	250
Purchases	19,500	Trade Expenses	100
Wages	1,400	Office Fixtures	500
Insurance	550	Cash in Hand	250
Sundry Debtors	15,000	Cash at Bank	2,375
Carriage Inwards	400	Rent & Taxes	550
Commission (Dr.)	400	Carriage Outwards	725
Interest on Capital	350	Sales	25,000
Stationary	225	Bills Payable	1,500
Returns Inwards	650	Creditors	9,825
		Capital	8,950

The closing stock was valued at Rs.12,500.

Solution

TRADING & PROFIT AND LOSS A/C OF MESSRS KAUTILYA & CO.

FOR THE YEAR ENDED 31ST MARCH, 2006

	Rs.	Rs.		Rs.	Rs.
To Opening stock		500	By Sales	25,000	
To Purchases	19,500		Less returns	650	24,350
Less returns	250	19,250	By Closing Stock		12,500
To Wages		1,400			
To Carriage Inwards		400			
To Gross Profit c/d		15,300			
		36,850			36,850
To Insurance		550	By Gross Profit b/d		15,300
To Commission		400	By Commission		200
To Interest on Capital		350			
To Stationary		225			
To Trade Expenses		100			
To Rent and Taxes		550			
To Carriage Outwards		725			
To Net Profit transferred to Capital A/c		12,600			
		15,500			15,500

BALANCE SHEET OF MESSERS KAUTILYA & CO

AS ON 31ST MARCH, 2006

Liabilities		Amount (Rs.)	Assets	Amount (Rs.)
Creditors		9,825	Cash in Hand	250
Bills Payable		1,500	Cash at Bank	2,375
Capital	8,950		Bill Receivable	2,250
Add Net Profit	12,600	21,550	Stock	12,500
			Sundry Debtors	15,000
			Office Fixtures	500
		32,875		32,875

ADJUSTMENTS

While preparing trading and Profit and Loss account one point thatmust be kept in mind is that expenses and incomes for the full tradingperiod are to be taken into consideration. For example if an expense hasbeen incurred but not paid during that period, liability for the unpaidamount should be created before the accounts can be said to show theprofit or loss. All expenses and incomes should properly be adjustedthrough entries. These entries which are passed at the end of theaccounting period are called adjusting entries. Some importantadjustments which are to be made at the end of the accounting year arediscussed in the following pages.

1. Closing Stock

This is the stock which remained unsold at the end of theaccounting period. Unless it is considered while preparing the tradingaccount, the gross profit shall not be correct. Adjusting entry for closingstock is as under:

Closing stock Account Dr.

To Trading account

(Being closing stock brought in to books)

Treatment in final accounts

(i) Closing stock is shown on the credit side of Trading account.

(ii) At same value it will be shown as an asset in the balancesheet.

2. Outstanding Expenses

Those expenses which have become due and have not been paid atthe end of the accounting year, are called outstanding expenses. Forexample, the businessman has paid rent only for 4 months instead of oneyear. This means 8 months' rent is outstanding. In order to bring thisfact into books of accounts, the following adjustment entry will be passedat the end of the year:

Rent A/c Dr.

To outstanding Rent A/c

(Being rent outstanding for 8 months)

The two fold effect of the above adjustment will be (i) the amount ofoutstanding rent will be added to the rent on the debit side of Profit andLoss Account, and (ii) outstanding rent will be shown on the liability sideof the Balance Sheet.

3. Prepaid Expenses

There are certain expenses which have been paid in advance orpaid for the future period which is not yet over or not yet expired. Thebenefit of such expenses is to be enjoyed during the next accountingperiod. Since, such expenses have already been paid, they have alsorecorded in the books of account of that period for which they do notrelate. For example, insurance premium paid for one year Rs.3,600 on 1stJuly, 1996. The final accounts are prepared on 31st March, 1997. Thebenefit of the insurance premium for the period from 1st April to 30thJune, 1997 is yet to expire. Therefore, the insurance premium paid forthe period from 1st April 1997 to 30th June, 1997, i.e. for 3 months, shallbe treated as "Prepaid Insurance Premium".

The adjustment entry for prepaid expenses is as under:

Prepaid Expenses Account Dr.

To Expenses Account

(Being the adjustment entry for prepaid expenses)

The amount of prepared expenses will appear as an asset in theBalance Sheet while amount of appropriate expense account will beshown in the Profit and Loss Account by way of deduction from the saidexpense.

4. Accrued Income

Accrued income means income which has been earned during thecurrent accounting year and has become due but not received by the endof the current accounting period. Examples of such income are incomefrom investments, dividend on shares etc. The adjustment entry foraccrued income is as under:

Accrued Income A/c Dr.

To Income A/c

(Being the adjustment entry for accrued income)

Treatment in final accounts

i) The amount of accrued income is added to the relevant itemof income on the credit side of the Profit and Loss Account toincrease the amount of income for the current year.

ii) The amount of accrued income is a debt due from a thirdparty to the business, so it is shown on the assets side of theBalance Sheet.

5. Income Received in Advance

Income received but not earned during the current accounting yearis called as income received in advance. For example, if building has beengiven to a tenant on Rs.2,400 p.a. but during the year Rs.3,000 has beenreceived, then Rs.600 will be income received in advance. In order tobring this into books of account, the following adjusting entry will bemade at the end of the accounting year:

Rent A/c Dr. Rs.600

To Rent Received in Advance A/c Rs.600The two-fold effect of this adjustment will be:

(i) It is shown on the credit side of Profit and Loss account byway of deduction from the income, and

(ii) It is shown on the liabilities side of the Balance Sheet asincome received in advance.

6. Depreciation

Depreciation is the reduction in the value of fixed asset due to itsuse, wear and tear or obsolescence. When an asset is used for earningpurposes, it is necessary that reduction due to its use, must be chargedto the Profit and Loss account of that year in order to show correct profitor loss and to show the asset at its correct value in the Balance Sheet.

There are various methods of charging depreciation on fixed assets.Suppose machinery for Rs.10,000 is purchased on 1.1.98, 20% p.a. isthe rate of depreciation. Then Rs.2,000 will be depreciation for the year1998 and will be brought into account by passing the following adjustingentry:

Depreciation A/c Dr. Rs. 2,000

To Machinery A/c Rs.2,000

The two-fold effect of depreciation will be:

(i) Depreciation is shown on the debit side of Profit and LossAccount, and

(ii) It is shown on the asset side of the balance sheet by way ofdeduction from the value of concerned asset.

7. Interest on Capital

The amount of capital invested by the trader in his business is justlike a loan by the firm. Charging interest on capital is based on theargument that if the same amount of capital were invested in somesecurities elsewhere, the businessman would have received interestthereon. Such interest on capital is not actually paid to the businessman.

Interest on capital is a gain to the businessman because it increases itscapital, but it is a loss to the business concern.

Calculation of Interest on Capital

Interest is calculated on the opening balance of the capital at thegiven rate for the full accounting period. If some additional amount ofcapital has been brought in the business during the course of accountingperiod, interest on such additional amount of capital is calculated fromthe date of introduction to the end of the accounting period. The followingadjustment entry is passed for allowing interest on capital:

Interest on Capital Account Dr.

To Capital Account

(Being the adjustment entry for interest on capital)

Treatment in final accounts

(i) Interest allowed on capital is an expense for the businessand is debited to Profit and Loss Account, i.e. it is shown onthe debit side of the Profit and Loss Account.

(ii) Such interest is not actually paid in cash to the businessmanbut added to his capital account. Hence, it is shown as anaddition to capital on the liabilities side of the Balance Sheet.

8. Interest of Drawings

It interest on capital is allowed, it is but natural that interest ondrawings should be charged from the proprietor, as drawings reducecapital. Suppose during an accounting year, drawings are Rs.10,000 andinterest on drawings is Rs.500. In order to bring this into account, thefollowing entry will be passed:

Drawings A/c Dr. Rs.500

To Interest on Drawings A/c Rs.500

The two-fold effect of interest on drawings will be:

(i) Interest on drawings will be shown on the credit side of Profitand Loss Account, and

(ii) Shown on the liabilities side of the Balance Sheet by way ofaddition to the drawings which are ultimately deducted fromthe capital.

9. Bad Debts

Debts which cannot be recovered or become irrecoverable arecalled bad debts. It is a loss for the business. Such a loss is recorded inthe books by making following adjustment entry:

Bad Debts A/c Dr.

To Sundry Debtors A/c

(Being the adjustment entry for bad debts)

Treatment in final accounts

The profit and Loss Account is debited with the amount of baddebts and in the Balance Sheet, the Sundry Debtors balance will bereduced by the same amount in the assets side.

10. Provisions for Doubtful Debts

In addition to the actual bad debts, a business unit may find onthe last day of the accounting period that certain debts are doubtful, i.e.,the amount to be received from debtors may or may not be received. Theamount of doubtful debts is calculated either by carefully examining theposition of each debtor individually and summing up the amount ofdoubtful debts from various debtors or it may be computed (as is usuallydone) on the basis of some percentage (say 5%) of debtors at the end ofthe accounting period. The percentage to be adopted is usually basedupon the past experience of the business. The reasons for makingprovision for doubtful debts are two as discussed below:

(i) Loss caused by likely bad debts must be charged to the Profitand Loss of the period for which credit sales have been madeto ascertain correct profit of the period.

(ii) For showing the true position of realizable amount of debtorsin the Balance Sheet, i.e., provision for doubtful debts will bededucted from the amount of debtors to be shown in thebalance sheet.

For example, sundry debtors on 31.12.1998 are Rs.55,200. Furtherbad debts are Rs.200. Provision for doubtful debts @ 5% is to be made ondebtors. In order to bring the provision for doubtful debts of Rs.2,750,

i.e., 5% on Rs.55,000 (55,200-200), the following entry will be made:

Profit and Loss A/c Dr. Rs.2,750

To Provision for Doubtful Debts A/c Rs.2,750

(Being Provision for Doubtful Debts provided)

It may be carefully noted that further bad debts (if any) will be firstdeducted from debtors and then a fixed percentage will be applied on theremaining debtors left after deducting further debts. It is so becausepercentage is for likely bad debts and not for bad debts which have beendecided to be written off.

Treatment in final accounts

(i) The amount of provision for doubtful debts is a provisionagainst a possible loss so it should be debited to Profit andLoss account.

(ii) The amount of provision for doubtful debts is deducted fromsundry debtors on the assets side of the balance sheet.

11. Provision for Discount on Debtors

It is a normal practice in business to allow discount to customersfor prompt payment and it constitutes a substantial sum. Some times thegoods are sold on credit to customers in one accounting period whereasthe payment of the same is received in the next accounting period and discount is to be allowed. It is a prudent policy to charge this expenditure(discount allowed) to the period in which sales have been made, so aprovision is created in the same manner, as in case of provision fordoubtful debts i.e.

Profit and loss account Dr.

To provision for discount on debtors account

(Being provision for discount on debtors provided)

TREATMENT IN FINAL ACCOUNTS

(i) Provision for discount on debtors is a probable loss, so itshould be shown on the debit side of Profit and Lossaccount.

(ii) Amount of provision for discount on debtors is deductedfrom sundry debtors on the assets side of the Balance Sheet.

Note: Such provision is made on debtors after deduction of furtherbad debts and provision for doubtful debts because discount is allowableto debtors who intend to make the payment.

12. Reserve for Discount on Creditors

Prompt payments to creditors enable a businessman to earndiscount from them. When a businessman receives cash discountregularly, he can make a provision for such discount since he is likely toreceive the discount from his creditors in the following years also. Thediscount received being a profit, the provision for discount on creditorsamounts to an addition to the profit.

Accounting treatment of Reserve for Discount on Creditors is justreverse of that in the case of Provision for Discount on Debtors. Theadjustment entries for Reserve for Discount on Creditors is as follows:

Reserve for Discount on Creditors Account Dr.

To Profit and Loss Account

(Being the adjustment entry for discount on creditors)

Treatment in final accounts

i) Reserve for discount on creditors is shown on the credit sideof Profit and Loss account.

ii) In the liabilities side of the Balance Sheet, the reserve fordiscount on creditors is shown by way of deductions fromSundry Creditors.

13. Loss of Stock by Fire

In business, the loss of stock may occur due to fire. The position ofthe stock may be:

(a) all the stock is fully insured.

(b) the stock is partly insured.

(c) the stock is not insured at all.

It the stock is fully insured, the whole loss will be claimed from theinsurance company. The following entry will be passed:

Insurance Co. A/c Dr.

To Trading A/c

(Being the adjustment entry for Loss of goods charged frominsurance Co.)

The value of goods lost by fire shall be shown on the credit side ofthe trading Account and this is shown as an asset in the Balance Sheet.

If the stock is not fully insured, the loss of stock covered byinsurance policy will be claimed from the insurance company and therest of the amount will be loss for the business which is chargeable toProfit and Loss Account. In this case, the following entry will be passed:

Insurance Co. A/c Dr.

Profit and Loss A/c Dr.

To Trading A/c

(Being the adjustment entry for Loss of goods)

The amount of goods lost by fire is credited to Trading Account, theamount of claim accepted by insurance company shall be treated as anasset in the Balance Sheet, while the amount of claim not accepted is aloss so it will be debited to Profit and Loss Account.

If the stock is not insured at all, the whole of the loss will be borneby the business and the adjusting entry shall be:

Profit and Loss A/c Dr.

To Trading A/c

(Being the adjustment entry for Loss of goods)

The double effect of this entry will be (a) it is shown on the creditside of the Trading Account (b) it is shown on the debit side of the Profitand Loss Account.

14. Manager's Commission

Sometimes, in order to increase the profits of the business,manager is given some commission on profits of the business. It can begiven at a certain percentage on the net profits but before charging suchcommission or on the net profits after charging such commission. In boththe cases, the adjustment entry will be:

Profit and Loss A/c Dr.

To Commission Payable A/c

(Being the adjustment entry for manager's commission)

Treatment in final accounts

(i) The amount of managers commission being a businessexpenditure is shown on the debit side of the Profit and Lossaccount.

(ii) As the commission to manager has not been paid so far,commission payable would be shown as liability on theliability side of balance sheet.

Illustration IV: The following adjustments are to be made in thefinal accounts being made as on 31st March, 2006.

i) Closing Stock in hand Rs.20,000.

ii) Salaries amounting to Rs.1,000 outstanding.

iii) Depreciate Plant and Machinery @10%. The value of Plant

and Machinery on 31st March, 2006 was at Rs.40,000.

iv) Prepaid insurance Rs.150.

v) Accrued income from investment Rs.1,500.

You are required to pass adjustment entries.

Solution

JOURNAL

Date	Particulars		L.F.	Dr. Rs.	Cr. Rs.
2006					
Mar 31	Closing Stock Account	Dr.		20,000	
	To Trading Account			20,000	
	(Being the adjustment entry for closing stock)				
Mar 31	Salaries Account	Dr.			1,000
	To Outstanding Salaries Account				1,000
	(Being the adjustment entry for outstanding Salaries)				

Mar 31	Depreciation Account Dr.		4,000	
	To Plant and Machinery Account			4,000
	(Being the adjustment entry for Depreciation)			
Mar 31	Prepaid Insurance Account Dr.		150	
	To Insurance Account			150
	(Being the adjustment entry for prepaid insurance)			
Mar 31	Accrued Income Account		1,500	
	To Income on Investment Account			1,500
	(Being the adjustment entry for accrued income)			

Illustration V: From the following Trial Balance of Mr. Garg as on31st March, 2006, prepare Trading Account, Profit and Loss Account andBalance Sheet.

TRIAL BALANCE

Debit Balance	Rs.	Credit Balance	Rs.
Stock on 1st April, 2005	500	Capital	2,000
Purchases	1,500	Sales	3,500
Land and Building	2,000	Sunday Creditors	750
Bills Receivable	300	Commission	50
Wages	300	Bills payable	300
Machinery	800	Loan	600
Carriage Inward	100		
Carriage Outward	100		
Power	150		
Salaries	200		
Discount Allowed	30		
Drawings	100		
Insurance Premium	20		
Cash at Bank	500		
Cash in Hand	100		
Investments	500		
	7,200		7,200

Adjustments

1. Stock as on 31st

March 2006 is valued at Rs. 200.

2. Provide depreciation @ 10% on Machinery and @ 5% on Land and Building.
3. Outstanding salariesamounted to Rs.50.
4. Insurance premium is paid in advance to the extent of Rs.10.
5. Allow interest on Capital @ 6% per annum.

6. Interest on loan @ 12% per annum is due for one year.

Solution

TRADING & PROFIT ANDLOSS A/C

FOR THE YEAR ENDED 31STMARCH, 2006

Particulars		Rs.	Particulars	Rs.
To Opening stock		500	By Sales	3,500
To Purchases		1,500	By Closing Stock	200
To Wages		300		
To Carriage Inward		100		
To Power		150		
To Gross Profit c/d		1,150		
		3,700		3,700
To Salaries	200		By Gross profit b/d	1,150
Add Outstanding Salaries	50	250	By Commission	50
To Carriage Inward		100		
To Insurance Premium	20			
Less prepaid Ins.	10	10		
To Discount allowed		30		
To Depreciation on:				
Machinery	80			
Land and Building	100	180		
To Interest on Loan		72		
To Interest on Capital		120		
To Net Profit (Transferred to capital account)		435		
		1,200		1,200

BALANCE SHEET AS ON 31ST MARCH 2006

Liabilities		Rs.	Assets		Rs.
Capital	2,000		Land and Building	2,000	
Add Interest on Capital	120		Less Dep.	100	1,900
Add Net profit	438		Machinery	800	
	2,558		Less Dep.	80	720
Less Drawings Loan	100	2,458	Investments		500
	600		Closing stock		200
Add Interest O/S	72	672	Bills Receivable		300
Sundry Creditors		750	Cash at Bank		500
Bills payable		300	Cash in Hand		100
Outstanding Salaries		50	Prepaid Insurance		10
		4,230			4,230

FINANCIAL STATEMENTS UNDER COMPANIES ACT, 2013

INTRODUCTION

The long-awaited Companies Bill 2013 got its assent in the Lok Sabha on 18th December 2012 and in the Rajya Sabha on 8th August 2013. After having obtained the assent of the President of India on 29 August 2013, it has now become the much awaited Companies Act, 2013 (2013 Act).

The Companies Act, 2013 comprises of 470 sections, 7 Schedules and 29 Chapters. Out of 470 sections, 99 sections were notified on 12.09.2013 and 183 sections of the Companies Act, 2013 were notified w.e.f. 01.04.2014 which include the sections regarding the financial statements of the Companies. The remaining Sections are expected to be notified in due course of time. Highlights of Financial Reporting Under Companies Act, 2013 Companies to follow uniform accounting period i.e. from 1st April to 31st March of next year, with exception of subsidiaries who with approval of Tribunal may opt for different accounting period.

Financial Statements to include cash flow statement and statement of changes in equity which has made the components of financial statements at par with those under International Financial Reporting Standards. National Advisory Committee on Accounting Standards (NACAS) is tobe replaced by National Financial Reporting Authority (NFRA) with enlarged power of setting audit standards and investigating professional misconduct. The Act provides for re-opening of books of accounts and recasting the financial statements. Companies (Accounts) Rules, 2014 details out various issues to be prescribed as per Chapter IX of the Companies Act, 2013. Financial Statements Presentation under Companies Act, 2013…

Financial Statements under Companies Act, 2013 Financial Statement: Section 2(40) Financial Statement in relation to a company, includes-

i) a balance sheet as at the end of the financial year; (ii) a profit and loss account, or in case of company carrying out activity not for profit, an income and expenditure account for the financial year; (iii) cash flow statement for the financial year; (iv) statement of changes in equity, if applicable; and (v) any explanatory note annexed to, or forming part of, any document referred to sub-clause (iv) stated above. Provided that the financial statement, with respect to One Person Company, small company and dormant company, may not include the cash flow statement. If we go through the above definition the two striking differences are regarding inclusion of cash flow statement and statement of changes of equity under umbrella of the financial statements. It is pertinent to mention here that although earlier in the Companies Act, 1956 there was no specific definition of financial statements, however balance sheet and profit and loss account were only mandated to be laid down by the Board of Directors before the Company at the annual general meeting.

However cash flow statement was earlier also required to be included in view of the Accounting Standard 3 Cash Flow Statements. The exemption in preparing the Cash Flow Statements to small companies has been intended to be maintained by Companies Act, 2013 as it states that its preparation may not be required for One Person Company, small company and dormant company. Accordingly, if we see practically statement of changes in equity is now to be additionally prepared as was not required under Companies act, 1956.We shall discuss about statement in changes in equity later. The term 'financial statement' has been aligned with the IFRS concept of the financial statement. Presentation of Financial Statement under Companies Act, 2013 Section 129 "Financial Statement" of the Companies Act, 2013 which corresponds to Section 210,211 and 212 of the Companies Act, 2012 is Financial Statements under Companies Act, 2013 – An Introduction 3 reproduced as under:- Section 129(1) The financial statements shall give a true and fair view of the state of affairs of the company or companies, comply with the accounting standards notified under section 133 and shall be in the form or forms as may be provided for different class or classes of companies in Schedule III: Provided that the items contained in such financial statements shall be in accordance with the accounting standards: Provided further that nothing contained in this sub-section shall apply to any insurance or banking company or any company engaged in the generation or supply of electricity, or to any other class of company for which a form of financial statement has been specified in or under the Act governing such class of company: Provided also that the financial statements shall not be treated as not disclosing a true and fair view of the state of affairs of the company, merely by reason of the fact that they do not disclose—- (a) in the case of an insurance company, any matters which are not required to be disclosed by the Insurance Act, 1938, or the Insurance Regulatory and Development Authority Act, 1999; (b) in the case of a banking company, any matters which are not required to be disclosed by the Banking Regulation Act, 1949; (c) in the case of a company engaged in the generation or supply of electricity, any matters which are not required to be disclosed by the Electricity Act, 2003; (d) in the case of a company governed by any other law for the time being in force, any matters which are not required to be disclosed by that law. At every annual general meeting of a company, the Board of Directors of the company shall lay before such meeting financial statements for the financial year. Where a company has one or more subsidiaries, it shall, in addition to financial statements provided under sub-section (2), prepare a consolidated financial statement of the company and of all the subsidiaries in the same form and manner as that of its own which shall also be laid before the annual general meeting of the company along with the laying of its financial statement under sub-section (2): Financial Statements Presentation under Companies Act, 2013… 4 Provided that the company shall also attach along with its financial statement, a separate statement containing the salient features of the financial statement of its subsidiary or subsidiaries in such form as may be prescribed: Provided further that the Central Government may provide for the consolidation of accounts of companies in such manner as may be prescribed. Explanation.—For the purposes of this sub-section, the word “subsidiary” shall include associate company and joint venture. The provisions of this Act applicable to the preparation, adoption and audit of the financial statements of a holding company shall, mutatis mutandis, apply to the consolidated financial statements referred to in subsection (3). Without prejudice to sub-section (1), where the financial statements of a company do not comply with the accounting standards referred to in subsection (1), the company shall disclose in its financial statements, the deviation from the accounting standards, the reasons for such deviation and the financial effects, if any, arising out of such deviation. The Central Government may, on its own or on an application by a class or classes of companies, by notification, exempt any class or classes of companies from complying with any of the requirements of this section or the rules made thereunder, if it is considered necessary to grant such exemption in the public interest and any such exemption may be granted either unconditionally or subject to such conditions as may be specified in the notification. If a company contravenes the provisions of this section, the managing director, the whole-time director in charge of finance, the Chief Financial Officer or any other person charged by the Board with the duty of complying with the requirements of this section and in the absence of any of the officers mentioned above, all the directors shall be punishable with imprisonment for a term which may extend to one year or with fine which shall not be less than fifty thousand rupees but which may extend to five lakh rupees, or with both. Explanation.—For the purposes of this section, except where the context otherwise requires, any reference to the financial statement shall include any notes annexed to or forming part of such financial statement, giving information required to be given and allowed to be given in the form of such notes under this Act. If we compare the above Section from the erstwhile Section 211 of the Financial Statements under Companies Act, 2013 –

Companies Act, 1956 on "Form and Contents of Balance Sheet and Profit and Loss Account" the major changes are stated as under:- (a) The term 'financial statement' has been used instead of the term 'Balance Sheet and Profit and Loss Account' used in old Act. (b) The Form and Content of Balance Sheet and Profit and Loss Account (Financial Statement) which was earlier provided in Schedule VI (Revised) in the Companies Act, 1956 has now been provided in Schedule III of the Companies Act, 2013. (c) It has been stated that the items contained in such financial statements shall be in accordance with the accounting standards, which were not earlier included in Sec 211 of old Act and has further recognized the importance of Accounting Standards. (d) Earlier under Sec 211(3C) of the Companies Act, 1956 defined the expression "accounting standard" which has now separately been defined under section 133 of the Companies Act, 2013 as such standards as prescribed by the Central Government as recommended by ICAI in consultation with and after examination of the recommendations made by National Financial Reporting Authority. However, as per Rule 7 of the Companies (Accounts) Rules, 2014 the standards of accounting as specified under the Companies Act, 1956 shall be deemed to be the accounting standards until accounting standards are specified by the Central Government under section 133. Accordingly, practically all the 28 Accounting Standards i.e. AS 1 to 7 and AS 9 to 29 as notified by the Central Government under Companies (Accounting Standard) Rules, 2006 (as amended) are still to be followed in FY 2014-15 also until separate standards are notified under section 133. It is important to note here that all Companies whether public or private and irrespective of level of operations are required to prepare their financial statements, in the manner provided in Schedule III. However, the requirements of the Schedule III, do not apply to any insurance or banking company, or any company engaged in the generation or supply of electricity or to any other class of company for which a form of financial statement has been specified in or under any other Act governing such class of company. This is in line with the earlier provisions wherein the Schedule VI was not applicable to above mentioned companies.

