KARPAGAM ACADEMY OF HIGHER EDUCATION

(Deemed to be University)
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Coimbatore-641021
Department of Management

Name: **Dr.M.Nandhini**
Department: **Management**
Subject Code: **18BAU201** Semester: **II** Year: **2018 -21 Batch**
Subject: **FINANCIAL ACCOUNTING - Lesson Plan**

S.No	Lecture Hours	Contents	References
UNIT I			
1	1	Accounting – Meaning, Definition, Objectives, Functions, Scope, Features	T : Page No : 1.1 – 1.4
2	1	Accounting – Advantages and Limitations	T : Page No : 1.5 – 1.8
3	1	Branches of Accounting, Sub fields of accounting, Accounting cycle, Basis of Accounting Users of Accounting Information	T : Page No : 1.9 – 1.12
4	1	TUTORIAL - Generally Accepted Accounting Principles - Accounting concepts: Business entity, Money measurement, Going concern, Dual aspect	T : Page No : 1.12 – 1.19
5	1	Generally Accepted Accounting Principles – Accounting Conventions: Consistency, Full Disclosure, Conservatism	T : Page No : 1.20 – 1.24
6	1	Accounting standards - Objectives Accounting policies- Accounting as a measurement discipline, valuation principles, Accounting estimates and ASI.	T : Page No : 1.24 – 1.31
7	1	TUTORIAL - International Financial Reporting Standards (IFRS). Understanding Accounting Standards issued by the ICAI related to Disclosure of Accounting Policies.	W1
8	1	Recapitulation and discussion of important questions	
Total Number of hours planned for Unit I			**8**
UNIT II			
1	1	System of Accounting – Single Entry and Double Entry System. Classification of Accounts, Accounting equations, Golden rules of accounting	W2
2	1