However under Companies Act, 2013 an additional comfort has been provided in the form of third proviso to Section 129(1) wherein it has been stated that the financial statements of above mentioned class of companies shall not be Financial Statements Presentation under Companies Act, 2013… 6 treated as not disclosing a true and fair view of the state of affairs of the company, merely by reason of the fact that they do not disclose any matters which are not required to be disclosed by their governing Acts. However, currently the above exception is not applicable to companies engaged in the generation or supply of electricity, as the act governing such companies i.e. Electricity Act, 2003 does not prescribe any specific format for presentation of Financial Statements by an electricity company. Accordingly, Schedule III would not be applicable only to insurance companies and banking companies. However, presentation of the financial statements of a non-banking finance companies would be governed by Schedule III.

CORPORATE ANNUAL REPORT:

An annual report is a comprehensive report on a company's activities throughout the preceding year. Annual reports are intended to give shareholders and other interested people information about the company's activities and financial performance. They may be considered as grey literature. Most jurisdictions require companies to prepare and disclose annual reports, and many require the annual report to be filed at the company's registry. Companies listed on a stock exchange are also required to report at more frequent intervals (depending upon the rules of the stock exchange involved).

TYPICAL ANNUAL REPORTS WILL INCLUDE:

- General corporate information
- Operating and financial review
- Director's Report

- Corporate governance information
- Chairpersons statement
- Auditor's report
- Contents: non-audited information
- Financial statements, including
- Balance sheet also known as Statement of Financial Position
- Income statement also profit and loss statement.
- Statement of changes in equity
- Cash flow statement
- Notes to the financial statements
- Accounting policies
- Other features

The Directors' Report is a document produced by the board of directors under the requirements of UK company law, which details the state of the company and its compliance with a set of financial, accounting and corporate social responsibilitystandards.

Corporate governance broadly refers to the mechanisms, processes and relations by which corporations are controlled and directed. Governance structures and principles identify the distribution of rights and responsibilities among different participants in the corporation (such as the board of directors, managers, shareholders, creditors, auditors, regulators, and other stakeholders) and includes the rules and procedures for making decisions in corporate affairs.[2] Corporate governance includes the processes through which corporations' objectives are set and pursued in the context of the social, regulatory and market environment. Governance mechanisms include monitoring the actions, policies, practices, and decisions of corporations, their agents, and affected stakeholders. Corporate governance practices are affected by attempts to align the interests of stakeholders.[3][4] Interest in the corporate governance practices of modern corporations, particularly in relation to accountability, increased following the high-profile collapses of a number of large corporations during 2001–2002, most of which involved accounting fraud; and then again after the recent financial crisis in 2008.

KARPAGAM ACADEMY OF HIGHER EDUCATION
DEPARTMENT OF MANAGEMENT
I BBA - (2017 - 2020 BATCH)
II SEMESTER
BUSINESS ACCOUNTING (17BAU202)
UNIT III

POSSIBLE QUESTIONS
PART B

1. From the following information ascertain Net Profit :

	Rs.		Rs.
Gross Profit	95,000	Stationery	5,840
Commission Received	800	Advertisement	15,500
Interest	2,850	Carriages Outwards	185

2. Ascertain the Gross Profit from the following figures:

	Rs.		Rs.
Opening Stock	8,550	`Purchases	13,816
Sales	15,284	Purchases Returns	516
Sales Return	584	Wages owing	200
Closing stock	15,000		

3. Write a short note on Trading Account?

4. List out the indirect expenses incurred in the business?

5. Bring out the need of preparing the Profit and Loss account?

6. Mention the importance of preparing the importance of Balance Sheet?

7. Write any two indirect expenses?

8. Write any two direct expenses?

***CIA- 3 X 2 = 6 (ANSWER ALL THE QUESTIONS)**

****ESE - 5 X 2 = 10 (ANSWER ALL THE QUESTIONS)**

PART C

1. Describe the importance of preparing Trading and Profit and Loss account?
2. The following balances are extracted from the books of Mr. Rajesh as on 31st December 2014.

Particulars	Debit (Rs.)	Credit (Rs.)
Capital	-	1,20,000
Sales	-	75,000
Purchases	45,000	-
Salaries	6,000	-
Rent	4,500	-
Insurance Premium	900	-
Drawings	15,000	-
Machinery	84,000	-
Cash and Bank	13,500	-
Cash in hand	13,500	-
Stock (1.1.2013)	15,600	-
Debtors	7,500	-
Creditors	-	10,500
Total	**2,05,500**	**2,05,500**

Prepare Trading, Profit and Loss account and balance sheet after considering the following adjustment:

Adjustment:

i) Closing stock Rs. 14,700

ii) Salary outstanding Rs. 1000

iii) Rent prepaid Rs. 750

iv) Create 5% provision for bad and doubtful debts on sundry debtors.

3. From the following Trial balance of Rajan& co., prepare Trading and Profit and loss account for the year ended 31.12.2013 and balance sheet as on that date:

Particulars	Debit (Rs.)	Credit (Rs,)
Capital	-	40,000
Sales	-	38,000
Loan	-	12, 000
Creditors	-	8, 500
Purchases	8,000	-
Salaries	3,000	-
Rent	1,500	-
Debtors	30,000	-
Cash	1, 500	-
Wages	2, 000	-
Bank Balance	3, 000	-
Stock on 1.1.12	2, 000	-
Machinery	15,000	-
Building	30, 000	-
Insurance	2,500	-
Total	**98, 500**	**98,500**

Adjustments

(i) The closing stock was Rs.18,000

(ii) Salary outstanding Rs.500

(iii) Insurance prepaid Rs.250

(iv) Depreciate machinery @ 10%

(v) Create a provision on Debtors @ 2% for bad debts.

4. The following are the balance exacted from the books of Ganesh as on 31.12.2014. Prepare Trading , Profit and Loss account and Balance sheet for the year ending 31.12.2014.

Trial balance as on 31.12.2014

Debit Balances	Rs.	Credit Balances	Rs.
Drawings	4, 000	Capital	20, 000
Cash at bank	1, 700	Sales	16, 000
Cash in hand	6, 500	Sundry creditors	4, 500
Wages	1, 000		
Purchases	2, 000		
Stock 1.1.2014	6, 000		
Buildings	10, 000		
Sundry debtors	4, 400		
Bills receivable	2, 900		
Rent	450		
Commission	250		
General expenses	800		
Furniture	500		
Total	**40, 500**	**Total**	**40,500**

The following adjustments are to be made:

a) Stock on 31.12.2014 was Rs. 4, 000

b) Interest on capital at 6% to be provided

c) Interest on Drawings at 5% to be provided

d) Wages yet to be paid Rs. 100

e) Rent prepaid Rs. 50

5. From the following Trial balance of Rajan& co., prepare Trading and Profit and loss account for the year ended 31.12.2013 and balance sheet as on that date:

Particulars	Debit (Rs.)	Credit (Rs,)
Capital	-	40,000
Sales	-	38,000
Loan	-	12, 000
Creditors	-	8, 500
Purchases	8,000	-
Salaries	3,000	-
Rent	1,500	-
Debtors	30,000	-
Cash	1, 500	-
Wages	2, 000	-
Bank Balance	3, 000	-
Stock on 1.1.12	2, 000	-
Machinery	15,000	-
Building	30, 000	-
Insurance	2,500	-
Total	**98, 500**	**98,500**

Adjustments

(i) The closing stock was Rs.18,000

(ii) Salary outstanding Rs.500

(iii) Insurance prepaid Rs.250

(iv) Depreciate machinery @ 10%

(v) Create a provision on Debtors @ 2% for bad debts.

6. From the following Trial balance, prepare a Trading and Profit and Loss account and balance sheet for the year ended 31.12.2014:

Trial balance

Particulars	Debit (Rs.)	Credit (Rs.)
Capital	-	40, 000
Sales	-	25, 000
Purchases	15, 000	-
Salaries	2, 000	-
Rent	1, 500	-
Insurance	300	-
Drawings	5, 000	-
Machinery	28, 000	-
Bank balance	4,500	-
Cash	2, 000	-
Stock 1.1.2014	5,200	-
Debtors	2,500	-
Creditors	-	1, 000
Total	**66,000**	**66, 000**

Adjustments required:

a) Stock on 31.12.2014 Rs. 4, 900

b) Salaries unpaid Rs. 300

c) Rent paid in advance Rs. 200

d) Insurance prepaid Rs. 90

7. From the following Trial balance, prepare Trading and Profit and Loss Account and the Balance sheet as on that date for the year ending 31.12.2013.

Particulars	Debit (Rs.)	Credit (Rs,)
Capital	-	6,40,000
Sales	-	4,00,000
Purchases	2,40,000	-
Salaries	32,000	-
Rent	24,000	-
Insurance	4,800	-
Drawings	80,000	-
Machinery	4,48,000	-
Cash and Bank	1,04,000	-
Stock (1.1.2013)	83,200	-
Debtors	40,000	-
Creditors	-	16,000
Total	**10,56,000**	**10,56,000**

Adjustments:

a. Stock on 31.12.2014 Rs. 78,400
b. Salaries outstanding Rs. 4,800
c. Rent paid in advance is Rs. 3,200
d. Prepaid Insurance Rs. 1,440

8. Elucidate the need for preparing the Trading and profit and loss account?

9. Describe the contents of Financial Statements of a Joint Stock Company as per Companies Act 2013?
10. Elaborate the importance of Corporate Annual Report?

***CIA- 3 X 8 = 24 (EITHER OR TYPE)**

****ESE- 5 X6 = 30 (EITHER OR TYPE)**

UNIT-IV

SYLLABUS

Financial Statement Analysis: Analyzing Financial Statements - Objectives of Financial Statement Analysis - Sources of Information - Standards of Comparison - Techniques of Financial Statement Analysis - Horizontal Analysis - Vertical Analysis - Ratio Analysis - Meaning and Usefulness of Financial Ratios - Analysis of Financial Ratios from the perspective of different Stakeholders like Investors - Lenders - Short-term Creditors - Profitability Ratio - Solvency Ratio - Liquidity Ratio - Turnover Ratio - Limitations of Ratio Analysis.

FINANCIAL STATEMENT ANALYZING

The term 'financial statements' refer to those statements which incorporate the accounting data in a purposive and useful manner. In India, such statements, commonly prepared for supplying to the outsiders, include the Income statement and the Position Statement which are widely known by the names Profit and Loss account and Balance Sheet respectively. In addition to these two, the management, for purposes of making evaluations and financial decisions, also prepares many other statements like funds-flow statement, statement of retained earnings, statement containing important ratios, statement highlighting various achievements, etc. According to the International According Standards Commit (ISAC), financial statements include : a balance sheet, income statement, notes and other statements and explanatory material which are identified as part of the financial statements.

MAINTENANCE OF ACCOUNTS:

Tracing back the history of accounting we find that it is as old as money – h only yardstick of accounting data. Chanakya highlighted the end for maintain of accounting and their audit long back in his well known and historical published work " Arthashastra". The single entry system, also called as the Indian system of accounting, is as scientific and systematic as the on developed by he Westerns. The present-day system of accounting, widely known as the double-entry system, was developed by LuccasPacioli of Italy far back in the 15th century. But modern uses of accounting data could b be developed only during the last few dads when after the industrial revolution, complex industrial units with heavy capital investment am into being and the various management experts like Taylor, Fayol and others 1ealized1z the need for improving h management of financial resources, efficiency, increasing productivity, And thus 1ealized output and minimis input. In this task, h 'American Institute of Certified Public Accounts" (AICPA) has played a mutable part. Further modern accounting machines an electronic computers have tremendously added the ‘use value of the accounting data an and h hence or their proper recording and maintenance.

According to AICPA accounting is “the art of recording, classifying and 2ealized2ze in a significant manner and in terms of money transactions an events which are, in part at least, of a financial character, and interpreting the results there”. Thus, important attributes of accounting are:

(d) Events and transactions of a financial nature, even though only partly of this type are record- events of a non-financial nature, say the passing of control from on person of another, can no be recorded;

(ii) The recorded must b in such a way as of b able of portray the significance of all transactions and events individually and collectively, class by class and as a whole-this involves both analysis and summarization;

(iii) The parties concerned must b able p gather the up message of the results as embodied in the statements finally prepared. Accounting knowledge should also help a person understand h meaning of the financial statements of any firm or institution placed before him.

Thus, maintenance of accounts, in on form or the other, dates back to the origin of human civilization and man’s taking-up of trade activities. It developed with the growth of h single entry system and was further improved upon by the invent of the double entry system of accounting. But the double entry system of accounting itself does no make I obligatory or any organisation, business or not-business, to keep proper accounts or even the books of accounts. According, originally, was adopted as an aid to memory, a pie of evidence in case of disputes and as a matter of convenience. But with the growth of civilization, innovations and transformations intrade, its activities and the manner of organizing, it is was felt more and more necessary to maintain proper accounting records. In the course of time different forms of organizations, namely company, partnership, cooperative societies, clubs and other associations go legal recognition., It was as early as in the 18th century when New York stock exchange and the Securities Exchange commission in USA first recognized h importance of protecting the interests of ever increasing share holders;’ other investors and their funds invested in any form in corporate firms (all companies in India). The exchange mad it obligatory on the part of the member firms to circulate publish accounts of its shareholders so that thy could know the state of affairs and true financial position of the firms(s) in which hey invest their funds.

Thus, through the efforts of organizations like stock exchanges, investors' or shareholders' organizations and growing awareness of the governments, today, we fin that in almost every civilized country there are laws which make I obligatory or organisation, both business and nonbusiness, to maintain proper accounts and distribute them in a given form to those who have invested heir funds in them or otherwise have an interest in their management. We in India find that Indian Companies Act, cooperative Societies Act Income Tax Act, T. Several status, rq u I r e d corporate firms, associations and other bodies corporate of maintain proper books of accounts. Some of these statues even require them of circulate copies of its accounts among its members periodically. Generally for this purpose most of the organisations have an independent accounting department. Besides maintaining proper accounting records one of the fundamental responsibilities of a modern accounting department is the preparation of various financial statements and reports to be used by management and external parties are generally interested in he financial statements.

(a) **Shareholders :** In the case of corporate bodies, Shareholders an learn about the results of operations and financial position of the company only thought the annual statements showing the profit earned (for loss suffered) and the assets and liabilities.(b) **Investors:** Those who wan to invest their funds in the shares or other securities of a corporate body are also naturally interested in the financial statements of know how safe the investment already made is and how safe the proposed investment will be.(c) **Creditors :** Generally supplies of goods to various organisations do so on credit, thy would also like to be satisfied that they will b paid on time, The financial statements greatly hp them in properly assessing the capability of the organisation to did so.(d) **Labour :** Workers being entitled to payment of bonus, which depends on the size like to b satisfy that the bonus being paid d to them is correct, they are much interested in knowing the profit earned or loss suffered by the firm. This knowledge also helps them in conducting negotiations for future ages.(e) Government: Financial statements also helps the state governments in compiling heir national accounts. Such statements are of obvious importance for them in ascertaining the income-tax realizable.

(f) **Researchers :** As a mirror to business condition, the financial statements are of immense value or conducting research suits into business affairs, thus statements are, therefore, of great interest to scholars undertaking research pertaining to aspects such as financing, profitability liquidity etc.

OBJECTIVES OF FINANCIAL STATEMENT ANALYSIS ARE AS FOLLOWS

(d) Assessment of Past Performance

Past performance is a good indicator of future performance. Investors or creditors are interested in the trend of past sales, cost of good sold, operating expenses, net income, cash flows and return on investment. These trends offer a means for judging management's past performance and are possible indicators of future performance.

2.Assessment of current position

Financial statement analysis shows the current position of the firm in terms of the types of assets owned by a business firm and the different liabilities due against the enterprise.

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3.Prediction of profitability and growth prospects

Financial statement analysis helps in assessing and predicting the earning prospects and growth rates in earning which are used by investors while comparing investment alternatives and other users in judging earning potential of business enterprise.

4.Prediction of bankruptcy and failure

Financial statement analysis is an important tool in assessing and predicting bankruptcy and probability of business failure.

5. Assessment of the operational efficiency

Financial statement analysis helps to assess the operational efficiency of the management of a company. The actual performance of the firm which are revealed in the financial statements can be compared with some standards set earlier and the deviation of any between standards and actual performance can be used as the indicator of efficiency of the management.

PROPOSED AND USES OF FINANCIAL STATEMENTS

Financial statements amy taken the form of an annual report, company prospectus, project report, et. As discussed above, those statements are frequently used for studying different financial aspects, relating of an organisation, by shareholders, creditors, financial analysis, government agencies, trade unions banks an even management. In every cas thy must furnish the receipt in with proper and sufficient information to enable him to make an gent decision or judgement concerning some aspect of the entity. About the purpose of financial statements a group of progressive American Accountants, some forty years ago, rightly stated hat "financial

statements are prepared or the purpose of presenting a periodical review or report on progress made by the management and deal with the status of h investment in the business and the results achieved during the period under review . Thy reflect a combination of recorded facts, accounting conventions, an personal judgements, an the judgements and conventions applied affect them materially. Thy soundness of the judgement necessary depends on the competence and integrity of those who make them and on their adherence to generally accepted accounting principles an conventions"

Again modern account maintain that accounting is useful for the purpose of: (a) formulating, implementing and approving he policies;

(b) Bringing our coordination among different activities:

IPlanning and control of day to day operations;

(d) Accounting for responsibilities within the business; (e) studying specific projects or phases of a business;

(f) Measuring he financial position and income of the business; and

(g) Reporting on he stewardship of the business to the owners and outsiders such as creditors, government agencies, etc.

In brief financial statements are prepared with h object of transmitting reliable an useful accounting information to those who and it, both within and outside the organisation, and that proper us of the information so transmitted Ihp the recipient in making a sound decision.

But, here , we must be aware of the fact that there are no 5ealized5zed forms which may be adopted by all industrial, commercial and other organisations, for presenting their accounting information and preparing financial statements, as consequence, the classification of some of he financial statement items varies widely. Such a variation is further widened buy the factors like;

• Managements' wishes;
• Intended use of he statements;
• Accounts' knowledge, training experience and his attitude towards such statements;

• Deviation from the generally accepted accounting principles concepts and changes in terminology. So, frequently, a researcher or an analyst may desire to recast and rearrange h accounting data in accordance with his requirements, views and the purpose of analyses.

Accounting is widely accepted as an art. It is also claimed to be a science, but an inexact science. The more we practice it the better we are in accounting and hence financial statement preparation. Financial statements reflect the opinion, experience an judgment of the accountant and the management. Thus, the estimated life an the method of depreciations to be used in the valuation of pant and equipment, the method of inventory valuation, the valuation of intangibles (patents, goodwill et.) are some of the areas which are largely influence by personal opinion and value judgments. As a result equally competent accountants, when given the same of fats. May arrive at different results.

IMITATIONS OF FINANCIAL STATEMENTS:

An financial statements are prepare with the help of the recorded facts of business transactions. Here accounting concept and conventions as also the personal judgements of the accountants play an important roe. As a consequence e, we experience the following imitations of the financial statements.

1. The allocation of revenue and costs to an accounting period involved personal judgment. The problem involves the achievement of satisfactory (but never a perfect) matching of costs with revenues Other factors that tend to make statement data uncertain include the existence of contingent assets and liabilities.
2. The e statements show exact rupee amounts, which give an impression of finality and precision.

Rarely does the stated value of an asset represent the amount of cash that would be realized on winding up of the business, even the cash balance would be reduced buy the expenses incidental to the liquidation process. For example, a patent, trade mark, or organisation costs may be stated, due to a management's policy, at the conservative value of rupee one : in a liquidation a large sum might b 6ealized on such assets.

3. Both the basic financial statements, namely balance sheet and profit and loss account, reflect transactions that involve rupee values of many dates. Du to continuous inflationary pressure on the economy, prices have ben showing an increasing trend. As a result many industrial pants established some forty years ago cannot be replaced today even at four times the original historical cost shown on

the balance that. The depreciation charge against current revenues by companies using pre-war plants is less than the depreciation appropriated on a replacement cost basis. The balance sheet itself does not indicate the current economic realities.

4. Non-monetary factors which too have a bearing on he working of an organisation, cannot b be communicated or shown on the financial statements. Such factors include sources and communicated or shown on the financial statements. Such factors include sources and commitments for materials, merchandise, and supplies, the reputation, and prestige of the company with the public : h credit rating of the company; and the efficiency, loyalty and integrity of management an employees, Contingent assets and liabilities customarily are not, and usually an no b, stated definitely in rupees.

The e forgoing discussion of h imitations of financial statements shown their tentative character under norma or peacetime conditions. It should b evident that financial statements are still more tentative when abnormal or wartime conditions prevail.

The variations complained in accounting classifications, practices, opinions and judgements can, to a are extent, b checked by adopting the following our principles of presenting accounting information :

(a) **Classification:** the acts figures and items recorded must b grouped in suitable groups or classification.

(b) **Arrangement :** The data should be arranged in a manner such that individual items, classes, totals highlight important facts, events and rations, if any,

I **Order :** The data should be so presented as to bring into focus the important figures, such as net profit on cost of materials consumed, product sales, etc. in a profit and loss account.

(d) **Descriptions :** Instead of taking titles verbatim from the edger there should be proper headings or group names. Also I must b ensured that description of amounts are both accurate and understandable.

FINANCIAL RATIOS

Financial ratios are one of the most common tools of managerial decision making. A ratio is comparisons of one number to another—mathematically, a simple division problem. Financial ratios involve the comparison of various figures from the financial statements in order to gain information about a company’s performance. It is the interpretation, rather than the calculation, that makes financial ratios a useful tool for business managers. Ratios may serve as indicators, clues, or red flags regarding noteworthy relationships between variables used to measure the firm's performance in terms of profitability, asset utilization, liquidity, leverage, or market valuation.

USE AND USERS OF RATIO ANALYSIS

There are basically two uses of financial ratio analysis: to track individual firm performance over time, and to make comparative judgments regarding firm performance. Firm performance is evaluated using trend analysis—calculating individual ratios on a per-period basis, and tracking their values over time. This analysis can be used to spot trends that may be cause for concern, such as an increasing average collection period for outstanding receivables or a decline in the firm's liquidity status. In this role, ratios serve as red flags for troublesome issues, or as benchmarks for performance measurement.

Another common usage of ratios is to make relative performance comparisons. For example, comparing a firm's profitability to that of a major competitor or observing how the firm stacks up versus industry averages enables the user to form judgments concerning key areas such as profitability or management effectiveness. Users of financial ratios include parties both internal and external to the firm. External users include security analysts, current and potential investors, creditors, competitors, and other industry observers. Internally, managers use ratio analysis to monitor performance and pinpoint strengths and weaknesses from which specific goals, objectives, and policy initiatives may be formed.

PROFITABILITY RATIOS

Perhaps the type of ratios most often used and considered by those outside a firm are the profitability ratios. Profitability ratios provide measures of profit performance that serve to evaluate the periodic financial success of a firm. One of the most widely-used financial ratios is net profit margin, also known as return on sales.

Return on sales provides a measure of bottom-line profitability. For example, a net profit margin of 6 percent means that for every dollar in sales, the firm generated six cents in net income.

Two other margin measures are gross profit margin and operating margin.

Gross margin measures the direct production costs of the firm. A gross profit margin of 30 percent would indicate that for each dollar in sales, the firm spent seventy cents in direct costs to produce the good or service that the firm sold.

Operating margin goes one step further, incorporating nonproduction costs such as selling, general, and administrative expenses of the firm. Operating profit is also commonly referred to as earnings before interest and taxes, or EBIT. An operating margin of 15 percent would indicate that the firm spent an additional fifteen cents out of every dollar in sales on nonproduction expenses, such as sales commissions paid to the firm's sales force or administrative labor expenses.

Two very important measures of the firm's profitability are return on assets and return on equity.

Return on assets (ROA) measures how effectively the firm's assets are used to generate profits net of expenses. An ROA of 7 percent would mean that for each dollar in assets, the firm generated seven cents in profits. This is an extremely useful measure of comparison among firms's competitive performance, for it is the job of managers to utilize the assets of the firm to produce profits.

Return on equity (ROE) measures the net return per dollar invested in the firm by the owners, the common shareholders. An ROE of 11 percent means the firm is generating an 11-cent return per dollar of net worth.

One should note that in each of the profitability ratios mentioned above, the numerator in the ratio comes from the firm's income statement. Hence, these are measures of periodic performance, covering the specific period reported in the firm's income statement. Therefore, the proper interpretation for a profitability ratio such as an ROA of 11 percent would be that, over the specific period (such as fiscal year 2004), the firm returned eleven cents on each dollar of asset investment.

Profitability Ratios

Gross profit margin Return on assets

Operating margin Return on equity

ASSET UTILIZATION RATIOS

Asset utilization ratios provide measures of management effectiveness. These ratios serve as a guide to critical factors concerning the use of the firm's assets, inventory, and accounts receivable collections in day-to-day operations. Asset utilization ratios are especially important for internal monitoring concerning performance over multiple periods, serving as warning signals or benchmarks from which meaningful conclusions may be reached on operational issues. An example is the total asset turnover (TAT) ratio.

This ratio offers managers a measure of how well the firm is utilizing its assets in order to generate sales revenue. An increasing TAT would be an indication that the firm is using its assets more productively. For example, if the TAT for 2003 was 2.2×, and for 2004 3×, the interpretation would follow that in 2004, the firm generated $3 in sales for each dollar of assets, an additional 80 cents in sales per dollar of asset investment over the previous year. Such change may be an indication of increased managerial effectiveness.

A similar measure is the fixed asset turnover (FAT) ratio.

Fixed assets (such as plant and equipment) are often more closely associated with direct production than are current assets (such as cash and accounts receivable), so many analysts prefer this measure of effectiveness. A FAT of 1.6× would be interpreted as the firm generated $1.60 in sales for every $1 it had in fixed assets.

Two other asset utilization ratios concern the effectiveness of management of the firm's current assets. Inventory is an important economic variable for management to monitor since dollars invested in inventory have not yet resulted in any return to the firm. Inventory is an investment, and it is important for the firm to strive to maximize its inventory turnover. The inventory turnover ratio is used to measure this aspect of performance.

Cost of goods sold (COGS) derives from the income statement and indicates the expense dollars attributed to the actual production of goods sold during a specified period. Inventory is a current asset on the balance sheet. Because the balance sheet represents the firm's assets and liabilities at one point in time, an average figure is often used from two successive balance sheets. Managers attempt to increase this ratio, since a higher turnover ratio indicates that the firm is going through its inventory more often due to higher sales. A turnover ratio of 4.75×, or 475 percent, means the firm sold and replaced its inventory stock more than four and one-half times during the period measured on the income statement.

One of the most critical ratios that management must monitor is days sales outstanding (DSO), also known as average collection period.

This represents a prime example of the use of a ratio as an internal monitoring tool. Managers strive to minimize the firm's average collection period, since dollars received from customers become immediately available for reinvestment. Periodic measurement of the DSO will "red flag" a lengthening of the firm's time to collect outstanding accounts before customers get used to taking longer to pay. A DSO of thirty-six means that, on average, it takes thirty-six days to collect on the firm's outstanding accounts. This is an especially critical measure for firms in industries where extensive trade credit is offered, but any company that extends credit on sales should be aware of the DSO on a regular basis.

LEVERAGE RATIOS

Leverage ratios, also known as capitalization ratios, provide measures of the firm's use of debt financing. These are extremely important for potential creditors, who are concerned with the firm's ability to generate the cash flow necessary to make interest payments on outstanding debt. Thus, these ratios are used extensively by analysts outside the firm to make decisions concerning the provision of new credit or the extension of existing credit arrangements. It is also important for management to monitor the firm's use of debt financing. The commitment to service outstanding debt is a fixed cost to a firm, resulting in decreased flexibility and higher break-even production rates. Therefore, the use of debt financing increases the risk associated with the firm. Managers and creditors must constantly monitor the trade-off between the additional risk that comes with borrowing money and the increased opportunities that the new capital provides. Leverage ratios provide a means of such monitoring.

Perhaps the most straightforward measure of a firm's use of debt financing is the total-debt ratio.

It is important to recall that there are only two ways to finance the acquisition of any asset: debt (using borrowed funds) and equity (using funds from internal operations or selling stock in the company). The total debt ratio captures this idea. A debt ratio of 35 percent means that, for every dollar of assets the firm has, 35 cents was financed with borrowed money. The natural corollary is that the other 65 cents came from equity financing. This is known as the firm's capital structure—35 percent debt and 65 percent equity. Greater debt means greater leverage, and more leverage means more risk. How much debt is too much is a highly subjective question, and one that managers constantly attempt to answer. The answer depends, to a large extent, on the nature of the business or industry. Large manufacturers, who require heavy investment in fixed plant and equipment, will require higher levels of debt financing than will service firms such as insurance or advertising agencies.

The total debt of a firm consists of both long- and short-term liabilities. Short-term (or current) liabilities are often a necessary part of daily operations and may fluctuate regularly depending on factors such as seasonal sales. Many creditors prefer to focus their attention on the firm's use of long-term debt. Thus, a common variation on the total debt ratio is the long-term debt ratio, which does not incorporate current liabilities in the numerator.

In a similar vein, many analysts prefer a direct comparison of the firm's capital structure. Such a measure is provided by the debt-to-equity ratio.

This is perhaps one of the most misunderstood financial ratios, as many confuse it with the total debt ratio. A debt-to-equity ratio of 45 percent would mean that for each dollar of equity financing, the firm has 45 cents in debt financing. This does not mean that the firm has 45 percent of its total financing as debt; debt and equity percentages, together, must sum to one (100 percent of the firm's total financing). A little algebra will illustrate this point. Let x = the percent of equity financing (in decimal form), so 0.45 x is the percent of debt financing. Then $x + 0.45\,x = 1$, and $x = 0.69$. So, a debt to equity ratio of 45 percent indicates that each dollar of the firm's assets are financed with 69 cents of equity and 31 cents with debt. The point here is to caution against confusing the interpretation of the debt-to-equity ratio with that of the total debt ratio.

Two other leverage ratios that are particularly important to the firm's creditors are the times-interest-earned and the fixed-charge coverage ratios. These measure the firm's ability to meet its on-going commitment to service debt previously borrowed. The times-interest-earned (TIE) ratio, also known as the EBIT coverage ratio, provides a measure of the firm's ability to meet its interest expenses with operating profits.

For example, a TIE of 3.6× indicates that the firm's operating profits from a recent period exceeded the total interest expenses it was required to pay by 360 percent. The higher this ratio, the more financially stable the firm and the greater the safety margin in the case of fluctuations in sales and operating expenses. This ratio is particularly important for lenders of short-term debt to the firm, since short-term debt is usually paid out of current operating revenue.

Similarly, the fixed charge coverage ratio, also known as the debt service coverage ratio, takes into account all regular periodic obligations of the firm.

The adjustment to the principal repayment reflects the fact that this portion of the debt repayment is not tax deductible. By including the payment of both principal and interest, the fixed charge coverage ratio provides a more conservative measure of the firm's ability to meet fixed obligations.

Leverage Ratios

Total debt ratio **Times interest earned**

Long-term debt ratio Fixed charge coverage

Debt-to-equity ratio

LIQUIDITY RATIOS

Managers and creditors must closely monitor the firm's ability to meet short-term obligations. The liquidity ratios are measures that indicate a firm's ability to repay short-term debt. Current liabilities represent obligations that are typically due in one year or less. The current and quick ratios are used to gauge a firm's liquidity.

A current ratio of 1.5× indicates that for every dollar in current liabilities, the firm has $1.50 in current assets. Such assets could, theoretically, be sold and the proceeds used to satisfy the liabilities if the firm ran short of cash. However, some current assets are more liquid than others. Obviously, the most liquid current asset is cash. Accounts receivable are usually collected within one to three months, but this varies by firm and industry. The least liquid of current assets is often inventory. Depending on the type of industry or product, some inventory has no ready market. Since the economic definition of liquidity is the ability to turn an asset into cash at or near fair market value, inventory that is not easily sold will not be helpful in meeting short-term obligations. The quick (or acid test) ratio incorporates this concern.

By excluding inventories, the quick ratio is a more strident liquidity measure than the current ratio. It is a more appropriate measure for industries that involve long product production cycles, such as in manufacturing.

Liquidity Ratios

Current ratio Quick ratio

MARKET VALUE RATIOS

Managers and investors are interested in market ratios, which are used in valuing the firm's stock. The price-earnings ratio and the market-to-book value ratio are often used in valuation analysis. The price/earnings ratio, universally known as the PE ratio, is one of the most heavily-quoted statistics concerning a firm's common stock. It is reported in the financial pages of newspapers, along with the current value of the firm's stock price.

A note of caution is warranted concerning the calculation of PE ratios. Analysts use two different components in the denominator: trailing earnings and forecast earnings. Trailing earnings refer to the firm's reported earnings, per share, over the last twelve months of operation. Forecast earnings are based on security analyst forecasts of what they expect the firm to earn in the coming twelve-month period. Neither definition is more correct than the other; one should simply pay attention to which measure is used when consulting published PE ratios. A PE ratio of sixteen can be interpreted as investors are willing to pay $16 for $1 worth of earnings. PE ratios are used extensively, on a comparative basis, to analyze investment alternatives. In investment lingo, the PE ratio is often referred to as the firm's "multiple." A high PE is often indicative of investors's belief that the firm has very promising growth prospects, while firms in more mature industries often trade at lower multiples.

A related measure used for valuation purposes is the market-to-book value ratio. The book value of a firm is defined as:

Technically, the book value represents the value of the firm if all the assets were sold off, and the proceeds used to retire all outstanding debt. The remainder would represent the equity that would be divided, proportionally, among the firm's shareholders. Many investors like to compare the current price of the firm's common stock with its book, or break-up, value.

This is also known as the price/book ratio. If the ratio is greater than one, which is often the case, then the firm is trading at a premium to book value. Many investors regard a market-to-book ratio of less than one an indication of an undervalued firm. While the interpretation one draws from market ratios is highly subjective (do high PE or low PE firms make better investments?), these measures provide information that is valued both by managers and investors regarding the market price of a firm's stock.

CAUTIONS ON THE USE ANDINTERPRETATIONOF FINANCIAL RATIOS

Financial ratios represent tools for insight into the performance, efficiency, and profitability of a firm. Two noteworthy issues on this subject involve ratio calculation and interpretation. For example, if someone refers to a firm's "profit margin" of 18 percent, are they referring to gross profit margin, operating margin, or net profit margin? Similarly, is a quotation of a "debt ratio" a reference to the total debt ratio, the long-term debt ratio, or the debt-to-equity ratio? These types of confusions can make the use of ratio analysis a frustrating experience.

Interpreting financial ratios should also be undertaken with care. A net profit margin of 12 percent may be outstanding for one type of industry and mediocre to poor for another. This highlights the fact that individual ratios should not be interpreted in isolation. Trend analyses should include a series of identical calculations, such as following the current ratio on a quarterly basis for two consecutive years. Ratios used for performance evaluation should always be compared to some benchmark, either an industry average or perhaps the identical ratio for the industry leader.

Another factor in ratio interpretation is for users to identify whether individual components, such as net income or current assets, originate from the firm's income statement or balance sheet. The income statement reports performance over a specified period of time, while the balance sheet gives static measurement at a single point in time. These issues should be recognized when one attempts to interpret the results of ratio calculations.

Despite these issues, financial ratios remain useful tools for both internal and external evaluations of key aspects of a firm's performance. A working knowledge and ability to use and interpret ratios remains a fundamental aspect of effective financial management. The value of financial ratios to investors became even more apparent during the stock market decline of 2000, when the bottom dropped out of the soaring "dot.com" economy. Throughout the long run-up, some financial analysts warned that the stock prices of many technology companies—particularly Internet start-up businesses—were overvalued based on the traditional rules of ratio analysis. Yet investors largely ignored such warnings and continued to flock to these companies in hopes of making a quick return. In the end, however, it became clear that the old rules still applied, and that financial ratios remained an important means of measuring, comparing, and predicting firm performance.

RATIO ANALYSIS

Ratio analysis is one of the techniques of financial analysis where ratios are used as a yardstick for evaluating the financial condition and performance of a firm. Analysis and interpretation of various accounting ratios gives a skilled and experienced analyst, a better understanding of the financial condition and performance of the firm than what he could have obtained only through a perusal of financial statements.

The most important task of a financial manager is to interpret the financial information in such a manner that it can be well understood by the people, who are not well versed in financial information figures. The technique, by which it is so done, is known as 'Ratio Analysis.'

The point to be noted is that a ratio reflecting a quantitative relationshiphelps to form a qualitative judgment. A comparative study of the relationships between various items of financial statements revealsthe profitability, liquidity, solvency as well as the overall position of the concern. As ratios are simple to calculate and easy to understandthere is tendency to employ them profusely. The absolute accounting figures reported in these financial statements do not provide a meaningful understanding of the performance and financial position of the concern. An accounting figure conveys meaning when it's related to some other relevant information. Ratios are useful indication of the progress position and prospects of a business unit in which the many parties are interested in different ways.

MEANING

Ratios are relationships expressed in mathematical terms between figures, which are connected with each other in some manner. Obviously, no purpose will be served by comparing two sets of figures, which are not at all connected with each other. Moreover, absolute figures are also unfit for comparison.

'Ratio' is relationship between two or more variable expressed in,

1.Percentage,

2.Rate

3.Proportion.

Ratio analysis is an important technique of financial analysis. It depicts the efficiency or
Short-fall of the organization in the form of trend analysis.

STANDARDSOFCOMPARISON

A single ratio in itself does not indicate favorable or unfavorable financial condition. It should be compared with some standard. Standards of comparison may consist of:

1. Time Series Analysis / Past RatiosPast ratios are the ratios calculated from the past financial statements of the same firm. By comparing current years ratios with past ratio the improvement or deterioration in firm's performance over the period can be studied. It is also known as Time Series Analysis.
2. Cross-sectional Analysis / Competitor's RatiosCompetitor's Ratios are ratios of some selected firms, especially the most progressive competitor, at the same point in time. By comparing firm's ratios with competitor's ratios the firm's financial position in respect to competitors can be known.

3. Industry Analysis / Industry Ratios Industry Ratios are the ratios of industryto which the firm belongs. By comparing firms ratios with industry average ratios the firm's position vis a vis other firms in the industry can be understood.
4. Proforma Analysis / Projected RatiosProjected Ratios are the ratios developed by using the projected financial statements of the firm. The comparison of current or past ratios with future ratios indicates the firm's relative strength and weaknesses in the past and in the future.

PRECAUTIONSTOBETAKENWHILEUSINGRATIOS

1. Standard for Comparison

   Ratios have meaning only if they are compared with some standards. Usually it is recommended that ratios should be compared with industry average, but industry average data is not easily available in India. Even while comparing ratios with the past ratios forecast may not be correct since several factors like market conditions, management policies etc. may affect the future operations.
2. Price Level Changes

Financial analysis based on accounting ratios will give misleading results if the effects of

changes in price level arenot taken into account. The accounting data, presented in financial statements is assumed to remain constant. In fact, prices change over yearswhich affect accounting earnings. Therefore, financial statements should be adjusted as per price level changes. For this current purchasing power and current cost accounting are quite helpful.

3. Historical Data

   The ratios indicate what has happened in the past because it is calculated on the basis of historical financial statements. Analysts are more interested in future and these ratios may not necessarily reply the firm's financial position and performance in future.
4. Ratios Alone Are Not Adequate

   Ratios are only indicators, they cannot be considered as the final regarding financial position of thebusiness. Other things also have to be seen. A high current ratio not necessarily mean sound liquidity position if most of current assets comprise outdated stocks.
5. Window Dressing

Window dressing means manipulation of accounts in a way so as to conceal vital facts and present financial statements in a way to show better position than what it actually is. In this case ratios cannot indicate true situation the quality of ratios depends on accuracy of accounts.

IMPORTANCEOFRATIOANALYSIS

The ratio analysis is the most powerful tool of the financial analysis. It is a quantitative technique for assessing the financial health of a unit from the accounting data. It helps to describe the significant relationship between two comparable figures in the financial statements with the help of Ratios, one can determine.

a.The ability of the firm to meet its current obligations.

b.The extent to which the firm has used its long term solvency by borrowing funds.

c.The efficiency with which the firm is utilizing its various assets in generating sales revenue.

d.The overall operating efficiency and performance of the firm.

It has been realized that the short term and long term financial position and the profitability of the firm are tested in every kind of financial analysis, the emphasis would differ. Some ratios are more important in one kind of analysis while other ratios are important in a different kind of analysis.

Management has to protect the interests of all concerned parties, creditors, owners etc.

They have to ensure some minimum operating efficiency and keep the risk of the firm at minimum level. Their survival depends upon their operating performance from time to time management used Ratio Analysis to determine the firm’s financial strengths and weaknesses, and accordingly takes actions to improve the firm's position.

LIMITATIONSOFRATIOANALYSIS

The ratio analysis is a very useful tool to evaluate the financial position and performance of a business. The following are some of the limitations of the ratio analysis.

a. It is difficult to find out a proper basis of comparison. Usually, it is recommended that ratio should be compared with the industry average. But the industry averages are not equally available.
b. The situations of two companies arenever the same. Similarly, the factors influencingthe performance of a company in one year may change in another year. Thus, comparison of the ratios of two companies becomes difficult.

c. The interpretation and comparison of ratios are also rendered invalid by the changing value of money. The accenting figures, presented in a financial statement, one expressed in a monetary unit which is assumed to remain constant, in fact, prices changes over years and as a result assets acquired at different dates will be expressed at different rupees in the balance sheet. This makes comparison meaningless.
d. In practice, the difference in the definitions of items in the balance sheet and the income statement make the interpretation of ratios difficult.
e. The ratios calculated at a point of time are less informative and defective as they suffer from short term changes.
f. The basis to calculate ratios are historical financial statements. The financial analysis is more interested in what happens in future, while the ratios, indicate what happened in the past. Themanagement has information about the company's future plans and policies and therefore is able to predict future happening to a certain extent. But the outside analyst has to rely on the past ratios, which may not necessarily reflect the firm's financial position and performance in future.

Problem 1. *From the data calculate :*

(i) Gross Profit Ratio (ii) Net Profit Ratio (iii) Return on Total Assets

(iv) Inventory Turnover (v) Working Capital Turnover (vi) Net worth to Debt

Sales	*25,20,000*	*Other Current Assets*	*7,60,000*
Cost of sale	*19,20,000*	*Fixed Assets*	*14, 40,000*
Net profit	*3,60,000*	*Net worth*	*15,00,000*
Inventory	*8,00,000*	*Debt.*	*9,00,000*
Current Liabilities	*6,00,000*		

Solution:

1. Gross Profit Ratio = (GP/ Sales) * 100 = 6

Sales - Cost of Sales Gross Profit

25,20,000 - 19,20,000 = 6,00,000

2. Net Profit Ratio = (NP / Sales)* 100 = 3

3. Inventory Turnover Ratio = Turnover / Total Assets) * 100= 1920000/800000= 2.4 times

Turnover Refers Cost of Sales

4. Return on Total Assets = NP/ Total Assets = (360000/3000000)*100 = 12%

FA+ CA +inventory [14,40,000 + 7,60,000 + 8,00,000] = 30,00,000

5. Net worth to Debt = Net worth/ Debt= (1500000/900000)* 100 = 1.66 times

6. Working Capital Turnover = Turnover/Working capital

Working Capital = Current Assets - Current Liabilities

= 8,00,000 + 7,60,000 - 6,00,000

15,60,000 - 6,00,000= 9,60,000

Working Capital Turnover Ratio = 19,20,000 = 2 times.

Problem 2. *Perfect Ltd. gives the following Balance sheet. You are required to compute the following ratios.*

(a) Liquid Ratio

(b) Solvency Ratio

(c) Debt-Equity Ratio

(d) Stock of Working Capital Ratio

Balance Sheet	*\$*		*\$*
Equity share capital	*1500000*	*Fixed Assets*	*1400000*
Reserve fund	*100000*	*Stock*	*500000*
6% Debentures	*300000*	*Debtors*	*200000*
Overdraft	*100000*	*Cash*	*100000*
Creditors	*200000*		*2200000*

Solution :

(a) Liquid Ratio= Liquid Assets / Liquid Liabilities

(or)

Liquid Assets / Current Liabilities

LA Debtors = 2,00,000 i.e., 3,00,000 / 200000 = 1.5

Cash = 1,00,000

= 3,00,000

Liquid Liabilities : Creditors = 2,00,000

(b) Debt – Equity Ratio = External Equities / Internal Equities

External Equities:

All outsiders loan Including current liabilities

3,00,000 + 1,00,000 + 2,00,000 = 6,00,000

All outsiders loan Including current liabilities

3,00,000 + 1,00,000 + 2,00,000 = 6,00,000

Internal Equities :

It Includes share holders fund + Reserves

15,00,000 + 1,00,000 = 16,00,000

Debt - Equity Ratio = 600000/ 1600000 = 0 · 375

© Solvency Ratio = Outside Liabilities / Total Assets

Outside Liabilities = Debenture + Overdraft + Creditors

= 3,00,000 + 1,00,000 + 2,00,000 = 6,00,000

*Solvency Ratio =(600000 / 2200000) * 100*

= 27.27%

(d) Stock of Working Capital Ratio = Stock / Working Capital

Working Capital = Current Assets - Current Liabilities

= 8,00,000 - 3,00,000 = 5,00,000

Stock of Working Capital Ratio =* 100 = 100%

Problem 3. Calculate the following ratios from the balance sheet given below :

(i) Debt – Equity Ratio (ii) Liquidity Ratio

(iii) Fixed Assets to Current Assets (iv) Fixed Assets Turnover

Balance Sheet

Liabilities	$	Assets	$
Equity shares of $ 10 each	1,00,000	Goodwill	60000
Reserves	20,000	Fixed Assets	140000
P.L. A/c	30,000	Stock	30000
Secured loan	80,000	Sundry Debtors	30000
Sundry creditors	50,000	Advances	10000
Provision for taxation	20,000	Cash Balance	10000
3,00,000		300000	

The sales for the year were $ 5,60,000.

Solution:

Debt - Equity = Long - Term Debt / Shareholders Fund

Ratio = Secured loan $. 80,000

Shareholder's Fund= Equity Share Capital + Reserves + P.L.A/c

= 1,00,000 + 20,000 + 30,000 = 1,50,000

Debt-Equity Ratio = 80,000 / 1,50,000=.53

Liquidity Ratio = Liquid Assets / Liquid Liabilities

Liquid Assets = Sundry Debtors + Advances + Cash Balance

30,000 + 10,000 + 30,000 = 70,000

Liquid Liabilities = Provision for Taxation + sundry creditors

= 20,000 + 50,000 = 70,000

Liquid Ratio = 70,000 / 70,000= 1

Fixed Assets to Current Assets

= Fixed Assets / Current Assets= 1,40,000/ 100000

= 1.4

Fixed Assets Turnover =Turnover / Fixed Assets= 5,60,000/1,40,000

= 4

Problem 4. The Balance sheet of Naronath & Co. as on 31.12.2000 shows as follows:

Liabilities	$	Assets	$
Equity capital	1,00,000	Fixed Assets	1,80,000
15% Preference shares	50,000	Stores	25,000
12% Debentures	50,000	Debtors	55,000
Retained Earnings	20,000	Bills Receivable	3,000
Creditors	45,000	Bank	2,000
2,65,000		2,65,000	

Comment on the financial position of the Company i. e., Debt - Equity Ratio, Fixed Assets Ratio, Current Ratio, and Liquidity.

Solution:

Debt - Equity Ratio = Debt - Equity Ratio / Long - Term Debt

Long-term Debt = Debentures

= 50,000

Shareholder's Fund = Equity + Preference + Retained Earnings

= 1,00,000 + 50,000 + 20,000

= 50,000

= 1,70,000

= ·29

Fixed Assets Ratio= Fixed Assets / Proprietor's Fund= -1,80,000

Proprietor's Fund=Equity Share Capital + Preference Share Capital+ Retained Earnings

=1,00,000 + 50,000 + 20,000 = 1,70,000

Fixed Assets Ratio = 1,80,000 / 1,70,000= 1.05

Current Ratio = Current Assets / Current Liabilities

Current Assets = Stores + Debtors + BR + Bank= 25,000 + 55,000 + 3,000 + 2,000 = 85,000

Liquid Ratio=45,000 / 85,000= 1.88

Liquid Assets = 45,000

Liquid Liabilities = Debtors + Bill Receivable + Cash=55,000 + 3,000 + 2,000 = 60,000

Liquid Ratio = 60,000 / 45,000 = 1.33

Problem 5: From the following particulars pertaining to Assets and Liabilities of a company calculate :

(a) Current Ratio (b) Liquidity Ratio (c) Proprietary Ratio

(d) Debt-equity Ratio (e) Capital Gearing Ratio

Liabilities	$	Assets	$
5000 equity shares $ 10			
each	500000	Land & Building	500000
8% 2000 pre shares $ 100		Plant & Machinery	600000
Each	200000	Debtors	200000
9% 4000 Debentures of		Stock	240000
$ 100 each	400000	Cash and Bank	55000
Reserves	300000	Prepaid expenses	5000
Creditors	150000		
Bank overdraft	50000		

1600000	1600000

Solution :

Current Ratio = Current Assets / Current Liabilities

Current Assets = Stock + Cash + Prepaid Expenses + Debtors

= 2,40,000 + 55,000 + 5,000 + 2,00,000 = 5,00,000

Current Liabilities = Creditors + Bank Overdraft

=1,50,000 + 50,000 = 2,00,000

=5,00,000 / 2,00,000

= 2.5 : 1

Liquid Ratio = Liquid Assets / Liquid Liabilities

Liquid Assets = Cash and Bank + Debtors

=55,000 + 2,00,000 = 2,55,000

Liquid Liabilities : Creditors = 1,50,000

Liquid Ratio = 2,55,000 / 1,50,000

= 1.7 : 1

Proprietor's Ratio = Proprietor's Fund / Total Tangible Assets

Proprietor's Fund = Equity Share Capital + Preference

Share Capital + Reserves and Surplus

=5,00,000 + 2,00,000 + 3,00,000

Proprietary Ratio=10,00,000 / 16,00,000

= 0.625 : 1

Debt - Equity Ratio = External Equities / Internal Equities

External Equities = Long-term Liabilities + Short-term Liabilities

= 4,00,000 + 2,00,000 = 6,00,000

Internal Equities = Proprietor's funds

= 6,00,000 / 10,00,000

= 0.6 : 1

Capital Gearing Ratio = Fixed Interest Bearing Securities / Equity Share Capital + Reserves

Fixed Interest Bearing Securities = Preference Shares 2,00,000

Debentures 4,00,000

6,00,000

= 6,00,000 / 8,00,000

= 0.75 : 1

Problem 6. From the following details of a trader you are required to calculate :

(i) Purchase for the year.

(ii) Rate of stock turnover

(iii) Percentage of Gross profit to turnover

Sales $	33,984	Stock at the close at cost price	1814
Sales Returns	380	G.P. for the year	8068
Stock at the beginning at cost price	1378		

Solution :

Trading Account

To Opening stock	1378	By Sales	33984
To Purchase (BD	25972	Sales Return	380
To gross profit	8068		33604
By closing Stock 1814			
35418	35418		

(i) Purchase for the year $ 25,972

(ii) Stock Turnover = Cost of Goods Sold

Cost of Goods Sold = Cost of Goods Sold / Average Stock

Average Stock = (Opening Stock + Closing Stock)/ 2

= (1372 + 1814)/2

= 25916/1596

=16.23 times

(iii) Percentage of Gross Profit to Turnover = Gross Profit / Sales *100

= 8068 / 33 ,984 * 100

= 23.74%.

Problem 7. Calculate stock turnover ratio from the following information :

Opening stock 5	8,000
Purchases	4,84,000
Sales	6,40,000

Gross Profit Rate - 25% on Sales.

Solution :

Stock Turnover Ratio = Cost of Goods Sold / Average Stock

Cost of Goods Sold = Sales- G.P

= 6,40,000 - 1,60,000 = 4,80,000

Stock Turnover Ratio= 4,80,000 /58000

= 8.27 times

Here, there is no closing stock. So there is no need to calculate the average stock.

Problem 8. Calculate the operating Ratio from the following figures.

Items	($ in Lakhs)
Sales	17874
Sales Returns	4
Other Incomes	53
Cost of Sales	15440
Administration and Selling Exp.	1843
Depreciation	63
Interest Expenses (Non- operating	456

Solution:

Operating Ratio = (Cost of Goods Sold + Operating Expenses * 100) / Sales

= ((15,440 + 1,843)/ 17,870)*100

= 97%

Problem 9. The following is the Trading and Profit and loss account of Mathan Bros Private Limited for the year ended June 30,2001.

	$		$
To Stock in hand	76250	By Sales	500000
To Purchases	315250	By Stock in hand	98500
To Carriage and Freight	2000		
To Wages	5000		
To Gross Profit	200000		
<u>598500</u>		<u>598500</u>	

To Administration Expenses		1,01,000	By Gross profit		2,00,000
To Finance Expenses. :			By Non-operating Incomes		
Interest	1200		Interest on Securities	1,500	
Discount	2400		Dividend on Shares	3, 750	
Bad Debts	<u>3400</u>	7000	Profit on Sale of Shares	<u>750</u>	6,000
To Selling Distribution Expenses		12000			
To Non-operating expenses					
Loss on sale of securities	350				
Provision for legal suit	<u>1,650</u>	2000			
To Net profit		<u>84000</u>			
<u>206000</u>			<u>206000</u>		

You are required to calculate :

(i) Gross profit Ratio (ii) Expenses Ratio (individual)

(iii) Net profit Ratio (iv) Operating profit Ratio

(v) Operating Ratio (vi) Stock turnover Ratio

Gross Profit Ratio =Gross Profit/ Sales * 100 = 2,00,000 / 500000 * 100

Expenses Ratio =Individual Expenses / Sales

Administration Expenses / Sales *100 =101000/500000 *100= 2.02%

Finance Expenses/ Sales *100 = 7000/ 500000 * 100=1.04 %

Selling and Distribution Expenses / Sales* 100= 12 000/ 500000 *100= 2.40%

Non- Operating Expenses / Sales * 100 = 2000/ 500000 * 100= 0.4%

Net Profit Ratio :

Net Profit/ Sales *100 = 84000/ 500000 *100= 16.8%

Operating Profit Ratio =Operating Profit / Sales *100

Operating Profit = Net Profit + Non-Operating Expenses - Non Operating Incomes

= 84,000 + 2,000 - 6,000 = 80,000

= 80•000 / 5000000* 100 = 16%

Operating Ratio = (Cost of Goods Sold + Operating Expenses)/Sales* 100

Cost of Goods Sold = Sales - Gross profit

5,00,000 - 2,00,000= 3,00,000

Operating Expenses

All Expenses Debited in the Profit & Loss A/c Except Non-Operating Expenses

[including Finance expense]

1,01,000 + 7,000 + 12,000 = 1,20,000

Operating Ratio = (3,00,000 + 1,20,0000) 500000 * 84%

Stock Turnover Ratio = Cost of Goods Sold / Average Stock

Costs of Goods Sold = 3,00,000

Average Stock = (Opening Stock + Closing Stock)/2

=(76,250 + 95,500) / 2

= 85,875

KARPAGAM ACADEMY OF HIGHER EDUCATION
DEPARTMENT OF MANAGEMENT
I BBA - (2017 - 2020 BATCH)
II SEMESTER
BUSINESS ACCOUNTING (17BAU202)
UNIT IV

POSSIBLE QUESTIONS
PART B

1. Bring out the objectives of Financial Statement?
2. State the meaning of ratio analysis?
3. List out the merits of ratio analysis?
4. Mention the demerits of ratio analysis?
5. Write a short note on profitability ratio?
6. Bring out the techniques of financial statement analysis?
7. Mention the benefits of financial ratios?

8. M/s. Asoka Ltd., has submitted the following Balance Sheet for the year ending 31st December 1984.

Liability	Amount (Rs.)	Asset	Amount (Rs.)
Equity Capital	1, 50, 000	Fixed Assets	1, 62, 000
Revenue reserves	30, 000	**Current Assets:**	
8% Debentures	20, 000	Stock	22, 000
		Debtors	51, 000
		Bills Receivable	2, 000
		Bank	12, 000
	2,49,000		**2,49,000**

Find the current ratio and liquidity ratio and comment on the financial condition of the company.

9. Premier Ltd., has submitted the following Balance Sheet for the year ending 31st December 1984.

Liability	Amount (Rs.)	Asset	Amount (Rs.)
Equity Capital	2, 50, 000	Fixed Assets	2, 62, 000

Revenue reserves	30, 000	**Current Assets:**	
8% Debentures	20, 000	Stock	22, 000
		Debtors	51, 000
		Bills Receivable	2, 000
		Bank	12, 000
	3,49,000		**3,49,000**

10. Write any two objectives of financial statement

11. List out the tools or techniques of financial statement?

***CIA- 3 X 2 = 6 (ANSWER ALL THE QUESTIONS)**

****ESE - 5 X 2 = 10 (ANSWER ALL THE QUESTIONS)**

PART C

1. Elucidate the different stakeholder benefited towards the financial statement?

2. Elaborate the importance of profitability ratio and solvency ratio?

3. From the following particulars pertaining to assets and liabilities of a company calculate i) Current ratio ii) Liquid ratio iii) Proprietory ratio iv) Debt equity ration v) Gearing ratio

Liability	Amount (Rs.)	Asset	Amount (Rs.)
5000 Equity shares of Rs. 100 each	5,00, 000	Land and Building	6, 00, 000
2000 8% Preference shares of Rs. 100 each	2,00, 000	Plant and Machinery	5, 00, 000
40000 9% Debentures of Rs. 100 each	4,00, 000	Stock	2, 40, 000
Reserves	3,00,000	Debtors	2, 00, 000
Creditors	1,50,000	Cash and bank	55, 000
Bank Overdraft	50,000	Prepaid expenses	5, 000
	16, 00, 000		**16, 00, 000**

4. State the meaning of the term financial statements and explain its nature?

5. List out the main objectives of financial statement analysis?

6. Calculate the amount of goodwill at three years purchase of last five years average profits. The profits were :

I year – Rs. 9,600: II year – Rs. 14,400: III year – Rs. 20,000:

IV year – Rs. 6,000: V year – Rs. 10,000

7. Following is the Balance sheet of Y ltd.

Liabilities	Amount (Rs.)	Asset	Amount (Rs.)
Equity shares capital	1,00, 000	Cash in hand	2, 000
6% Preference shares capital	1,00, 000	Cash at bank	10, 000
7% Debentures – 10 years	40, 000	Bills Receivable	30, 000

8 % Public Debt – 5 years	20,000	Investment (Short term)	20, 000
Bank Overdraft	40,000	Debtors	70, 000
Creditors	60,000	Stock	40, 000
Outstanding Creditors	7, 000	Furniture	30, 000
Proposed dividend	10, 000	Machinery	1, 00, 000
Reserves	1, 50, 000	Land and Buildings	2, 20, 000
Provision for Taxation	20, 000	Goodwill	35, 000
Profit and Loss a/c	20, 000	Preliminary expenses	10, 000
	5, 67, 000		**5, 67, 000**

During the year provision for taxation was Rs. 20, 000. Dividend proposed was Rs. 10, 000. Profit carried forward from the last year was Rs. 15, 000. You are required to calculate a) Short term solvency ratios (Current ratio , liquidity ratio) and b) long term solvency ratios.(Proprietory ratio, Capital gearing ratio and debt equity ratio)

8. Ratio analysis is a tool of management for measuring efficiency and guiding business policies – Discuss.
9. Explain the features of ratio analysis?
10. Discuss the advantages and disadvantages of ration analysis?

***CIA- 3 X 8 = 24 (EITHER OR TYPE)**

****ESE- 5 X6 = 30 (EITHER OR TYPE)**

UNIT-V

SYLLABUS

Partnership Accounts: Partnership Accounts: Past adjustments and guarantees- Basic concepts of Admission, Retirement and death of a partner including treatment of goodwill.

PARTNER SHIP ACCOUNTS

Basic Concept

A business can be organized in theform of a sole proprietorship, apartnership firm or a company.Earlier, you have studied how toprepare Profit and Loss Account andBalance Sheet of a sole proprietor.If one man was intelligent enoughand commanded all the resourcesthat he needed and also thenecessary power to do everything,he would have carried on hisbusiness as an individual. Alas, thisis not true in life. Every man needshelp from others and this is true inbusiness which requires hugeresources for the ongoing expansionprogrammes. Therefore, one of theinevitable ways is to formpartnership by joining hands withperson(s) who can complement theefforts by bringing in the necessaryintellectual as well as financialcapital. This chapter is devoted tothe basic aspects of partnershipaccounting dealing with theaccountancypreparation of Profit and Loss Account and Balance Sheet of a partnership firm.

Although the basic accounting procedure is similar in all cases, there are certainspecial features in the accounts of a partnership firm. In the case of a partnershipfirm, for example, the special features relate to the distribution of profits, themaintenance of capital accounts and the adjustments required when the firm isreconstituted. In this chapter, we shall study the nature of partnership anddiscuss the basic aspects of partnership accounts like preparation of capitalaccounts, distribution of profits amongst partners and change in the profitsharingratio of the existing partners along with preparation of Profit and LossAccount and Balance Sheet of the partnership firm.

NATURE OF PARTNERSHIP

The sole proprietorship has its limitations such as limited capital, limitedmanagerial ability and limited risk-bearing capacity. Hence, when a businessexpands or when it is to be set up on a scale, which needs more capital andinvolves more risk, two or more persons join hands to run it. They agree toshare the capital, the management, the risk and profits of the business. Suchmutual economic relationship based on a written or an oral agreement amongstthese persons is termed as 'partnership'.

The persons who have entered intopartnership are individually known as 'partners' and collectively as 'firm'.

The Indian Partnership Act, 1932 defines partnership as "the relationbetween persons who have agreed to share the profits of a business carried onby all or any of them acting for all". Based on this definition, the essentialfeatures of partnership are as follows:

1. Two or more persons:

To form a partnership, there must be at least twopersons. There is, however, a limit on the maximum number of personswho constitute a partnership firm. It should not exceed 10 if the firm iscarrying on a banking business and 20 if it is engaged in any other business.

2. Agreement between the partners :

A partnership is created by an agreement.It is neither created by operation of law as in the case of Hindu UndividedFamily nor by status. The agreement forms the basis of economicrelationship amongst the partners. The agreement can be written or oral.

3. Business :

The agreement should be for carrying on some legal business. Ajoint ownership of some property by itself does not constitute partnership.However, the joint ownership of the property may be used for forming thepartnership in order to pursue the business objectives for which thepartnership is formed.

4. Sharing of profits :

The agreement should be to share the profits of thebusiness. If some persons join hands to carry on some charitable activity,it will not be termed as partnership. Of course, the ratio in which thepartners will share the profits is determined by the agreement or in theabsence of the agreement; it is shared equally amongst the partners.

5. Business carried on by all or any of them acting for all :

The firm's businessmay be carried on by all the partners or any one of them acting for all. This means that partnership is based on the concept of mutual agencyrelationship. A partner is both an agent (he can, by his acts, bind the otherpartners) and a principal (he is bound by the acts of other partners). Theimplication of this is that partner binds others and others bind him in thesame way. Further implication of this is that each partner is entitled toparticipate in the conduct of business affairs and act for and on behalf ofthe firm.

PARTNERSHIP DEED

Meaning

A partnership is formed by an agreement. This agreement may be written ororal. Though the law does not expressly require that there should be anagreement in writing but the absence of a written agreement may be a sourceof trouble in managing the affairs of the partnership firm. Therefore, apartnership deed should be written, assented and signed by all the partners.

Contents of Partnership Deed

The partnership deed usually contains the following particulars:

_ Name of the firm;
_ Names and addresses of all partners;
_ Nature and place of the business;
_ Date of commencement of partnership;
_ Duration of partnership, if any;
_ Amount of capital contributed or to be contributed by each partner;
_ Rules regarding operation of bank accounts;
_ Ratio in which profits are to be shared;
_ Interest, if any, on partners' capital and drawings;
_ Interest on loan by the partners(s) to the firm;
_ Salaries, commissions, etc. if payable to any partner(s);
_ The safe custody of the books of accounts and other documents ofthe firm;
_ Mode of auditor's appointment, if any;
_ Rules to be followed in case of admission, retirement, death, of a partner;
_ Settlement of accounts on dissolution of the firm; and
_ Mode of settlement of disputes among the partners.

Provisions Affecting Accounting Treatment

Normally, a partnership deed covers all matters relating to the mutualrelationship amongst the partners. But if the deed is silent on certain mattersor in the absence of any deed or an express agreement, the relevant provisionsof the Partnership Act shall become applicable. It is, therefore, necessary toknow the provisions of the Act, which have a direct bearing on the accountingtreatment of certain items. These are as follows:

1. Profit Sharing :The partners shall share the profits of the firm equallyirrespective of their capital contribution.

2. Interest on Capital :No interest is allowed to partners on the capitalcontributed by them. Where, however, the agreement provides for intereston capital, such interest is payable only out of the profits of the business.

In other words, if there are losses, interest on capital will not be allowedeven if the agreement so provides.

3. Interest on Loan :If any partner, apart from his share of capital, advancesmoney to the firm as a loan, he is entitled to interest on such amount at therate of 6 per cent per annum. Such interest shall be paid even out of theassets of the firm. This means that interest on loan shall be paid even ifthere are losses. Implying, thereby, that it is a charge against the revenues.

4. Interest on Drawings :No interest will be charged on drawings made bythe partners.

5. Remuneration to Partners :No partner is entitled to any salary orcommission for participating in the business of the firm.It should be remembered that the above rules are applicable only in theabsence of any provision to the contrary in the partnership agreement.

Special Aspects of Partnership Accounts

Following are the specific issues that require special attention in case of
partnership accounts:

_ Maintenance of capital accounts of partners;
_ Ascertainment and allocation of profit and losses;
_ Adjustment for wrong allocation of profits and losses ;
_ Allocation of profits involving minimum guaranteed profit to a partner;
_ Reconstitution of the partnership firm; and
_ Dissolution of the firm.

The first four aspects are discussed in this chapter and the last two are dealt
with in the following chapters.

Partners' Capital Accounts

In case of partnership firm, the transactions relating to partners are recorded intheir respective capital accounts. Normally, each partner's capital account isprepared separately. But these accounts can also be shown in a tabular form asshown later in this chapter.

There are two methods by which the capital accounts of partners can bemaintained. These are:

_ Fluctuating Capital Method; and

_ Fixed Capital Method.

Fluctuating Capital Method

Under the fluctuating capital method, only one account *viz.*, the capital accountfor each partner, is maintained. It records all items affecting partner's accountlike interest on capital, drawings, interest on drawings, salary, commission,and share of profit or loss in the capital account itself. As a result of these, thebalance in the capital account keeps on fluctuating.

The items that usually appear on the debit and the credit side of thePartners' capital account are :

_ Credit Side

1. Capital introduced or the opening balance;
2. Additions to capital made during the year, if any;
3. Interest on capital, if any;
4. Salary to the partners, if any;
5. Commission and bonus to the partners;
6. Share of profit.

_ Debit Side

1. Drawings made during the year, if any;
2. Interest on drawings, if any;
3. Share of loss, if any;
4. Withdrawal of capital, if any;
5. Closing Balance.

Thus, the capital account of a partner will appear as follows:

Partners' Capital Account

Dr. Cr.

Date	Particulars	J.F.	Amount (Rs.)	Date	Particulars	J.F.	Amount (Rs.)
	Drawings		* * *		Opening balance		* * *
	Interest on drawings		* * *		Addition to capital		* * *
	Share of loss		* * *		Interest on capital		* * *
	Withdrawal of capital		* * *		Salary		* * *
	Closing balance		* * *		Commission/Bonus		* * *
					Share of profit		* * *
	Total		* * *		**Total**		* * *

Format under fluctuating method

Fixed Capital Method

Under the fixed capital method, the capitals of the partners shall remain fixedunless some additional capital is introduced or some amount of capital iswithdrawn by an agreement among the partners. Hence, all items like intereston capital, drawings, interest on drawings, salary, commission, and share ofprofit or loss are not to be shown in the capital accounts. For all thesetransactions, a separate account called 'Partner's Current Account' is opened.

Thus, under fixed capital method, two accounts are maintained for each partnerviz., (i) Capital Account, and (ii) Current Account. It may be noted that thecapital account will continue to show the same balance from year to yearunless some amount of capital is introduced or withdrawn, while the balanceof current account will fluctuate from year to year.

Under the fixed capital account method, the capital account and the current account would appear as shown below:

Partners' Capital Account

Dr. Cr.

Date	Particulars	J.F.	Amount (Rs.)	Date	Particulars	J.F.	Amount (Rs.)
	Withdrawal of capital		* * * *		Opening balance		* * * *
					Addition to capital		* * * *
	Closing balance		* * * *				
	Total		* * * *		**Total**		* * * *

Format under fixed capital method

Partners' Current

Dr. Cr.

Date	Particulars	J.F.	Amount (Rs.)	Date	Particulars	J.F.	Amount (Rs.)
	Opening balance*		* * * *		Opening balance*		* * * *
	Drawings		* * * *		Interest on capital		* * * *
	Interest on		* * * *		Salary		* * * *
	drawings		* * * *		Commission/Bonus		* * * *
	Share of loss		* * * *		Share of profit		* * * *
	Closing balance*		* * * *		Closing balance*		* * * *
	Total		* * * *		**Total**		* * * *

Format of Current Account

* *In Partners' Current Account, opening balance and closing balance may appear on either side, i.e. debit or credit.*

Illustration 1 (Fixed and Fluctuating Capital Account)

Amit and Sumit commenced business as partners on April 1, 2000. Amitcontributed Rs. 40,000 and SumitRs. 25,000 as their share of capital. Thepartners decided to share their profits in the ratio of 2:1. Amit was entitled toa salary of Rs. 6,000 p.a. Interest on capital was to be provided @ 6% p.a. Thedrawings of Amit and Sumit for the year ending March 31, 2001wereRs. 4,000 and Rs. 8,000, respectively. The profits of the firm after providingAmit's salary and interest on capital were Rs. 12,000.

Draw up the Capital Accounts of the partners:

(i) When capitals are fluctuating, and

(ii) When capitals are fixed.

Solution

(i) When capitals are fluctuating

Books of Amit and Sumit
Amit's Capital Account

Dr. **Cr.**

Date	Particulars	J.F.	Amount (Rs.)	Date	Particulars	J.F.	Amount (Rs.)
	Drawings Balance c/f		4,000 52,400		Cash Salary Interest on Capital Profit and Loss Appropriation A/c. (Share of profit 2/3 of Rs. 12,000)		40,000 6,000 2,400 8,000
	Total		**56,400**		**Total**		**56,400**

Sumit's Capital Account

Dr. **Cr.**

Date	Particulars	J.F.	Amount (Rs.)	Date	Particulars	J.F.	Amount (Rs.)
	Drawings Balance c/f		8,000 22,500		Cash Interest on Capital Profit and Loss Appropriation A/c (Share of profit 1/3 of Rs.12,000)		25,000 1,500 4,000
	Total		**30,500**		**Total**		**30,500**

(ii) When capitals are fixed.

Books of Amit and Sumit
Amit's Capital Account

Dr. **Cr.**

Date	Particulars	J.F.	Amount (Rs.)	Date	Particulars	J.F.	Amount (Rs.)
	Balance c/f		40,000		Cash		40,000
	Total		**40,000**		**Total**		**40,000**

Amit's Current Account

Dr. Cr.

Date	Particulars	J.F.	Amount (Rs.)	Date	Particulars	J.F.	Amount (Rs.)
	Drawings Balance c/f		4,000 12,400		Salary Interest on Capital Profit and Loss Appropriation (Share of profit 2/3 of Rs. 12,000)		6,000 2,400 8,000
	Total		**16,400**		**Total**		**16,400**

Sumit's Capital Account

Dr. Cr.

Date	Particulars	J.F.	Amount (Rs.)	Date	Particulars	J.F.	Amount (Rs.)
	Balance c/f		25,000		Cash		25,000

Sumit's Current Account

Dr. Cr.

Date	Particulars	J.F.	Amount (Rs.)	Date	Particulars	J.F.	Amount (Rs.)
	Drawings		8,000		Interest on Capital Profit and Loss Appropriation (Share of profit 1/3 of Rs. 12,000) Balance c/f		1,500 4,000 2,500
	Total		**8,000**		**Total**		**8,000**

DISTRIBUTION OF PROFIT

In case of partnership firm, the net profit (after charging the interest on capital,partners' salary and commission and after taking into account the interest ondrawings) is to be shared by all the partners in the agreed profit sharing ratio. In the absence of any specific agreement to this effect, theprofit is to be distributed equally among the various partners.

Profit and Loss Appropriation Account

As stated above, the net profit as shown by the profit and loss account of apartnership firm needs certain adjustments with regard to interest on capitals,interest on drawings, salary, commission to the partners, if provided, underthe agreement. For this purpose, 'Profit and Loss Appropriation Account' maybe prepared. This is merely an extension of the profit and loss account and isprepared to show how net profit is to be distributed among the partners. Thisaccount is credited with net profit and interest on drawings, and debited withinterest on capitals, salary or commission to partners. If, however, the profitand loss appropriation account shows a net loss, it will be shown on the debitside of the profit and loss appropriation account. After these adjustmentshave been made, the Profit and Loss Appropriation Account will show theamount of profit or loss, which shall be distributed among the partners in theagreed profit sharing ratio.

For preparing the profit and loss appropriation account, the following journalentries have to be recorded for various items:

1. For Interest on Capital

(i) For Crediting Interest on Capital to Capital/Current Account :

Interest on Capital a/c Dr.

Partners' Capital/Current a/c

(ii) For transferring Interest on Capital to Profit and Loss Appropriation Account:

Profit and Loss Appropriation a/c Dr.

Interest on Capital a/c

2. For Interest on Drawings

(i) Interest on Drawings is a gain to the firm and is charged to Partner's Capital/Current Account

Partners Capital/Current a/c Dr.

Interest on Drawings a/c

(ii) For transferring Interest on Drawings to Profit and Loss Appropriation Account, the following entry is to be recorded:

Interest on Drawings a/c Dr.

Profit and Loss Appropriation a/c

3. Partner's Salary

(i) Salary allowed to a partner is a gain of the individual partner and charge againstthe profits of the firm as per partnership agreement. For this following entry is recorded:

Salary to Partner a/c Dr.

Partner Capital/Current a/c

(ii) For charging salary allowed to a partner:

Profit and Loss Appropriation a/c Dr.

Salary to partner a/c

4. Partner's Commission

(i) Commission is an expense for the firm and a gain to the partner. For this, followingentry is made:

Commission to partner a/c Dr.

Partner's capital/current a/c

(ii) Commission paid to a partner is charged to Profit and Loss Appropriation account byrecording the following entry:

Profit and Loss Appropriation a/c Dr.

Commission to partners a/c

5. For Transfer to Reserve:

Profit and Loss Appropriation a/c Dr.

Reserve

6. For share of Profit or Loss on Appropriation

If Profit:

Profit and Loss Appropriation a/c Dr.

Partner's Capital/Current a/c

If Loss:

Partner's Capital/Current a/c Dr.

Profit and Loss Appropriation a/c

The Profit and Loss Appropriation Account will appear as follows:

Profit and Loss Appropriation Account

Dr. **Cr.**

Date	*Particulars*	*J.F.*	*Amount (Rs.)*	*Date*	*Particulars*	*J.F.*	*Amount (Rs.)*
	Net Loss as per Profit and Loss A/c (if loss)		* *		Net profit as per Profit and Loss A/c (if profit)		.....
	Interest on Capital A ×× B ××		* *		Interest on drawings A ×× B ××		×××
	Partner's Salary		......		Capital A/cs Share of loss (if loss) A ×× B ××		×××
	Partner's Commission		......				
	Reserve (transfer)		......				
	Capital A/cs - Share of profit (if profit) A ×× B ××		...... * * *				
	Total		....		**Total**		....

Proforma of Profit and Loss Appropriation Account

Illustration 2 (Preparation of Profit and Loss Account and Balance Sheet) Aakriti and Akash are partners sharing profits in the proportion of 3:2. The undermentioned trial balance was extracted from their books on December 31, 2000.

Trial Balance as on December 31, 2000

	Rs.	*Rs.*
Aakriti's Capital		65,000
Akash's Capital		40,000
Aakriti's Drawings	4,000	
Akash's Drawings	3,000	
Goodwill	10,000	
Plant and Machinery	40,000	
Office Furniture	5,000	
Purchases	85,000	
Sales		1,60,000
Total c/f	1,47,000	2,65,000

Total b/f	1,47,000	2,65,000
Sundry Debtors	40,500	
Sundry Creditors		14,510
Returns Inwards and Outwards	1,500	2,500
Rent	3,750	
Postage and Telegrams	500	
Advertising Expenditure	9,000	
Opening stock	11,500	
Cash in hand	16,000	
Wages	14,000	
Telephone Charges	500	
Salaries to staff	12,250	
Printing and Stationery	750	
Commission	5,000	
Travelling Expenses	2,000	
Carriage Inwards	5,800	
Motor Van	20,860	
Bills payable		8,900
Total	**2,90,910**	**2,90,910**

You are required to prepare the Profit and Loss Account for the year ended December 31, 2000 and Balance Sheet as at that date. The following adjustments are to be made:

1. The value of stock on December 31, 2000 was Rs. 12,500.
2. Write off Rs. 250 from office furniture; 10% on plant and machinery and 20% on motor van.
3. Create a provision of 5% on the sundry debtors for bad debts.
4. Write off 1/5th of the advertising expenses.
5. Partners are entitled to interest on capital @ 5% p.a. and Akash is entitled to a salary of Rs. 1,800 p.a.

Solution

Books of Akriti and Akash
Profit and Loss Account for the year ended December 31, 2000.

Dr. **Cr.**

Particulars		*Amount (Rs.)*	*Particulars*		*Amount (Rs.)*
Opening Stock		11,500	Sales	1,60,000	
Purchases	85,000		Less : Returns	1,500	1,58,500
Less: Returns	2,500	82,500			
Wages		14,000			
Carriage Inwards		5,800			
Gross Profit c/f		57,200	Closing Stock		12,500
		1,71,000			**1,71,000**
Salaries to staff		12,250	Gross Profit b/f		57,200
Rent		3,750			
Postage and Telegram		500			
Advertising Exp. written off		1,800			
Telephone Charges		500			
Printing and Stationery		750			
Commission		5,000			
Travelling Expense		2,000			
Depreciation					
Plant	4,000				
Furniture	250				
Motor Van	4,172	8,422			
Provision for Bad Debts		2,025			
Salary to Akash		1,800			
Interest on capital :					
Aakriti	3,250				
Akash	2,000	5,250			
Net Profit Transferred to Capital a/c:					
Aakriti	7,892				
Akash	5,261	13,153			
Total		**57,200**	**Total**		**57,200**

Balance Sheet as at December 31, 2000

Liabilities		*Amount (Rs.)*	*Assets*		*Amount (Rs.)*
Aakriti's Capital	65,000		Goodwill		10,000
Less:Drawings	4,000		Plant and Machinery	40,000	
	61,000		Less: Depreciation	4,000	36,000
Add: Interest on Capital	3,250				
Net profits	7,892	72,142	Office Furniture	5,000	
			Less: Depreciation	250	4,750
Akash's Capital	40,000				
Less: Drawings	3,000		Motor Vans	20,860	
	37,000		Less: Depreciation	4,172	16,688
Add: Interest on Capital	2,000				
Salary	1,800		Sundry Debtors	40,500	
Net profits	5,261	46,061	Less: Provision	2,025	38,475
Sundry Creditors		14,510	Cash on hand		16,000
Bills Payable		8,900	Advertising exp.	9,000	
			Less: Written-off (1/5)	1,800	7,200
			Stock on hand		12,500
Total		**1,41,613**	**Total**		**1,41,613**

Illustration 3 (Distribution of profit)

Ajit, Choudhary and Vishal set up a partnership firm on January 1, 2001.They contributed Rs. 50,000, Rs. 40,000 and Rs. 30,000 respectively astheir capitals and decided to share profits in the ratio of 3:2:1. The partnershipdeed provided that Ajit is to be paid a salary of Rs. 1,000 p.m. and Choudharya commission of Rs. 5,000. It also provided that interest on capital be allowed@ 6% p.a. The drawings for the year were: AjitRs. 6,000, ChoudharyRs.4,000 and Vishal Rs. 2,000. Interest on drawings Rs. 270 on Ajit's drawings,Rs. 180 on Choudhary's drawings and Rs. 90 on Vishal's drawings. The netamount of profit as per the profit and loss account for the year ended 2001 wasRs. 35,660.

You are required to record the necessary journal entries relating toappropriation of profit and prepare the profit and loss appropriation accountand the partners' capital accounts.

Solution

Books of Ajit, Chaudhary and Vishal
Journal

Date 2001	*Particulars*		*L.F.*	*Debit Amount (Rs.)*	*Credit Amount (Rs.)*
End of the year	Profit and Loss a/c	Dr.		35,660	
	Profit and Loss Appropriation a/c				35,600
	(Transfer of Profit to Profit and Loss Appropriation Account)				
	Ajit's Salary a/c	Dr.		12,000	
	Ajit's Capital a/c				12,000
	(Amount of Ajit's Salary)				
	Profit and Loss Appropriation a/c	Dr.		12,000	
	Ajit's Salary a/c				12,000
	(Transfer of Ajit's Salary to Profit and Loss Appropriation Account)				
	Choudhary's Commission a/c	Dr.		5,000	
	Choudhary's Capital a/c				5,000
	(Amount of Choudhary's Commission)				
	Profit and Loss Appropriation a/c	Dr.		5,000	
	Choudhary's Commission a/c				5,000
	(Transfer of Choudhary's Commission to Profit and Loss Appropriation Account)				
	Interest on Capital a/c	Dr.		7,200	
	Ajit's Capital a/c				3,000
	Choudhary's Capital a/c				2,400
	Vishal's Capital a/c				1,800
	(Amount of interest on capital)				
	Interest on Capital a/c	Dr.		7,200	
	Ajit's Capital a/c				3,000
	Choudhary's Capital a/c				2,400
	Vishal's Capital a/c				1,800
	(Amount of interest on capital)				
	Profit and Loss Appropriation a/c	Dr.		7,200	
	Interest on Capital a/c				7,200
	(Transfer of Interest on Capital to Profit and Loss Appropriation Account)				
	Ajit's Capital a/c	Dr.		270	
	Choudhary's Capital a/c			180	
	Vishal's Capital a/c			90	
	Interest on Drawings a/c				540
	(Amount of interest on drawings)				
	Interest On Drawings a/c	Dr.		540	
	Profit and Loss Appropriation a/c				540
	(Transfer of Interest on drawings to Profit and Loss Appropriation Account)				
	Profit and Loss Appropriation a/c	Dr.		12,000	
	Ajit's Capital a/c				6,000
	Choudhary's Capital a/c				4,000
	Vishal's Capital a/c				2,000
	(Amount of profit on appropriation)				

Profit and Loss Appropriation Account for the year ended December 31,2001

Dr. **Cr.**

Particulars		*Amount (Rs.)*	*Particulars*		*Amount (Rs.)*
Ajit's Salary		12,000	Net profit as per profit and loss account		35,660
Choudhary's Commission		5,000	Interest on Drawings :		
Interest on Capital:			Ajit's Capital	270	
Ajit's Capital	3,000		Choudhary's capital	180	
Choudhary's Capital	2,400		Vishal's Capital	90	540
Vishal's Capital	1,800	7,200			
Capital Accounts - Share of Profit:					
Ajit's Capital	6,000				
Choudhary's Capital	4,000				
Vishal's Capital	2,000	12,000			
Total		**36,200**	**Total**		**36,200**

Ajit's Capital Account

Dr. **Cr.**

Date 2001	*Particulars*	*J.F.*	*Amount (Rs.)*	*Date 2001*	*Particulars*	*J.F.*	*Amount (Rs.)*
	Drawings		6,000		Cash		50,000
	Interest on Drawings		270		Salary		12,000
	Balance c/f		64,730		Interest on Capital		3,000
					Profit and Loss Appropriation (Share of profit)		6,000
	Total		**71,000**		**Total**		**71,000**

Choudhary's Capital Account

Dr. Cr.

Date 2001	Particulars	J.F.	Amount (Rs.)	Date 2001	Particulars	J.F.	Amount (Rs.)
	Drawings		4,000		Cash		40,000
	Interest on Drawings		180		Commission		5,000
	Balance c/f		47,220		Interest on Capital		2,400
					Profit and Loss Appropriation (Share of profit)		4,000
	Total		**51,400**		**Total**		**51,400**

Vishal's Capital Account

Dr. Cr.

Date 2001	Particulars	J.F.	Amount (Rs.)	Date 2001	Particulars	J.F.	Amount (Rs.)
	Drawings		2,000		Cash		30,000
	Interest on Drawing		90		Interest on Capital		1,800
	Balance c/f		31,710		Profit and Loss Appropriation (Share of profit)		2,000
	Total		**33,800**		**Total**		**33,800**

Illustration 4 (Distribution of profit)

Pawan and Purna are partners in a firm sharing profits in the ratio of 3:2. Thebalance in their capital and current accounts as on January1, 1998 wereas under :

PawanPurna

Capital Account 30,000 20,000… Current Account (Cr.) 10,000 8,000

The partnership deed provided that Pawan is to be paid salary @ Rs. 500 p.m.WhereasPurna is to get commission of Rs. 4,000 for the year.

Interest on capital is to be allowed @ 6% p.a. The drawings of Pawan andPurna for the year were Rs. 3,000 and Rs. 1,000, respectively. Interest on drawings for Pawan and Purna works out at Rs. 75 and Rs. 25, respectively.

The net profit of the firm before making these adjustments was Rs. 24,900.Prepare the Profit and Loss Appropriation Account and the partners' capitaland current accounts.

Solution

Books of Pawan and Purna
Profit and Loss Appropriation Account for the year ended Dec. 31,1998

Dr. Cr.

Particulars		Amount (Rs.)	Particulars		Amount (Rs.)
Pawan's Salary		6,000	Net profit as per Profit and Loss account		24,900
Purna's Commission		4,000	Interest on drawings :		
Interest on Capital:			Pawan's current a/c	75	
Pawan's current	1,800		Purna's current a/c	25	100
Purna's current	1,200	3,000			
Capital accounts (Share of Profit):					
Pawan's current	7,200				
Purna's current	4,800	12,000			
Total		**25,000**	**Total**		**25,000**

Partners' Capital Account

Dr. Cr.

Date 1998	Particulars	J. F.	Pawan Rs.	Purna Rs.	Date 1998	Particulars	J. F.	Pawan Rs.	Purna Rs.
	Balance c/f		30,000	20,000		Balance b/f		30,000	20,000

Partners' Current Account

Dr. Cr.

Date 1998	Particulars	J.F.	Pawan Rs.	Purna Rs.	Date 1998	Particulars	J.F.	Pawan Rs.	Purna Rs.
	Drawings		3,000	1,000		Balance b/f		10,000	8,000
	Interest on Drawing		75	25		Salary		6,000	--
	Balance c/f		21,925	16,975		Commission		--	4,000
						Interest on Capital		1,800	1,200
						Share of profit		7,200	4,800
	Total		**25,000**	**18,000**		**Total**		**25,000**	**18,000**

Calculation of Interest on Capital

If the partnership agreement specifically provides for the payment of the intereston the capital contributed by the partners, the same has to be allowed. Interestto be allowed on capital is to be calculated with respect to the time, rate andamount. Generally, following points are to be borne in mind while calculatingthe interest on capital:

1. Normally, interest on the opening balance at the beginning of the year isallowed for the whole accounting year.

2. If additional capital is invested during the year, interest for the relevantperiod is calculated.

3. If part of the capital is withdrawn during the year, interest on the part ofthe capital that was invested for the whole year, interest is calculated forthe whole year and it is added with the amount of interest that is calculatedon the remaining capital that was invested for the relevant period.

Forexample, Anmolhas Rs. 30,000 as balance in his capital account at thebeginning of the year. In the middle of the year he withdrew Rs.10,000from his capital. He is entitled for interest @ 10% p.a.

In this case, interest will be calculated in the following manner:

(20,000 × 10/100) + (10,000 × 10/100 × 1/2) = Rs. 2,500;

Alternatively, we can calculate interest on capital with respect to theamount remained invested for the relevant period. In the above example,the interest may also be calculated as follows:

(30,000 × 10/100 × 1/2) + (20,000 × 10/100 × 1/2) = Rs. 2,500.

Illustration 5 (Interest on Capital)

Mansoor and Reshma are partners in a firm. Their capital accounts showedthe balance on Jan 1, 2000 as Rs. 20,000 and Rs. 15,000 respectively.Duringthe year, Mansoor introduced additional capital of Rs.10,000 on May 1,2000 and Reshma brought in further capital of Rs.15,000 on July 1, 2000. Reshma withdrew Rs. 5,000 from her capital on October 1, 2000. Interestis allowed @ 6% p.a. on the capitals. Calculate the interest to be paid onthe capital.

Solution

Statement showing calculation of interest

Particulars	*Mansoor* Rs.	*Reshma* Rs.
1. Interest on capital balance on Jan 1, 2000:		
Mansoor – (20,000×6/100)	1,200	
Reshma – (15,000×6/100)		900
2. Add interest on additional capital:		
Mansoor – (10,000×6/100×8/12)	400	
Reshma – (15,000×6/100×6/12)		450
3. Less: Interest on capital withdrawn by Reshma (5000×3/12×6/100)		(75)
Total Interest Payable	**1,600**	**1,275**

Calculation of Interest on Drawings

Interest on drawings is to be charged from the partners, if the same has beenspecifically provided in the partnership deed. Interest on drawings is to becalculated with reference to the time period for which the money was withdrawn.

Following may be the possibilities requiring the different calculations ofinterest when:

(1) Amount, rate of interest and date of withdrawal is given:Suppose, Johnson is a partner who withdrew Rs. 20,000 on October 1,2002. Interest on drawings is charged @ 10% per annum. The calculationof interest will be as follows:

$$\text{Rs. } 20,000 \times \frac{10}{100} \times \frac{3}{12} = \text{Rs. } 500$$

(2) Amount and rate of interest are given but date of withdrawal is not specified: Suppose, Ahmed is a partner who withdraws Rs. 20,000 and interest on drawings is charged @ 10% per annum. The calculation of interest will be as follows:

$$\text{Rs. } 20,000 \times \frac{10}{100} \times \frac{6}{12} = \text{Rs. } 1,000$$

Here, it is noted that in the absence of any particular date of withdrawal,it is assumed that withdrawals are made evenly throughout the year. Hence,interest is charged for the average of the period of the year, i.e., six months.

(3) Fixed amount is withdrawn every month:

In this case, there may be three possibilities and accordingly the interest forthat period will be charged:

a) If amount is withdrawn during the month (implicitly assumed to be inthe middle of month), interest is calculated for six months;

b) If the withdrawal is made in the beginning of the month, interest iscalculated for 6½ months (six and a half months), and

c) If withdrawal is made at the end of the month, interest is calculatedfor 5 ½ months (five and a half months).

(4) If amount is withdrawn at each quarter:

(a) If amount is withdrawn in the beginning of each quarter, in this casethe interest is calculated on total drawings for a period of seven anda half months, and

(b) If amount is withdrawn at the end of each quarter, the amount ofinterest is calculated on total drawings for a period of four and a halfmonths.

(5) Different amounts are withdrawn at different intervals:In this case, the sum of the product of amount withdrawn and the time iscalculated and then the rate of interest is applied for a period of one month.

For example, Sonu withdraws Rs. 1,000 on March 1; Rs. 2,000 on 30th June; Rs. 1,000 on 1st November and Rs. 2,000 on 31st December. Intereston drawings is charged at 10% per annum. In this case, interest ondrawings will be calculated as follows :

Statement of Calculation of Interest on Drawings

(1)	(2)	(3)	(4)	(5)	
Date	*Amount(Rs.)*	*Time Period*	*Product*	*Interest*(Rs.)*	
			(2×3)		
March 1	1000	10 Months	10,000	10,000 × 10/100 × 1/12	= 83.33
June 30	2000	6 Months	12,000	12,000 × 10/100 × 1/12	= 100
Nov.1	1000	2 Months	2,000	2,000 × 10/100 × 1/12	= 16.67
Dec.31	2000	0	0		0
Total			**24,000**		**200***

* *Instead of this cumbersome calculation, the same result can be obtained by calculating the Interest on the sum of product for a period of one month = Rs. 24,000 × 10/100 × 1/12 = Rs. 200*

Illustration 6 (Interest on Drawings)

Rajesh is a partner in a firm. He withdrew the following amounts during the year 2000 :

	Rs.
January 31	6,000
March 31	4,000
June 30	8,000
September 30	3,000
October 31	5,000

The interest on drawings is to be charged @ 6% p.a. Assuming the accounting year closes on December 31each year, interest on drawings to be debited to Rajesh shall be worked out as follows :

1	2	3	4
Date	*Amount(Rs.)*	*Period Months*	*Product(Rs.)*
			(2×3)
Jan 31	6,000	11	66,000
March 31	4,000	9	36,000
June 30	8,000	6	48,000
Sept 30	3,000	3	9,000
Oct 31	5,000	2	10,000
Total	**26,000**		**1,69,000**

Interest on drawings for one month on the sum of products :

$$\frac{\text{Rate of interest}}{100} \times \text{sum of products} \times \frac{1}{12}$$

$= \quad 6/100 \times \text{Rs. } 1{,}69{,}000 \times 1/12$

$= \quad \text{Rs. } 845$

Alternatively, interest can be calculated separately for each amount for theperiod involved and then totalled. In that case also, we shall arrive at the sameamount of interest.

Illustration 7 (Interest on drawings)

Amit and Sonu are partners sharing profits equally. Amit withdrew Rs. 1,000p.m. regularly on the first day of every month for personal expenses. If interest on drawings is to be charged @ 5% p.a., calculate the interest on the drawings of Amit.

Solution

Calculation of Interest on Drawings

(1) Date 2001	(2) Amount of drawings(Rs.)	(3) Period for which money has been used	(4) Product(Rs.) (2 × 3)
Jan 1	1,000	12	12,000
Feb 1	1,000	11	11,000
Mar 1	1,000	10	10,000
Apr 1	1,000	9	9,000
May 1	1,000	8	8,000
June 1	1,000	7	7,000
July 1	1,000	6	6,000
Aug 1	1,000	5	5,000
Sept 1	1,000	4	4,000
Oct 1	1,000	3	3,000
Nov 1	1,000	2	2,000
Dec 1	1,000	1	1,000
Total	**12,000**		**78,000**

Interest on Drawings = Rate of Interest/100 × 1/12 × Sum of the product
= 5/100 × 1/12 × 78,000
= Rs. 325

It may be noted that when a fixed amount is drawn at regular intervals, the interest on drawings can also be calculated on the basis of the average period. The calculation of the average period depends upon the fact whether the fixed amount is withdrawn on the first day of every month or the last day of every month.

If the fixed amount is withdrawn on the first day of every month, the average period will be calculated with the help of following formula :

Average period = (Total period in months + 1)/2

If the fixed amount is withdrawn on the last day of every month, the average period will be calculated by the following formula :

Average period = (Total period in months – 1)/2

In illustration 6, the partners withdrew a fixed amount on the first day of every month. Hence, the interest on drawings can also be calculated by applying the average period formula.

Average period = (Total period in months + 1)/2

= (12 +1)/2 = 6.5 Months

Interest on drawings for 6.5 months @ 5% p.a.

$$= 12000 \times \frac{5}{100} \times \frac{13}{2} \times \frac{1}{12}$$

$$= \text{Rs. } 325$$

Illustration 8 (Interest on Drawings)

Maneesh and Mohan are partners in a firm. The partnership deed provided that interest on drawings will be charged @ 6% p.a.. During the year ended, December 31, 2002, Maneesh withdrew Rs.5,000 in the beginning of each quarter and Mohan withdrew Rs. 5,000 at the end of each quarter. Calculate interest on the partners' drawings.

Solution

Maneesh's total drawings = Rs.5,000 × 4 = Rs.20,000

Mohan's total drawings = Rs.5,000 × 4 = Rs.20,000

Interest on Maneesh's Drawings :

Number of months for which interest will be charged = $\frac{12+3}{2} = 7.5$ months

$$\text{Interest} = \text{Rs. } 20{,}000 \times \frac{6}{100} \times \frac{15}{2} \times \frac{1}{12} = \text{Rs. } 750$$

Interest on Mohan's drawings :

Number of months for which interest will be charged = $\frac{12-3}{2} = 4.5$ months

$$\text{Interest} = \text{Rs. } 20{,}000 \times \frac{6}{100} \times \frac{9}{2} \times \frac{1}{12} = \text{Rs. } 450$$

GUARANTEE OF PROFIT TO A PARTNER

Guarantee is an assurance that a partner will not get as his share of profit lessthan the guaranteed amount. There may be two situations:

(a) Guarantee to one partner by (others) the firm,

(b) Guarantee to a partner by another partner individually.

(a) Guarantee to one partner by (others) the firm

Sometimes, a partner is guaranteed a minimum amount by way of hisshare in the profits of the firm. Such a guarantee may be given to anexisting partner or to a new partner at the time of admission. Suchguaranteed amount shall be paid to partner when his share of profit, ascalculated, according to his profit sharing ratio is less than the guaranteedamount. The deficiency of such guaranteed amount will be borne by theother partner's in their profit sharing or agreed ratio as the case may be.

Example, Soni and Mita are partners and they decide to admit Mary intothe partnership firm. The profit sharing ratio is agreed as 3:2:1 with aguaranteed amount of Rs. 5,000 to Mary. For the year ended 2001, thebusiness earns a profit of Rs. 24,000. Mary's share works out to Rs. 4,000(1/6 of Rs. 24,000). This is Rs. 1,000 less than the guaranteed amount ofRs. 5,000. Hence, Mary will get Rs. 4,000 as her share of the profit in theprofit sharing ratio and the deficiency of Rs.1,000 (i.e. the amount bywhich Rs. 4,000 falls short of the guaranteed amount) shall be transferredto the credit of Mary by transfer from Soni and Mita in their profit sharingratio, i.e. 3:2.

Illustration 9 (Guarantee of Profit)

Mouse, Keyboard and Monitor are partners. They admit Printer as a partnerwith a guarantee that his share of profits shall not be less than Rs. 20,000 p.a.Profits are to be shared in the proportion of 4:3:3:2. The total profits for theyear ended 2002 were Rs. 96,000. Prepare the profit and loss appropriationaccount showing the division of the profits for the year.

Solution

Books of Mouse, Key Board and Monitor
Profit and Loss Appropriation Account
for the year ended........2002

Dr. **Cr.**

Particulars	*Amount (Rs.)*	*Particulars*	*Amount (Rs.)*
Mouse	30,400	Net Profits	96,000
Keyboard	22,800		
Monitor	22,800		
Printer	20,000		
Total	**96,000**	**Total**	**96,000**

Notes to Solution :

Printer's share = Rs. 96,000 × 2/12 = Rs. 16,000.

Since Printer has been guaranteed a minimum amount of Rs. 20,000, therefore, he will givenRs. 20,000 and remaining amount i.e., Rs. 20,000 – Rs.16,000 = Rs. 4,000 will be borne by Mouse, Keyboard and Monitor in the ratio of 4:3:3.

Mouse's share	= Rs. 96,000 × 4/12	=	Rs. 32,000	
Less :				
contribution to Printer (Rs. 4,000 × 4/10)		=	Rs. 1,600	Rs. 30,400
Keyboard's share	= Rs. 96,000 × 3/12	=	Rs. 24,000	
Less:				
contribution to Printer (Rs. 4,000 × 3/10)		=	Rs. 1,200	Rs. 22,800
Monitor's share	= Rs. 96,000 × 3/12	=	Rs. 24,000	
Less:				
contribution to Printer (Rs. 4,000 × 3/10)		=	Rs. 1,200	Rs. 22,800

(b) Guarantee to a partner by another partner individually

The guarantee to an existing or incoming partner may be given by all theold partners or any of them in their new profit sharing ratio or an agreedbasis.

In illustration 9, all the three partners have agreed to guaranteePrinter for the minimum share of profit. Hence, these three divided thePrinter's share in the ratio of 4:3:3. Suppose Mouse alone agrees toguarantee Printer then profit distribution will be as follows :

Mouse's share	Rs. 96,000 × 4/12 =	Rs. 32,000
Less : Printer's share		Rs. 4,000
Final share of Mouse		Rs. 28,000

In other words Keyboard and Monitor will get full share, i.e. Rs.24,000 each.

Illustration 10 (Guarantee of Profit)

Kim and Lal are partners in a firm sharing profit in the ratio of 2:1. They decide toadmit Mohit with 1/4th share in profits with a guaranteed amount of Rs.25,000. Kim undertook to meet the liability arising out of the guaranteed amountto Mohit. The profit sharing ratio between Kim, Lal and Mohit will be 2:1:1. Thefirm earned profit of Rs. 76,000 for the year ended March 31, 2001.

You are required to prepare Profit and Loss Appropriation Account andshow the distribution of profit amongst the partners.

Solution

The Profit and Loss Appropriation Account will be prepared as follows :

The Profit and Loss Appropriation Account
for the year ended March 31, 2001

Dr. **Cr.**

Particulars		*Amount (Rs.)*	*Particulars*	*Amount (Rs.)*
Share of Profit			Net Profit as per profit and loss account	76,000
Kim				
(2/4 of 76,000)	38,000			
Less: Mohit's deficiency				
(2/3 of 9,000)	6,000	32,000		
Lal				
(1/4 of 76,000)		19,000		
Mohit				
(1/4 of 76,000)	19,000			
Add: deficiency borne by Kim	6,000	25,000		
Total		**76,000**	**Total**	**76,000**

Notes to the Solution :

The minimum guaranteed amount to Mohit is Rs. 25,000 whereas, his share of profit as per the profit sharing ratio works out to be Rs. 19,000 only. Hence, there is a shortfall of Rs 6,000. This amount will be borne by Kim.

Past Adjustments

Sometimes, after the final accounts have been prepared and the partners' capital account are closed, it is found that certain items have been omitted by mistake or have been wrongly treated. Such omissions and commissions usually relate to the interest on capital, interest on drawings, salary to partners, etc.

In such a situation, necessary adjustments have to be made in the partners' capital account through an account called Profit and Loss Adjustment Account.

The following procedure may be helpful in recording necessary adjustments :

1. If, interest on capital is one of the items of omissions, then first ascertain the partners' capital at the beginning. This can be done by deducting partners' share of current year's profit from their capitals at the end and adding their drawings thereto.

2. Work out the amounts of omitted items that are to be credited to partners' capital accounts such as interest on capital, salaries to partners, etc. The following journal entry for the adjustment is recorded :

Profit and Loss Adjustment a/c Dr.
Partners' Capital a/c (individually)

3. Work out the amounts of omitted items which are to be debited to Partners' Capital Accounts such as interest on drawings and record the following adjustment entry are recorded :

Partners' Capital (individually) a/c Dr.
Profit and Loss Adjustment a/c

4. Work out the balance of the Profit and Loss Adjustment Account. The credit balance of the Profit and Loss Adjustment Account reflects the profit and the debit balance, the loss. This is to be distributed among the partners.

5. The balance of the Profit and Loss Adjustment Account as worked out in point 4 above be transferred to the partners' capital accounts in their profit sharing ratio. Thus, the Profit and Loss Adjustment Account will stand closed. It will involve the following journal entry :

If it is a credit balance (profit)

Profit and Loss Adjustment a/c Dr.
Partners' Capital (individually) a/c

If it is a debit balance (loss)

Partners' Capital (individually) a/c Dr.
Profit and Loss Adjustment a/c

The adjustment can also be made directly in the Partners' Capital Accounts without preparing a Profit and Loss Adjustment Account. In such a situation, we shall prepare a statement to find out the net effect of omissions and commissions and then to debit the capital account of the partner who had been credited in excess and credit the capital account of the partner who had been debited in excess.

Illustration 11 (Past adjustments)

Asha and Bony are partners in a firm sharing profits equally. Their capital accounts as on December 31, 2000 showed balances of Rs. 60,000 and Rs. 50,000 respectively. After taking into account the profits of the year 2000, which amounted to Rs 20,000, it was subsequently found that the following items have been left out while preparing the final account of the year ended 2000.

(i) The partners were entitled to interest on capitals @ 6% p.a.

(ii) The drawings of Asha and Bony for the year 2000 were Rs.8,000 and Rs.6,000 respectively. The interest on drawings was also to be charged @ 5% p.a.

(iii) Asha was entitled to salary of Rs.5,000 and Bony, a commission of Rs.2,000 for the whole year. It was decided to make the necessary adjustments to record the above omissions. Give the necessary journal entries and prepare the profit and loss adjustment account and Partners' capital accounts.

Solution

(1) Partners capital at the beginning

	Asha (Rs.)	Bony (Rs.)
Capital at the end	60,000	50,000
Less: Share of Profit	(10,000)	(10,000)
(Rs. 20,000 shared equally)	50,000	40,000
Add: Drawings	8,000	6,000
Capital at the beginning	**58,000**	**46,000**

(2) Interest on Capital

For Asha : 58,000 × 6/100 = Rs. 3,480
For Bony : 46,000 × 6/100 = Rs. 2,760

(3) Interest on Drawings

For Asha : on Rs. 8,000 @ 5% p.a. for 6 months.

$$8,000 \times \frac{5}{100} \times \frac{6}{12} = \text{Rs. } 200$$

For Bony : on Rs. 6,000 @ 5% p.a. for 6 months

$$6,000 \times \frac{5}{100} \times \frac{6}{12} = \text{Rs. } 150$$

Books of Asha and Bony
Journal

Date 2000	Particulars	L.F.	Debit Amount (Rs.)	Credit Amount (Rs.)
Dec 31	Profit and Loss Adjustment a/c Dr.		6,240	
	Asha's Capital a/c			3,480
	Bony's Capital a/c			2,760
	(Amount of interest on capital)			
..	Asha's Capital a/c Dr.		200	
	Bony's Capital a/c Dr.		150	
	Profit and Loss Adjustment a/c			350
	(Amount of interest on drawings)			
..	Profit and Loss Adjustment a/c Dr.		5,000	
	Asha's Capital a/c			5,000
	(Amount of salary)			
..	Profit and Loss Adjustment a/c Dr.		2,000	
	Bony's Capital a/c			2,000
	(Amount of commissions)			
..	Asha's Capital a/c Dr.		6,445	
	Bony's Capital a/c Dr.		6,445	
	Profit and Loss Adjustment a/c			12,890
	(Amount of loss on adjustment)			

Profit and Loss Adjustment Account
for the year ended December 31, 2000

Dr. **Cr.**

Particulars		Amount (Rs.)	Particulars		Amount (Rs.)
Capital (Interest on capital)			Capital (Interest on Drawings)		
Asha	3,480		Asha	200	
Bony	2,760	6,240	Bony	150	350
Asha's capital (Salary)		5,000	Capital (Loss on adjustments)		
Bony's capital (Commission)		2,000	Asha	6,445	
			Bony	6,445	12,890
Total		**13,240**	**Total**		**13,240**

Partners' Capital Account

Dr. **Cr.**

Date 2000	Particulars	J.F.	Asha's Rs.	Bony's Rs.	Date 2000	Particulars	J.F.	Asha's Rs.	Bony's Rs.
Dec31	Profit and Loss Adjustment: (interest on drawings)		200	150	Dec 31	Balance b/f		60,000	50,000
	Profit and Loss Adjustment: (Loss on Adjustment)		6,445	6,445		Profit and Loss Adjustment: (Interest on capital)		3,480	2,760
	Balance c/f		61,835	48,165		Profit and Loss Adjustment: (Salary)		5,000	
						Profit and Loss Adjustment: (Commission)			2,000
			68,480	**54,760**				**68,480**	**54,760**
						Balance b/f		61,835	48,165

For a Single adjustment entry an analysis table to find out the amount to be debited or credited to the capital accounts of the partners individually.

Analysis Table

Particulars	Asha (Rs.)	Bony (Rs.)
Amount credited (Interest on capital, salary and commission)	8,480	4,760
Amount debited (Interest on drawings and share of loss)	6,645	6,595
	Cr. 1,835	Dr. 1,835

Journal Entry

Bony's Capital a/c	Dr.	1,835	
Asha's Capital a/c			1,835

Alternatively: A detailed statement can be prepared as follows :

Statement of Adjustment

Particulars	*Amount already recorded*		*Amount as should have been recorded*		*Adjustment*
	Dr. (Rs.)	*Cr. (Rs.)*	*Dr. (Rs.)*	*Cr. (Rs.)*	*Dr./Cr (Rs.)*
Asha's Capital :	--	--	--		
Interest on Capital	--	--		3,480	
Interest on Drawings	--	--	200		
Salary	--		--	5,000	
Share of Profit		10,000		3,555	
			200	12,035	
NET		**10,000**	--	**11,835**	**Cr. 1,835**
Bony's Capital :					
Interest on Capital	--	--	--	2,760	
Interest on Drawings	--	--	150	--	
Commission	--	--	--	2,000	
Share of Profit	--	10,000	--	3,555	
			150	8,315	
NET		**10,000**	--	**8,165**	**Dr. 1,835**

Goodwill

Goodwill is also one of the special aspects of partnership accounts which requires adjustment at the time of a change in the profit sharing ratio, the admission of a partner or the retirement or death of a partner.

Meaning of Goodwill

Over a period of time, a well-established business develops an advantage of good name, reputation and wide business connections. This helps the business to earn more profits as compared to a newly set up business. In accounting, the monetary value of such advantage is known as 'goodwill'.

It is regarded as an intangible asset. In other words, goodwill is the value of the reputation of a firm in respect of the profits expected in future over and above the normal profits. It is generally observed that when a person pays for goodwill, he/she pays for something, which places him in the position of being able to earn super profits as compared to the profit earned by other firms inthe same industry.

In simple words, goodwill can be defined as "the present value of a firm's anticipated excess earnings" or as "the capitalized value attached to thedifferential profit capacity of a business". Thus, goodwill exists only when thefirm earns super profits. Any firm that earns normal profits or is incurringlosses has no goodwill.

Factors giving rise to Goodwill

The main factors helping the creation of goodwill are as follows :

1.Nature of Business : A firm that produces high value added products or having a stable demand is able to earn more profits and therefore has more goodwill.

2. Location :If the business is centrally located or is at a place having heavycustomer traffic, the goodwill tends to be high.

3. Efficiency of Management :A well-managed concern usually enjoys theadvantage of high productivity and cost efficiency. This leads to higherprofits and so the value of goodwill will also be high.

4. Market situation :The monopoly condition or limited competition enablesthe concern to earn high profits which leads to higher value of goodwill.

5. Special Advantages : The firm that enjoys special advantages like importlicenses, low rate and assured supply of electricity, long-term contractsfor supply of materials, well-known collaborators, patents, trade marks,etc. enjoy higher value of goodwill.

Need for Valuation

Normally, the need for valuation of goodwill arises at the time of the sale of abusiness. But, in case of a partnership firm it may also arise in the followingcircumstances:

1. Change in the profit sharing ratio amongst the existing partners;
2. Admission of a new partner;
3. Retirement of a partner;
4. Death of a partner;
5. Dissolution of a firm which involves sale of business as a going concern; and
6. Amalgamation of firms.

Methods of Valuation of Goodwill

The important methods of valuation of goodwill are as follows :

1. Average Profits Method :Under this method, the goodwill is valued at agreednumber of 'years' purchase of the average profits of the past few years. Itis based on the assumption that a new business will not be able to earnany profits during the first few years of its operations. Hence, the personwho purchases a running business must pay in the form of goodwill asum which is equal to the profits he is likely to receive for the first fewyears. The goodwill, therefore, should be calculated by multiplying thepast average profits by the number of years during which the anticipatedprofits are expected to accrue.

For example, if the past average profits of a business works out atRs. 20,000 and it is expected that the same profits will be available infuture, the value of goodwill will be Rs. 60,000 (Rs. 20,000 × 3), if threeyears, purchase of the past average profits constitute the basis of valuationof the goodwill.

Illustration 12 (Goodwill)

The profit for the last five years of a firm were as follows year 1999 Rs. 4,00,000;year 2000 Rs. 3,98,000; year 2001 Rs. 4,50,000; year 2002 Rs. 4,45,000 andyear 2003 Rs. 5,00,000. Calculate goodwill of the firm on the basis of 4 yearspurchase of 5 years average profits.

Solution

Year *Rs.*	*Profit* *Rs.*
1999	4,00,000
2000	3,98,000
2001	4,50,000
2002	4,45,000
2003	5,00,000
Total	**21,93,000**

Average Profit $= \dfrac{\text{Total profit of last 5 years}}{\text{No. of years}} = \dfrac{\text{Rs. } 21,93,000}{5} = \text{Rs. } 4,38,600$

Goodwill = Average Profits × No. of years purchased
= Rs. 4,38,600 × 4 = Rs. 17,54,400

llustration 13 (Goodwill)

Compute the value of goodwill on the basis of four years' purchase of the average profits based on the last five years.

The profits for the last five years were as follows :

Year	Rs.
1999	40,000
2000	50,000
2001	60,000
2002	50,000
2003	60,000

Solution

Calculation of Average Profits

Year	(Profits) Rs.
1999	40,000
2000	50,000
2001	60,000
2002	50,000
2003	60,000
Total	**2,60,000**

Average Profits = 2,60,000/5
= Rs. 52,000
Goodwill = Rs. 52,000 × 4
= Rs. 2,08,000

Illustration 14 (Goodwill)

The following were the profits of a firm for the last three years.

Year ending March 31	Profit (Rs.)
2000	4,00,000 (including an abnormal gain of Rs. 50,000)
2001	5,00,000 (after charging an abnormal loss of Rs. 1,00,000)
2002	4,50,000 (excluding Rs. 50,000 payable on the insurance of plant and machinery)

Calculate the value of firm's goodwill on the basis of two years purchase of the average profits for the last three years.

Solution

Calculation of average maintainable profits.

Year ended	*Profit (Rs.)*
2000 (4,00,000 – 50,000)	3,50,000
2001 (5,00,000 + 1,00,000)	6,00,000
2002 (4,50,000 – 50,000)	4,00,000
Total	**13,50,000**

$$\text{Average profit} = \frac{\text{Rs.}13,50,000}{3} = \text{Rs. } 4,50,000$$

Goodwill at 2 years purchase of Average Profit

$$= \text{Rs. } 4,50,000 \times 2 = \text{Rs. } 9,00,000$$

The above calculation of goodwill is based on the assumption that no changein the overall situation of profits is expected in the future.

1. Weighted Average Profit Method :This method is a modified version of theearlier method. Under this method each year's profit is multiplied by therespective number of weights i.e. 1,2,3,4 etc., in order to find out value ofproduct and the total of products is then divided by the total of weights inorder to ascertain the weighted average profits. Thereafter, the weightedaverage profit is multiplied by the agreed number to find out the value ofgoodwill.

Weighted average profit method of valuation of goodwill is better than the simple average profit method because it gives weight age to latest profit, which is likely to be maintained in the future by the firm. It is applicable when the profit shows a rising or falling trend.

Change in Profit Sharing Ratio

Sometimes, the partners of a firm may agree to change their existing profit sharing ratio. As a result of this, some partners will gain in future profits while others will lose. In such a situation, the partner who gains by the change in the profit sharing ratio must compensate the partner who has made the sacrifice because this effectively amounts to one partner buying the share of profits from another partner. For example, Anu and Benu are partners in a firm sharing profits in the ratio of 3:2. They decide to have an equal share in profits in future. In this case, Anulooses 1/l0th (3/5 – 1/2) share of profits and Benu gains this 1/l0th. Hence, Benu must compensate Anu for her loss in the share of future profits.

The amount of compensation will be equal to the proportionate amount of goodwill. Suppose, the total value of goodwill is ascertained as

Rs. 50,000/-, then Benu must pay 1/10 of Rs. 50,000/-, i.e. Rs. 5,000 to Anu.

Alternatively, Benu's Capita1 Account be debited by Rs 5,000 and Anu's Capital

Account credited with Rs. 5,000. The entry, thus, will be :

Benu's Capital a/c Dr. 5,000

Anu's Capital a/c 5,000

Alternatively, if the amount is paid privately by the gaining partner to the other partner, then no entry is made in the books of the firm.

Apart from the payment of compensation for goodwill, the change in profit sharing ratio may also necessitate adjustment in the partners' capital accounts with regard to reserves, revaluation of assets and liabilities, etc. These are similar to those made at the time of the admission or retirement of a partner. All these aspects will be discussed in details in chapter dealing with admission of a partner.

Joint Life Policy

A life assurance policy obtained jointly on the lives of the members of a partnership firm is called a joint life policy. Since the firm has an insurable interest in the lives of its members, hence to make finances available for payment to the retiring partner on his retirement or to the legal heirs of the deceased partner, it obtains a joint life policy. The payment for the policy may be made either privately by the partners or by the firm. The joint life policy matures on the death of any one of the partners or on the expiry of the time for which it is obtained. Maturity of the policy means that the insurance company becomes liable to pay the sum assured to the firm either on the death of a partner or on the expiry of the time whichever happens earlier.

Accounting Treatment

The premium on the joint life policy may be paid either privately by the partners or by the firm. When the premium is paid privately by the partners then no accounting treatment is required in the books of the firm. But when the premium is paid out of the firms cash then the transactions relating to joint life policy will be shown in the books of the firm. The treatment of joint life policy in the books of the firm will depend upon the fact whether the premium paid has been considered as revenue expenditure or capital expenditure.

When premium paid is considered by the firm as a revenue expenditure then it opens in its books an account called 'Joint Life Policy Premium Account'.

Premium paid annually is debited to this account and credited to cash account. At the end of the year the premium paid is transferred to joint life policy account. These two entries of payment of premium and its writing off to profit and loss account are recorded every year. On maturity of the policy the maturity amount received from the insurance company is credited to the capital accounts of all the partners including the retiring/deceased partner in their profit sharing ratio.

When premium paid is considered as a capital expenditure then the firm opens in its books 'Joint Life Policy Account' which is an asset account.

Premium paid is debited to this account and credited to bank account. At the end of the year the 'Joint Life Policy Premium Account' is reduced to surrender value by debiting the difference between the premium paid and surrender value. Surrender value is that amount of money which the insurance company pays to the policy holders in the event of surrendering the policy to the insurance company before the date of its maturity. At the time of maturity of the policy a joint life policy account is credited with an amount which is equal to the claim receivable from the insurance company. Afterwards the joint life policy account is closed by transferring its balance to the capital accounts of all the partners in their profit sharing agreement.

The treatment of Joint Life Policy has been discussed in detail in the chapter on retirement/death of a partner.

KARPAGAM ACADEMY OF HIGHER EDUCATION
DEPARTMENT OF MANAGEMENT
I BBA - (2017 - 2020 BATCH)
II SEMESTER
BUSINESS ACCOUNTING (17BAU202)
UNIT V

POSSIBLE QUESTIONS
PART B

1. Define Partnership
2. Bring out the basic concepts in Admission?
3. Mention the basic concepts in retirement?
4. List the aspects in profit sharing ratio among partners?
5. Write a short note of treatment of partnership account on death of a partner?
6. Write a short note of treatment of partnership account on retirement of a partner?
7. Explain the treatment of partnership account on including of goodwill?
8. P,Q and R are partners sharing profits and losses in the ratio of 5:3:2 respectively. Q retires. Q's share of profit is taken up by P and R in their profit sharing ratio. Calculate the new ratio.
9. Give the meaning for partnership deed
10. Write any two feature of partnership firm

***CIA- 3 X 2 = 6 (ANSWER ALL THE QUESTIONS)**

****ESE - 5 X 2 = 10 (ANSWER ALL THE QUESTIONS)**

PART C

1. Elaborate the treatment of partnership account in admission a new partner and retirement of partner?

2. Elucidate the treatment of partnership account on attainment of goodwill?

3. Anitha and Banu are partners in a firm. They share profits and losses in the ratio of 3:1. Their Balance sheet is as follows :

Liabilities	Amount	Assets	Amount
Capital Anitha	75,000	Buildings	1,00,000
Banu	35,000	Plant	25,000
Reserve	40,000	Stock	30,000
Creditors	60,000	Debtors	70,000
Bills Payable	20,000	Cash	5,000
	2,30,000		2,30,000

Chitra is admitted into partnership for $1/5^{th}$ share of the business on the following terms:

a. Building is revalued at Rs. 1,20,000
b. Plant is depreciated to 80%
c. Provision for bad debts is made at 5%
d. Stock is revalued at Rs. 30,000
e. C should introduce 50% of the adjusted capitals of both A and B. Open various accounts and the new Balance sheet after the admission of C.

4. Give two circumstances in which adjustment for goodwill is usually required: Explain it with suitable examples?

   i) When a new partner is admitted
   ii) When a partner retires or dies

5. A, B and C are partners in a firm sharing profits and losses in the ratio of 1/3:1/2:1/6 respectively Their Balance Sheet as on 31.03.2006 was as follows.

Liabilities	**Amount**	**Assets**	**Amount**

Reserve Fund	16,000	Building	50,000
Capital A	30,000	Machinery	40,000
B	40,000	Furniture	10,000
C	25,000	Stock	25,000
Loan payable	15,000	Debtors 18,000 Less: Provision 500	17,500
Sundry Creditors	25,000	Cash	8,500
	1,51,000		**1,51,000**

'C' retires on 31.03.2006 subject to the following conditions:

a. Goodwill of the firm is valued at Rs. 24,000
b. Machinery to be depreciated by 10%
c. Furniture to be depreciated by 5%
d. Stock to be appreciated by 15% and buildings to be appreciated by 10%
e. Reserve for doubtful debts to be raised to Rs. 2,000.

Prepare necessary ledger accounts and show the Balance Sheet of the new firm.

6. Describe the provisions affecting accounting treatment in absence of a partnership deed?
7. Explain the features of partnership?
8. Discuss the different methods of computing goodwill?
9. Explain the importance of revising the profit sharing ratio in a firm while admitting a partner?
10. Explain the importance of revising the profit sharing ratio in a firm at the time of retirement a partner?

***CIA- 3 X 8 = 24 (EITHER OR TYPE)**

****ESE- 5 X6 = 30 (EITHER OR TYPE)**

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(Established under section 3 of UGC Act, 1956)
Coimbatore-641021
Department of Management

Name: **Dr.M.NANDHINI (Associate Professor)**
Department: **Management**
Course Code: **17BAU202** Semester: **II** Year: **2017-20 Batch**
Course: **Business Accounting – Assignment Title**

S.No.	REGISTER NUMBER	NAME OF THE STUDENT	Assignment Title
1	17BAU002	Abinaya.D	Accounting – Origin, Book Keeping
2	17BAU003	Abisha.J	Accounting – Objects and Features
3	17BAU004	Aishwarya.S	Accounting – Functions
4	17BAU005	Akshay K Ajay	Accounting – Merits and Demerits
5	17BAU006	Anto William . P	Branches of Accounting
6	17BAU007	Aravind Kumar. P	Accounting – Classification
7	17BAU008	Aravind. M	Accounting System
8	17BAU009	Balaji. P	Accounting – Rules
9	17BAU010	Elavarasan. K	Journal
10	17BAU011	Govarthini. S	Ledger
11	17BAU012	Immanuvel. G	Trial Balance
12	17BAU013	Jegadheesh Kumar. S	Subsidiary Book
13	17BAU014	Kannan. M	Accounting concepts
14	17BAU015	Kowsika. V	Accounting Conventions
15	17BAU016	Kumar. C	IFRS
16	17BAU017	Manikandan. G	Depreciation – Meaning and Causes
17	17BAU018	Manikandan. M	Methods – Straight Line method
18	17BAU019	Marimuthu. M	Methods – Diminishing Balance method
19	17BAU020	Mohammed Ameen . B	Sum of digit method
20	17BAU021	Nagoor mohideen. S	Insurance Method
21	17BAU022	Nagulan. R. V	Depletion
22	17BAU023	Natarajan. S	Bank Reconciliation Statement
23	17BAU024	Naveen. N	Final Accounts – Meaning
24	17BAU025	Naveeth.R	Final Accounts – Format
25	17BAU026	Pandiyan. S	Final Accounts – Items to be posted to Debit side
26	17BAU027	Prabhakaran. D	Final Accounts – Items to be posted to credit side
27	17BAU028	Pradeesh. P	Content – Corporate annual Report

28	17BAU029	Praveenkumar. P	Financial Statement – Features
29	17BAU030	Rajagopal. P	Financial Statement – Objectives
30	17BAU031	Rajeshwari . K	Financial Statement – Advantages and Limitations
31	17BAU032	Ramasamy Ahilan	Financial Statement – Sources of Information
32	17BAU033	Riyazuddin. B	Techniques of Financial Statement
33	17BAU034	Ruban Raj Kumar. K	Ration Analysis - Features
34	17BAU035	Sakthivel. E	Ration Analysis – Merits and Demerits
35	17BAU036	Santhosh. N	Ration Analysis – Short Term Solvency Ratio
36	17BAU037	Saranya.G	Ration Analysis – Long Term solvency Ratio
37	17BAU038	Sheik Arfath. R	Ration Analysis – Activity Ratio
38	17BAU039	Sindhuja. R	Ration Analysis = Profitability Ratio
39	17BAU040	Sivaram. C	Importance of Financial Statement Analysis
40	17BAU041	Sivasakthi. L	Partnership - Features
41	17BAU042	Sruthi. R	Partnership - Advantages and Disadvantages
42	17BAU043	Swathi. J	Partnership – Admission
43	17BAU044	Tarun Kumar. R	Partnership - Admission – Treatment of Goodwill
44	17BAU045	Tony Akash. G. J	Partnership - Retirement
45	17BAU046	Vasunthara. S	Partnership - Retirement - Treatment of Goodwill
46	17BAU047	Venkatesh. A	Partnership - Death
47	17BAU048	Vennila. R	Partnership – Death - Treatment of Goodwill
48	17BAU049	Vetriselvan. K	Financial Statement - Joint Stock companies
49	17BAU050	Vidhya Shree. G	Subsidiary Book - Features

50	17BAU051	Vignesh. R	Accounting Standard
51	17BAU052	Vignesh.C	BRS - Format
52	17BAU053	Vigneshwaran. M	Accounting concept
53	17BAU054	Vinodkumar. P	Accounting Convention
54	17BAU055	Vinoth kumar. P	Accounting - Functions
55	17BAU056	Wasim Agram. S	Accounting – Merits and Demerits

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Coimbatore-641021
Department of Management

Name: **Dr.M.NANDHINI (Associate Professor)**
Department: **Management**
Course Code: **17BAU202** Semester: **II** Year: **2017-20 Batch**
Course: **Business Accounting – Seminar Topic**

S.No.	REGISTER NUMBER	NAME OF THE STUDENT	Seminar Topic
1	17BAU002	Abinaya.D	Accounting – Origin, Book Keeping
2	17BAU003	Abisha.J	Accounting – Objects and Features
3	17BAU004	Aishwarya.S	Accounting – Functions
4	17BAU005	Akshay K Ajay	Accounting – Merits and Demerits
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Register No.: ....
[17BAU202]

KARPAGAM ACADEMY OF HIGHER EDUCATION
(Deemed to be University Established Under Section 3 of UGC Act, 1956)
COIMBATORE – 641021
(For the candidates admitted from 2017 onwards)
I INTERNAL EXAMINATION – JANUARY 2018
SECOND SEMESTER

I BBA

BUSINESS ACCOUNTING

Date: 20.01.2018 - FN
Maximum: 50 Marks
Time: 2 Hours

PART – A (20 X1 = 20 Marks)
ANSWER ALL THE QUESTIONS

1 The concept that recognizes revenue and expense as they are earned or incurred is ______________

a. Cost b. Realization c. Accrual d. Matching

2. Furniture is a ____________

a. Fixed asset b. Current asset c. Liquid asset d. Tangible asset

3. The Financial record should always be published in a definite time period according to ___________

a. Accounting Period Concept b. Cost Concept c. Money Measurement Concept
d. Consistency Concept

4. Purchases Book, Sales Book, Purchase Return Book and Sales Return Book are __________

a. Day book b. Cash book c. Subsidiary book d. Debtors book

5. When cash is withdrawn from bank for office use, cash account will be _______

a. Debited b. Credited c. Posted d. Contra

6. Management Accounting is primarily concerned with the supply of information which is useful to _________

a. Suppliers b. Employees c. Management d. Supervisors

7. The book used for recording transactions relating to return of goods to the business___________

a. Cash book b. Sales book c. Purchase book d. Sales return book

8. Cash sales are recorded in ___________

a. Cash book b. Purchase book c. Sales return book d. Sales book

9. When asset is purchased for cash ________ a /c is debited

a. Cash b. Bank c. Debtors d. Asset

10. The example of intangible asset is__________

a. Land b. Building c. Furniture d. Patents

11. All transactions are first recorded in ___________

a. Journal b. Ledger c. Trial Balance d. Subsidiary Book

12. Expenses like wages, salaries, lighting are ______

a. Nominal account b. Real account c. Personal account d. Cash account

13. When a proprietor, withdraw cash from the business for his personal use _____ account will be debited

a. Drawings b. Cash c. Withdrawal d. Bank

14. The cash sales made to surya, _____ account will be debited

a. Cash account b. Purchases account c. Sales account d. Surya account

15. Depreciation is a process of __________

a. Allocation b. Valuation c. Reduction d. Appreciation

16. The main objective of providing depreciation is to calculate ___________

a. Estimated Profit b. True Profit c. Abnormal Profit d. Super Profit

17. Straight Line Method is otherwise called as _________ Method.

a. Fixed Installment b. Written Down Value c. Annuity d. Machine Hour Rate

18 Written Down value method is otherwise known as _________ Method

a. Diminishing balance b. Annuity c. Original cost d. Insurance Policy

19 __________ is a Current asset

a. Bills Receivable b. Furniture c. Machinery d. Building

20. Mention the two accounting principles__________

a. Accounting Concepts and practice b. Accounting Terms and Conditions
c. Accounting Period and Realization d. Accounting Concepts and Convention

PART – B (3 X 2 = 6 Marks)
ANSWER ALL THE QUESTIONS

21. Define Accounting

22. Define Depreciation

23. Journalize the following :

1st June 2017 : Received cash from Mani Rs. 500.

2nd June 2017 : Paid cash to Rajesh Rs. 300.

PART – C (3 X 8 = 24 Marks)
ANSWER ALL THE QUESTIONS

24. a. 'Every debit has got a credit and vice versa'. Explain the significance of this statement with suitable examples.

Or

b. Journalize the following transaction of Manisha & Co.:

July 2015	Rs.
1 Commenced business with cash	15, 00, 000
2 Purchased goods for cash	10, 000
4 Sold goods for cash	25, 000
6 Purchased goods from Mohan	5, 000
7 Sold goods to Rahul	35, 000
8 Rent paid	6, 500
9 Received cash from Rahul in full settlement	34, 950
and discount allowed	50
13 Paid cash to Mohan in full settlement	4, 950
and discount received	50
15 Commission paid	200
25 Interest received	500

25.a. Explain the different methods of depreciation with suitable illustration?

Or

b. Prepare Trail balance from the following information as on 31st December, 2016

Particulars	Rs.
Cash in hand	540
Cash at Bank	2,630
Purchases Account	40,675
Sales Account	98,780
returns Inwards Account	680
Returns Outwards Account	500
Wages Account	10,480
Fuel and Power Account	4,730
Carriage Inward	3,200
Rent	2,040
Opening Stock	5,760
Buildings	30,000
Land	10,000
Machinery	20,000
Electricity charges	7,500
Salaries Account	15,000
General Expenses Account	3,000
Insurance Account	600
Commission	5,245
Capital	71,000
Sundry Debtors	14,500
Sundry Creditors	6,300

26. a. Enter the following transactions in proper subsidiary books of Ram:

2015	Rs.
March 1 Sold goods to Ramesh	5, 250
2 Ramesh retuned goods	1, 500
3 Purchased goods from Mangal	3, 500
4 Returned goods to Mangal	500
5 Sold goods to Ramsaran	1, 000
6 Sold goods to Guna	1, 500
7 Bought goods from Devilal with trade discount of 10%	2, 500
8 Sold to Rajaram at a trade discount of 5%	3, 500

Or

b. A Machine purchased on 1st July 2008 at a cost of Rs. 14,000 and Rx. 1,000 was spent on its installation. The depreciation is written off at 10% on the original cost every year. The books are closed on 31st December each year. The machine was sold for Rs. 9,500 on 31st March, 2011. Show the Machinery Account for all the three years.

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COIMBATORE – 641 021
(For the candidates admitted from 2017 onwards)
I Internal Examination, January - 2018
I BBA
II Semester
BUSINESS ACCOUNTING
COURSE CODE : 17BAU202

ANSWER KEY

PART – A (20 X 1 = 20 Marks)

Q.No.	Answer
1	Matching
2	Fixed asset
3	Accounting Period Concept
4	Subsidiary Book
5	Debited
6	Management
7	Sales return book
8	Cash book
9	Asset
10	Patents

Q.No.	Answer
11	Asset
12	Nominal account
13	Drawings
14	Cash account
15	Allocation
16	True Profit
17	Fixed Installment
18	Diminishing balance
19	Bills Receivable
20	Accounting Concepts and Convention

PART – B (3 X 2 = 6 Marks)

ANSWER ALL THE QUESTIONS

21. Define Accounting

American Institute of Certified Public Accountants (AICPA) which defines accounting as "the art of recording, classifying and summarizing in a significant manner and in terms of money, transactions and events, which are, in part at least, of a financial character and interpreting the results thereof".

22. Define Depreciation

"A non-cash expense (also known as non-cash charge)that provides a source of free cash flow. Amountallocated during the period to amortize the cost ofacquiring long-term assets over the useful life of the assets"

23. Journal Entry

Date	Particulars	LF	Rs.	Rs.
1st June 2017	Cash a/c Dr To Mani a/c		500.	 500
2nd June 2017	Rajesh a/c Dr To Cash a/c		300	 300
	TOTAL		**800**	**800**

PART – C (3X 8 = 24 Marks)

ANSWER ALL THE QUESTIONS

24. a. Every debit has got a credit and vice versa'. Explain the significance of this statement with suitable examples.

Business transactions are recorded in two different ways.

Single Entry

Double Entry

Single Entry: It is incomplete system of recording business transactions. The business organization maintains only cash book and personal accounts of debtors and creditors. So the complete recording of transactions cannot be made and trail balance cannot be prepared.

Double Entry: It this system every business transaction is having a two fold effect of benefits giving and benefit receiving aspects. The recording is made on the basis of both these aspects. Double Entry is an accounting system that records the effects of transactions and other events in at least two accounts with equal debits and credits.

STEPS INVOLVED IN DOUBLE ENTRY SYSTEM

(a) Preparation of Journal

(b) Preparation of Ledger.

(c) Trial Balance preparation

(d) Preparation of Final Account.

Or

24. b. Journal Entry

Date	Particulars	LF	Rs.	Rs.
01.07.2015	Cash a/c Dr To Capital a/c		15, 00, 000	15,00,000
02.07.2015	Purchases a/c Dr To Cash a/c		10, 000	10, 000
04.07.2015	Cash a/c Dr To Sales a/c		25, 000	25, 000
06.07.2015	Mohan a/c Dr To Cash a/c		5, 000	5, 000
07.07.2015	Raghul a/c Dr To Sales a/c		35, 000	35, 000
08.07.2015	Rent a/c Dr To Cash		6, 500	6, 500
09.07.2015	Cash a/c Dr Discount Allowed a/c Dr		34, 950 50	

	To Raghul a/c			35,000
13.07.2015	Mohan a/c Dr To Cash a/c To Discount Received a/c		5,000	4, 950 50
15.07.2015	Commission a/c Dr To Cash a/c		200	200
25.07.2015	Cash a/c Dr To Commission a/c		500	500
	TOTAL		**16,22,200**	**16,22,200**

25.a. . Explain the different methods of depreciation with suitable illustration?

METHODS OF CALCULATING DEPRECIATION

The following are various methods of depreciation in use:

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

Or

25. b. Trail balance for the year ending31st December, 2016

Particulars	Debit Balance Rs.	Credit Balance Rs.
Cash in hand	540	
Cash at Bank	2,630	
Purchases Account	40,675	
Sales Account		98,780
Returns Inwards Account	680	

Returns Outwards Account		500
Wages Account	10,480	
Fuel and Power Account	4,730	
Carriage Inward	3,200	
Rent	2,040	
Opening Stock	5,760	
Buildings	30,000	
Land	10,000	
Machinery	20,000	
Electricity charges	7,500	
Salaries Account	15,000	
General Expenses Account	3,000	
Insurance Account	600	
Commission	5,245	
Capital		71,000
Sundry Debtors	14,500	
Sundry Creditors		6,300
TOTAL	**1,76,580**	**1,76,580**

26. a. SUBSIDIARY BOOKS OF RAM

PURCHASE BOOK

Date	Particulars	LF	Details	Rs.
3.03.2015	Mangal			3, 500
7.03.2015	Devilal **Less :** Discount		2,500 250	 2,250
	Purchases Account Dr			**5,750**

SALES BOOK

Date	Particulars	LF	Details	Rs.
1.03.2015	Ramesh			5, 250
5.03.2015	Ramsaran			1,000
6.03.2015	Guna			1, 500

8.03.2015	Rajaram **Less :** Discount		3,500 175	3,325
	Sales Account Cr			**11,075**

PURCHASE RETURN BOOK

Date	Particulars	LF	Details	Rs.
1.03.2015	Mangal			500
	Purchase Return Account Cr			**500**

SALES RETURN BOOK

Date	Particulars	LF	Details	Rs.
2.03.2015	Ramesh			1, 500
	Sales Return Account Dr			**1,500**

Or

26. b. Depreciation

I YEAR – Rs.1,500

II YEAR – Rs.1,500

III YEAR – Rs.1,500

Loss on Sale of Machinery – Rs.1,000

Reg. No................................

[16BAU202]

KARPAGAM UNIVERSITY

Karpagam Academy of Higher Education
(Established Under Section 3 of UGC Act 1956)
COIMBATORE – 641 021
(For the candidates admitted from 2016 onwards)

BBA DEGREE EXAMINATION, APRIL - 2017

Second Semester

BUSINESS ADMINISTRATION

BUSINESS ACCOUNTING

Time: 3 hours Maximum : 60 marks

PART – A (20 x 1 = 20 Marks) (30 Minutes)
(Question Nos. 1 to 20 Online Examinations)

PART B (5 x 2 = 10 Marks) (2 ½ Hours)
Answer ALL the Questions

21. Explain the Going Concern Concept?
22. From the following particulars, prepare a Bank Reconciliation Statement as on 31.03.2013
    i) Balance as per Pass book Rs. 2,400
    ii) Cheques issued to creditors amounting to Rs. 1,340 were not presented to the bank before 31.03.2013
    iii) Cheques amounting to Rs. 1,900 deposited into bank were not collected and credited before 31.03.2013
23. From the following information ascertain Net Profit :

	Rs.		Rs.
Gross Profit	95,000	Stationery	5,840
Commission Received	800	Advertisement	15,500
Interest	2,850	Carriages Outwards	185

24. List out the limitations of Financial Statements?
25. Prem and Chandra share profits in the ratio of 7:3. Rama was admitted as a partner. Prem surrendered 1/7th of his share and Chandra 1/3 of his share in favour of Rama. Calculate new ratio.

PART C (5 x 6 = 30 Marks)
Answer ALL the Questions

26. a. Prepare Trail balance from the following information as on 31st December, 2013

Particulars	Rs.
Cash in hand	540
Cash at Bank	2,630
Purchases Account	40,675
Sales Account	98,780
Returns Inwards Account	680
Returns Outwards Account	500
Wages Account	10,480
Fuel and Power Account	4,730
Carriage Inward	3,200
Rent	2,040
Opening Stock	5,760
Buildings	30,000
Land	10,000
Machinery	20,000
Electricity charges	7,500
Salaries Account	15,000
General Expenses Account	3,000
Insurance Account	600
Commission	5,245
Capital	71,000
Sundry Debtors	14,500
Sundry Creditors	6,300

Or

b. Enter the following transactions in proper subsidiary books of Ram:

2015		Rs.
March 1	Sold goods to Ramesh	5, 250
2	Ramesh retuned goods	1, 500
3	Purchased goods from Mangal	3, 500
4	Returned goods to Mangal	500
5	Sold goods to Ramsaran	1, 000
6	Sold goods to Guna	1, 500
7	Bought goods from Devilal with trade discount of 10%	2, 500
8	Sold to Rajaram at a trade discount of 5%	3, 500

27. a. Briefly describe the needs of preparing Bank Reconciliation Statement and explain the method of preparation with suitable examples?

Or

b. A Furniture was purchased on 1st January 2010 for Rs. 1,00, 000 and its installation charges are Rs. 10,000, at the end of the third year the furniture was sold for Rs. 80000. Depreciation is to be charged @ 10% p.a. Show Furniture Account for three years under Straight Line Method.

28. a. The following are the balance exacted from the books of Ganesh as on 31.12.2014. Prepare Trading , Profit and Loss account and Balance sheet for the year ending 31.12.2014.

Trial balance as on 31.12.2014

Debit Balances	Rs.	Credit Balances	Rs.
Drawings	4, 000	Capital	20, 000
Cash at bank	1, 700	Sales	16, 000
Cash in hand	6, 500	Sundry creditors	4, 500
Wages	1, 000		
Purchases	2, 000		
Stock 1.1.2014	6, 000		
Buildings	10, 000		
Sundry debtors	4, 400		
Bills receivable	2, 900		
Rent	450		
Commission	250		
General expenses	800		
Furniture	500		
Total	**40,500**	**Total**	**40,500**

The following adjustments are to be made:
i) Stock on 31.12.2014 was Rs. 4, 000
ii) Interest on capital at 6% to be provided
iii) Interest on Drawings at 5% to be provided
iv) Wages yet to be paid Rs. 100
v) Rent prepaid Rs. 50

Or

b. Elaborate the contents and aspects in financial statements of a Joint Stock Company?

29. a. From the following particulars pertaining to assets and liabilities of a company calculate i) Current ratio ii) Liquid ratio iii) Proprietory ratio iv) Debt equity ration v) Gearing ration

Liability	Amount (Rs.)	Asset	Amount (Rs.)
5000 equity shares of Rs. 100 each	6,00, 000	Land and Building	6, 00, 000
2000 8% Preference shares of Rs. 100 each	2,00, 000	Plant and Machinery	5, 00, 000
40000 9% Debentures of Rs. 100 each	4,00, 000	Stock	2, 40, 000
Reserves	3,00,000	Debtors	3, 00, 000
Creditors	1,50,000	Cash and bank	55, 000
Bank Overdraft	50,000	Prepaid expenses	5, 000
	17, 00, 000		**17, 00, 000**

Or

b. State the objective and explain the importance of financial statement?

30. a. A and B are partners sharing profits in the ratio of 3:1. Their Balance sheet stood as under on 31.03.2004 :

Liabilities	Amount	Assets	Amount
Salary due	5,000	Stock	10,000
Creditors	40,000	Prepaid Insurance	1,000
Capital A : 30,000 B : 20,000	50,000	Debtors 8,000 Less: Provision 500	7,500
		Cash	18,500
		Machinery	22,000
		Buildings	30,000
		Furniture	6,000
	95,000		95,000

C is admitted as a new partner introducing a capital of Rs. 20,000, for his 1/4th share in future profits.

Following revaluations are made:
i) Stock be depreciated by 5%
ii) Furniture be depreciated by 10%
iii) Building be revalued at Rs. 45,000
iv) The provision for doubtful debts should be increased to Rs. 1,000. Pass Journal entries, prepare Revaluation Account and Balance Sheet after admission.

Or

b. Elaborate the different methods for treatment of goodwill at admission of a partner?

Reg. No.................................

[15BAU102]

KARPAGAM UNIVERSITY

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COIMBATORE – 641 021
(For the candidates admitted from 2015 onwards)

BBA DEGREE EXAMINATION, NOVEMBER 2015

First Semester

BUSINESS ADMINISTRATION

FINANCIAL ACCOUNTING

Time: 3 hours Maximum : 60 marks

PART – A (20 x 1 = 20 Marks) (30 Minutes)
(Question Nos. 1 to 20 Online Examinations)

PART B (5 x 8 = 40 Marks) (2 ½ Hours)
Answer ALL the Questions

21. a. Define accounting and explain the Concepts and Conventions?

Or

b. Post the following transaction in the Ledger:

March 2015		Rs.
1	Anil Started business with cash	2, 00, 000
2	Deposited into bank	50, 000
3	Purchased Machinery	45, 000
4	Sold goods to Manisha	65,000
5	Salary Paid	15, 000
6	Received cash from Manisha	65, 000
8	Purchased goods for Nithish	20, 500
	Retuned goods to Nithish	5, 000

22. a. Elaborate the various types of errors with suitable examples?

Or

b. Prepare a Three Columnar Cash Book from the information given below
2015

August 1	Introduced Capital Rs. 9000
2	Bought furniture, payment made by cheque to keshav furniture Mart Rs. 5000
3	Bought stationery through cheque Rs. 1,000
4	Deposited into bank Rs. 7,000
10	Purchase goods through cheque Rs. 800
15	Received cheque Rs. 1,500 for sales
18	Deposited into bank Rs. 500
20	Paid to Mahesh Rs. 980 by cheque and discount received Rs. 20
27	Received cash from subhash Rs. 1,480 and allowed discount Rs. 20
30	Withdrew cash from bank for personal use Rs. 100

23. a. From the following Trial balance, prepare a Trading and Profit and Loss account for the year ended 31.12.2014 and a balance sheet on that date:

Trial balance

Particulars	Debit (Rs.)	Credit (Rs.)
Capital	-	40, 000
Sales	-	25, 000
Purchases	15, 000	-
Salaries	2, 000	-
Rent	1, 500	-
Insurance	300	-
Drawings	5, 000	-
Machinery	28, 000	-
Bank balance	4,500	-
Cash	2, 000	-
Stock 1.1.2014	5,200	-
Debtors	2,500	-
Creditors	-	1, 000
Total	**66,000**	**66, 000**

Adjustments required:

i. Stock on 31.12.2014 Rs. 4, 900
ii. Salaries unpaid Rs. 300
iii. Rent paid in advance Rs. 200
iv. Insurance prepaid Rs. 90

Or

b. Distinguish between single entry system and double entry system?

24. a. From the following prepare a Receipts and payments account

	Rs.
Cash balance as on 1.1.2002	1,750
Bank balance as on 1.1.2002	16,800
Subscriptions received	28,000
Entrance fees collected	10,500
Donations	3,500
Salary	10, 500
Rent paid	4, 200
Furniture purchased	10, 500
Expenses on tournament	3, 500
Printing of stationery	1, 750
Books	4, 200
Miscellaneous expenses	1,050
Cash balance as on 31.12.2002	2, 800

Or

b. A plant was purchased by a company whose accounting year is the calendar year. On 1st April 2001, plant costing Rs. 90,000 was purchased. The company purchased another plant on 1st October 2001 Rs. 60, 000. On 1.7.2002 it purchased another plant costing Rs. 30,000. On 1st January 2003 one third of the plant which was purchased on 1st April 2001 became obsolete and was sold for Rs. 9000. Show the Plant a/c when the depreciation rate by Straight line method is @ 10% p.a.

25. a. Nathan has purchased goods, the due dates of which are as follows. He wishes to give a bill for the total amount due, the bill to be drawn payable on the average due date.

April 15th Rs. 1,100 Due May 18th
May 21st Rs. 625 Due June 24th
May 27th Rs. 1,000 Due July 30th
June 15th Rs. 1,750 Due August 18th

i. Take 18th May (first due date) as the starting point.
ii. Take 18th August (last due date) as the starting point.

Calculate the Average Due Date for above two cases.

Or

b. From the following particulars make out an Account current to be rendered by Nataraj to Aruna as at 30th June, charging interest at 5% per annum.

2015		Rs.
January 1	Balance due to Nataraj by Aruna	900
11	Goods sold by Nataraj by Aruna	2,200
20	Received Bill accepted by Aruna at 2 months for	1,000
February 25	Cash received from Aruna	1,200
March 12	Bought Goods of Aruna	5,500
13	Nataraj accepted Aruna's draft at 1 month for	2,000
April 25	Cash paid to Aruna	2,000
30	Goods sold to Aruna, due end of May	2,400
May 21	Bought goods from Aruna	1,500
June 10	Sold goods to Aruna, due 20th June	2,200
June 25	Bought goods from Aruna	3,000

Reg. No.................................

[12BAU201]

KARPAGAM UNIVERSITY

(Under Section 3 of UGC Act 1956)
COIMBATORE – 641 021
(For the candidates admitted from 2012 onwards)

BBA DEGREE EXAMINATION, APRIL 2014

Second Semester

BUSINESS ADMINISTRATION

FINANCIAL ACCOUNTING

Time: 3 hours Maximum : 100 marks

PART – A (15 x 2 = 30 Marks)
Answer ALL the Questions

1. Give short note on accounting principles?
2. Define financial accounting.
3. State the importance of Financial Accounting?
4. Journalise the following transactions:
   2009 March
   a. Rahul Commenced business with Rs. 32,000: Building Rs.50,000: Machinery Rs. 15,000
   b. Sold goods to Ravi for cash 1,500
5. Prepare the Trial Balance from the following informations:

	Rs.		Rs.
Cash in hand	2,000	Plant and Machinery	5,000
Sales	15,000	Closing Stock	8,000
Salaries	8,500	Bills Receivable	1,500
Wages	5,000	Bills Payable	15,000

6. Find out the Capital which shown in the balance sheet for A & B?

Particulars	A	B
Capital	65,500	90,000
Net Profit	35,500	10,000
Drawings	12,000	8,500

7. Rectify the following errors:
   a. Goods returned to D for Rs. 725 was not recorded.
   b. Goods sold to Shri Ram for Rs. 4,500 was debited to Sitaram.
   c. The Purchase of Machinery for Rs. 12,500 was incorrectly passed through the Invoice Book.

8. How will you rectify the following mistakes?
   a. A sum of Rs. 300 received from Nataraj a tenant towards rent was credited to his account.
   b. Sales Returns Book was undercast(added short) by Rs. 50.

9. On 31st March 2010, the Pass Book of Mr. Kamal showed a debit balance Rs. 6,000. A Comparison of pass book and cash book revealed the following:
   Cheques deposited but not yet cleared by 31st March 2010 Rs. 3,500
   Insurance premium paid by the bank on behalf of Kamal but not recorded in the cash book Rs. 240
   From the above particulars prepare a bank reconciliation statement as on 31st March 2010.

10. On 1st January 2008, the Gudur mines leased some land for a minimum rent of Rs. 3,000 for the first year, Rs. 5,000 in the second year and thereafter Rs. 10,000 per annum merging into a royalty of 75 paise per ton with power to recoup short workings over two years ater occurring of short workings. The outputs were as follows:

2008	3,000 tonnes	2009	22,000 tonnes
2010	8,600 tonnes	2011	50,000 tonnes

    Prepare the Royalty payment schedule.

11. M and N Ltd purchased two assets, particulars of which are given as under:

	Cost Rs.	Turn-in value Rs.	Estimated life
Furniture	7,320	480	6 Years
Plant	15,280	3,280	8 Years

    You are required to determine the amount of depreciation to be written off in each case. Assume the company has adopted Straight line method of depreciation.

12. An asset is purchased for Rs. 50,000. Depreciation is to be provided annually according to the straight-line method. The life of the asset is 5 years and the residual value is Rs. 5,000. You are required to find out the rate of depreciation and amount of depreciation.

13. Arun has withdrawn the following sums of money in the year 2007.

	Rs.
6th October	100
21st December	2,000

    Calculate the average due date.

14. From the following particulars make out an Account current to be rendered by A to B as at 30th June, charging interest at 5% per annum.

January	Rs.
1 Balance due to A by B	1,000
11 Goods sold by A to B	2,500
20. Received Bill accepted by B At two months for	1,000

15. Write the formula for Account Current by Product method and Red Ink Method.

PART B (5 X 14= 70 Marks)
Answer ALL the Questions

16. a. Define the term accounting and explain its functions.

Or

b. Distinguish between single entry system and double entry system.

17. a. From the following transactions you are asked to prepare the subsidiary books.

2011 January	Rs.
Bought goods from Das	3,500
Sold goods to Saran	950
3. Sold goods to Ramesh	750
4. Bought goods from Suresh	1,200
6. Received goods returned by Saran	350
8. Sold goods to Arun for cash	900
9. Purchased goods from Shyam	1,200
10. Returned goods to Suresh	150
11. Sold goods to Roy	900
12. Roy returned us goods	100
13. Sold goods to Ram	600
14. Bought goods from Naresh	2,200
16. Returned goods to Naresh	200
19. Sold goods to Balu	1,500
20. Bought goods from Kajol	3,620
21. Purchased furniture from Vijay steel & Co for cash	4,000
23. Sold goods to Dinesh	260
25. Balu returned us goods	300
29. Dinesh returns us goods	120
31. Returned goods to Kajol	550

Or

b. Consider the following the balances extracted form the books of Mr.Gopal as on 31st December 2007 prepare the final accounts.

	Rs.		Rs.
Capital	20,000	Office Salaries	6,600
Debtors	8,000	Rent	3,900
Creditors	10,000	Trade expenses	2,300
Purchases	60,000	Furniture	10,000
Sales	80,000	Cash in hand	2,400
Opening stock	12,000	Drawings	4,800

Adjustments: Salaries outstanding for December 2007 amounting to Rs. 600. Rent paid in advance for January 2008 Rs.300. Depreciation on furniture @ 10% p.a. Provide interest on capital for the year @ 5% p.a. Stock on 31st December 2007 Rs. 14,000.

18. a. In taking a Trial Balance, a book-keeper finds that debit total exceeds the credit total. This amount is placed to the credit of a newly opened Suspense Account. Subsequently the following mistakes were discovered. Give the correcting entries and prepare the Suspense Account, and prepare a statement to ascertain the difference in Trial Balance.

a. Sales Day Book was overcast by Rs. 300.
b. A sale of Rs. 150 to X was wrongly debited to Y.
c. General Expenses Rs. 78 was posted as Rs. 87.
d. Cash received from C. Das was debited.
e. While carrying forward the total of one page of the Purchases Book to the next, the amount of Rs. 1,235 was written as Rs. 1,325.

Or

b. From the following particulars relating to the business of Vinoth, prepare the bank reconciliation statement.

	Rs.
a. Balance as per Pass book (Cr.)	35,000
b. Cheques issued but not presented	10,000
c. Cheques deposited but not credited	4,500
d. The credit side of the cash column has been over-added by	1,600
e. Banker has given credit in the pass book for interest	150
f. He has also given a wrong credit relating to some other account	400

19. a. Second-hand machinery was purchased on 1st January, 2007 for Rs. 50,000 and Rs. 5,000 and Rs. 5,000 were spent on its repairs and erection immediately. Pm 1st July 2008 another machinery was purchased for Rs.25,000 and on 1st July 2009 the first machinery having become obsolete was auctioned for Rs. 30,000. On the same date another was purchased for Rs. 25,000. On 1st July, 2010 the second machinery was also sold off and it fetched Rs. 23,000. Depreciation was provided on machinery at the rate of 10% on the original cost annually on 31st December. In 2009 the method of providing depreciation was charged to the written down (diminishing) value method, the rate of depreciation being 15%. You are required to prepare machinery account for all the calendar years mentioned here.

Or

b. A Coal Limited leased a colliery on 1st January 2009 at a minimum rent of Rs. 25,000 merging into a royalty of Rs. 60 per ton with a stipulation to recoup short workings over the first three years of the lease. The output for the first four years of the lease was Rs. 10,000: Rs. 12,000: Rs. 25,000 and Rs. 38,000 tons respectively. Draft the necessary Journal entries in the books of the company giving effect to the above.

20. a. Dhamu has purchased goods, the due dates of which are as follows. He wishes to give a bill for the total amount due, the bill to be darawn payable on the average due date.

April 15th Rs. 1,500 Due May 18th
May 21st Rs. 725 Due June 24th
May 27th Rs. 2,000 Due July 30th
June 15th Rs. 1,750 Due August 18th

Take 18th May (first due date) as the starting point.
Take 18th August (last due date) as the starting point.
Calculate the Average Due Date for above two cases.

Or

b. Moorthy has the following transactions with Mohan

2009			Rs.
January	4	Sold Goods to Mohan	500
February	18	Remittances received from Mohan	650
March	5	Bought Goods from Mohan	700
	6	Accepted Mohan Draft at 1 m/d	300
April	14	Cash paid to Mohan	300
	30	Goods sold to Mohan Rs. 232 due end of May	
May	14	Bought goods from Mohan	170
June	3	Sold goods to Mohan	550
June	18	Bought goods from Mohan Rs. 290 due end of July.	

Make out an account current to be rendered by Moorthy at 30th June reckoning interest @ 5% per annum.

Reg. No.................................

[12BAU201]

KARPAGAM UNIVERSITY

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COIMBATORE – 641 021
(For the candidates admitted from 2012 onwards)

BBA DEGREE EXAMINATION, APRIL 2013

Second Semester

BUSINESS ADMINISTRATION

FINANCIAL ACCOUNTING

Time: 3 hours

Maximum : 100 marks

PART – A (15 x 2 = 30 Marks)
Answer ALL the Questions

1. Define the term financial accounting
2. What are the advantages of accounting?
3. What is the necessity of accounting
4. Journalise the following transactions
   2009 April
   a. Arun Commenced business with Rs. 25,000
   b. Bought goods for cash Rs. 9,200
   c. Paid rent by cheque Rs. 1,500
   d. Sold furniture for cash Rs.10,000 to Ramu

5. Enter the following transactions in a Single column cash book

2009 Dec	Rs.
1. Commenced business with cash	50,000
2. Bought goods for cash	20,000
5. Received cash from Arun	2,000
7. Paid cash to Sanjay	2,900
Discount allowed by him	100
10. Paid wages	3,000

6. Ascertain the Gross Profit from the following figures:

	Rs.		Rs.
Opening Stock	8,550	Purchases	13,816
Sales	15,284	Purchases Returns	516
Returns inwards	584	Wages owing	200
Closing stock	15,000		

7. Rectify the following errors:
   a. A credit sale to Raju for Rs. 700 was posted as Rs. 70.
   b. A credit sale to Sharma & Co for Rs. 634 was debited as Rs. 343.
   c. A credit sale to Patel & Co for Rs. 750 was credited to him.

8. How will you rectify the following mistakes :
   a. Goods worth Rs. 56 returned by Sankar, a customer was entered in the Books of Account as Rs. 65.
   b. A sum of Rs. 250 paid to Ram towards his salary stands debited to his personal Account

9. On 31st March 2008, the Pass Book of Mr. X showed a credit balance Rs. 10,500. A Comparision of pass book and cash book revealed the following:
   a. Cheques deposited but not yet cleared by 31st March 2008, Rs. 2,500
   b. Cheques issued by X but not presented for payment before 31st March 2008. Rs. 1,500.

   From the above particulars prepare a bank reconciliation statement as on 31st March 2008.

10. M and N Ltd purchased two assets, particulars of which are given as under:

	Cost Rs.	Turn-in value Rs.	Estimated life
Furniture	10,000	1,000	3 Years
Plant	20,500	3,500	5 Years

You are required to determine the amount of depreciation to be written off in each case. Assume the company has adopted Straight line method of depreciation.

11. An asset is purchased for Rs. 50,000. Depreciation is to be provided annually according to the straight-line method. The life of the asset is 5 years and the residual value is Rs. 5,000. You are required to find out the rate of depreciation and amount of depreciation.

12. A company purchased 10 cars at Rs. 60,000 each. It is estimated that residual value of a car is Rs. 6,000 and the average life is 9 years. At the first year the company sold away one car at Rs: 2,000. You are required to give journal entries for the first year.

13. A Partner has withdrawn the following sums of money in the year 2007. Find the average due date.

	Rs.
1st August	3,000
21st August	500
6th October	100
21st December	1,000

14. From the following particulars make out an Account current to be rendered by A to B as at 31st July, charging interest at 5% per annum.

January

	Rs.
1 Balance due to A by B	800
11 Goods sold by A to B	2,200
20. Received Bill accepted by B at two months for	1,000

15. What is the formula for calculating Average Due Date?

PART B (5 X 14= 70 Marks)
Answer ALL the Questions

16. a. Define accounting and explain its Concepts and Conventions.

Or

b. Determine the process of accounting and explain the types of accounting?

17. a. Enter the following transactions in the cash book with cash, discount, and bank columns.

April 2009

1. Balance of cash in hand Rs.400, overdraft at bank Rs. 5,000.
4. Invested further capital Rs.10,000 out of which Rs. 6,000 deposited in the bank.
5. Sold goods for cash Rs. 3,000.
6. Collected from debtors of last year Rs. 8,000: Discount allowed to them Rs. 200.
10. Purchased goods for cash Rs. 5,500.
11. Paid Ram Vilas our creditor, Rs. 2,500: Discount allowed by him Rs.65
13. Commission paid to our agent Rs. 530.
14. Office furniture purchased form Keshav for cash Rs. 200
14. Rent paid Rs. 50.
14. Electricity charges paid Rs. 10.
16. Drew cheque for personal use Rs. 700.
17. Cash sales Rs. 2,500.
18. Collection from Atal Rs. 4,000 deposited in the bank on 19th April.
19. Drew from the bank for office use Rs. 500.
22. Drew cheque for petty cash Rs. 150.
24. Dividend received by cheque Rs. 50, deposited in the bank on the same date.
25. Commission received by cheque Rs. 230: deposited in the bank on 28th.
29. Drew from the bank for salary of the office staff Rs. 1,500.
29. Paid salary to the manager by cheque Rs. 500.
30. Deposited cash in the bank Rs. 10,000.

Or

b. The following are the Trial Balance of Nathan & Company on 31st December, 2009

Particulars	Dr. Rs.	Cr. Rs.
Cash in hand	540	
Cash at Bank	2,630	
Purchases Account	40,675	
Sales Account		98,780
Returns Inwards Account	680	
Returns Outwards Account		500
Wages Account	10,480	
Fuel and Power Account	4,730	
Carriage on Sales Account	3,200	
Carriage on Purchases Account	2,040	
Stock (1st July 2006) Account	5,760	
Buildings Account	30,000	
Freehold Land Account	10,000	
Machinery Account	20,000	
Patents Account	7,500	
Salaries Account	15,000	
General Expenses Account	3,000	
Insurance Account	600	
Drawings Account	5,245	
Capital		71,000
Sundry Debtors	14,500	
Sundry Creditors		6,300
	1,76,580	1,76,580

Taking into account the following adjustments, prepare Trading and Profit and Loss Account and the Balance Sheet for the year ending 31st December, 2009.

i. Stock on hand on 31st December 2009 was Rs. 680.
ii. Machinery is to be depreciated at the rate of 10% and patents at the rate of 20%.
iii. Salaries for the month of December 2009 amounting to Rs. 1,500 were outstanding.
iv. Insurance includes a premium of Rs. 170 on a policy, is prepaid.
v. Wages include a sum of Rs. 2,000 spent on the erection of a cycle shed for employees an customers.
vi. A Provision for Bad and Doubtful Debts is to be created to the extent of 5% on sundry debtors.

18. a. In taking a Trial Balance, a book-keeper finds that debit total exceeds the credit total by Rs. 352. This amount is placed to the credit of a newly opened Suspense Account. Subsequently the following mistakes were discovered:

Give the correcting entries and prepare the Suspense Account, and prepare a statement to ascertain the difference in Trial Balance.

a. Sales Day Book was overcast by Rs. 100.

b. A sale of Rs. 50 to X was wrongly debited to Y

c. General Expenses Rs. 18 was posted as Rs. 80.

d. Cash received from C. Das was debited.

e. While carrying forward the total of one page of the Purchases Book to the next, the amount of Rs. 1,235 was written as Rs. 1,325.

Or

b. According to Lal's cash book there was a balance of Rs, 8,000 overdrawn on 30th June 2010, on his No. 1 bank Account

On investigation you find:

1. Cheques drawn amounting to Rs. 3,000 had not been presented.
2. Cheques Rs. 1,500 entered in the cash book as paid into bank, had not yet been cleared.
3. A Cheque for Rs. 1,200 drawn on his No. 1 account has been charged by the bank to his No. 2 account.
4. The Payment side of the cash book had been undercast by Rs. 600
5. A dividend, Rs. 400 paid direct to the bank had not been recorded in cash book.
6. Bank charges of Rs. 300 entered in the bank statement had not been entered in the cash book.
7. A cheque of Rs. 600, paid into the bank has been dishonoured and shown as such by the bank; but no entry of the dishonor had been made in the cash book.
8. A charge of Rs. 10 had been entered in the bank statement but not entered in the cash book.

You are required:

i. To show the appropriate adjustments to be made in the cash book, and ii. To prepare a Bank Reconciliation Statement for the No. 1 account

19. a. A second-hand machinery was purchased on 1st January, 2007 for Rs. 30,000 and Rs. 6,000 and Rs. ,000 were spent on its repairs and erection immediately. On 1st July 2008 another machinery was purchased for Rs.26,000 and on 1st July 2009 the first machinery having become obsolete was auctioned for Rs. 30,000. On the same date another was purchased for Rs. 25,000. On 1st July, 2010 the second machinery was also sold off and it fetched Rs. 23,000.

Depreciation was provided on machinery at the rate of 10% on the original cost annually on 31st December. In 2009 the method of providing depreciation was charged to the written down (diminishing) value method, the rate of depreciation being 15%.

You are required to prepare machinery account for all the calendar years mentioned here.

Or

b. Mohan took a mine on lease for 20 years. Rate of Royalty is Rs. 1 per ton. Minimum rent is Rs. 5,000 per year. Next year short workings of that year will not be recouped in which yield will be less than 4,000 tons and the year in which royalty will be more than minimum rent. Only 50% of excess will be used for recoupment of short workings. Prepare the necessary accounts in the books of lessee when the yield for the first four years respectively is 3,500 tons: 7,000 tons: and 9,000 tons.

20. a. Raman has purchased goods, the due dates of which are as follows. He wishes to give a bill for the total amount due, the bill to be drawn payable on the average due date.

April 15th Rs. 1,100 Due May 18th
May 21st Rs. 625 Due June 24th
May 27th Rs. 1,000 Due July 30th
June 15th Rs. 1,750 Due August 18th

i. Take 18th May (first due date) as the starting point;
ii. Take 18th August (last due date) as the starting point.
Calculate the Average Due Date for above two cases.

Or

b. Kiran has the following transactions with Guna.

2009			Rs.
January	4	Sold Goods to Guna	280
February	18	Remittances received from Guna	100
March	5	Bought Goods from Guna	690
	6	Accepted Guna's Draft at 1 m/d	200
April	14	Cash paid to Guna	200
	30	Goods sold to Guna Rs. 232 due end of May	
May	14	Bought goods from Guna	170
June	3	Sold goods to Guna	250
June	18	Bought goods from G Rs. 290 due end of July.	

Make out an account current to be rendered by Kiran at 30th June reckoning interest @ 5% per annum.

(i) Calculate the Interest Products Method

(ii) Interest is calculated on each item

Reg. No.................................

[11BBU302]

KARPAGAM UNIVERSITY

(Under Section 3 of UGC Act 1956)
COIMBATORE - 641 021
(For the candidates admitted from 2011 onwards)

BBM DEGREE EXAMINATION, NOVEMBER 2012

Third Semester

BUSINESS MANAGEMENT (COMPUTER APPLICATIONS)

FINANCIAL ACCOUNTING

Time: 3 hours   Maximum : 100 marks

PART – A (15 x 2 = 30 Marks)
Answer ALL the Questions

1. Define Accounting
2. What is Book-keeping?
3. What is Dual Aspect concept?
4. Define single entry.
5. What is Journal?
6. List out the various subsidiary books maintained by an organization.
7. What is error of principle?
8. What is meant by Rectification of errors?
9. Write any two advantages of Bank Reconciliation statement.
10. Define Depreciation.
11. Give the formula to find out the amount of depreciation under straight-line method of depreciation.
12. What is Royalty?
13. What do you understand by an Account current?
14. Give the meaning of "By Product Method".
15. Explain the term "Grace Days"

PART B (5 X 14= 70 Marks)
Answer ALL the Questions

16. a. Who are the users of accounting information? Explain.

Or

b. Explain in detail the different accounting concepts.

17. a. Prepare a Trial Balance from the following balance of Sriram as on 31st March 2011.

Particulars	Rs.	Particulars	Rs.
Sriram's Capital	51,000	Purchases	30,000
Sriram's Drawing	12,000	Discount (Dr)	1,200
Stock on 1.4.2010	17,000	Sales	65,000
Plant & Machinery	20,000	Carriage inwards	1,200
Office Furniture & Fixtures	1,500	Insurance	800
Sundry Debtors	38,000	Printing & Stationery	675
Sundry Creditors	45,000	Rent and Rates	1,100
Cash at Bank	18,200	Office Salaries	18,300
Cash in Hand	1,750	Return Inwards	2,000
Bills Payable	2,600	Return Outwards	1,925
		Bills Receivable	1,800

Or

b. Mr. Raja's book show the following balances. Prepare his Trading and Profit and Loss account for the year ended 31st March 2005 and Balance Sheet as on that date.

Particulars	Debit (Rs.)	Credit (Rs.)
Stock on 1.4.2004	1,50,000	
Purchases	1,30,000	
Sales	-----	3,00,000
Carriage Inwards	2,000	
Salaries	50,000	
Printing & Stationary	8,000	
Drawing	17,000	
Sundry Creditors	-----	20,000
Sundry Debtors	1,80,000	
Furniture	10,000	
Capital	-----	2,50,000
Postage & Telephone	7,500	
Interest paid	4,000	
Machinery	41,500	
Loan Account		25,000
Suspenses a/c		5,000

Adjustments:

1. Closing stock Rs. 1,20,000
2. Provide 5% for bad & doubtful debts on debtors
3. Depreciate Machinery & furniture by 5%
4. Allow interest on capital at 5%
5. Prepaid printing charges Rs 2,000

18 a. A book keeper finds that the debit side of the Trial balance is short of Rs. 308 and the difference is put to a suspense account. Subsequently, the following errors were disclosed.

i. An entry for sale of goods for Rs. 102 to Madan was posted to his account as Rs. 120.

ii. Rs. 100 being the monthly total of discount allowed to customers were credited to discount account in the Ledger.

iii. Rs. 275 paid by Madan was credited to Sadan's a/c.

iv. Rs. 26 appearing in the cash book as paid for the purchase of stationery for office use, has not been posted to ledger.

v. The debit side of purchases book was under cost by Rs. 100

Make necessary journal entries and prepare the suspense account.

Or

b. From the following particulars prepare a BRS as on 31.03.2009.

1. Overdraft balance as per pass book on 31.3.2009 is Rs. 13,095
2. Cheque deposited in bank not recorded in cash book Rs. 105.
3. Cheque received and recorded in cash book not sent for collection Rs. 1,015.
4. Cheques issued for Rs. 15,075, but cheques for Rs. 9,075 alone were debited in the pass book.
5. Cheques paid into bank for Rs. 9,400 but cheques for Rs. 3,500 alone not credited in the pass book.
6. Insurance premium Rs. 250 paid by but not credited in cash book.
7. Bank charges Rs. 30 was recorded twice in the cash book.
8. Interest of Rs. 1,400 debited in the pass book but not recorded in cash book.

19. a. Ram Brothers purchased a machine on 1st July 2005 at a cost of Rs. 14,000 and spent Rs. 1,000 on its installation. The firm writes off depreciation at 10% of original cost every year. The books are closed on 31st December every year. Give Journal entries (without narration) and prepare machinery a/c and Depreciation a/c for 3 years.

Or

b. Bengal Coal Limited leased a colliery on 1st January, 2004 at a minimum rent of Rs. 15,000 merging into a royalty of Re.1 per ton with a stipulation to recoup shortworkings over the first three years of the lease. The output for the first four years of the lease was 8,000, 13,000, 21,000 and 18,000 tonnes respectively. Draft the necessary journal entries in the books of the Bengal Coal Limited giving effort to the above

20. a. On 1.1.2010 Ramesh Owed Rs. 6,000 to Umesh on account. During the six months ended 30.06.2010, the transaction were as follows in the books of Umesh.

		Rs.
Jan 1	Goods sold to Ramesh	3,000
Feb 1	Amount received from Ramesh	6,000
Mar 1	Goods sold to Ramesh	12,000
Apr 1	Goods purchased from Ramesh	4,500
May 1	Goods sold to Ramesh	15,000
May 1	Cash received from Ramesh	6,000
Jun 1	Goods purchased from Ramesh	7,500
Jun 30	Cash received from Ramesh	3,000

Prepare Account current to be rendered to Ramesh on 30.06.2010. Interest to be calculated at 18% p.a. in months

Or

b. The due dates for the payment of certain amounts are as follows

January 1	Rs. 400 due February 4
February 4	Rs. 500 due April 7
April 1	Rs. 800 due May 4
May 10	Rs. 700 due June 13
May 17	Rs. 1,000 due June 20

Suggest a data on which all the bills may be paid without any loss of interest to any part assuming that the year of transactions is a leap year.
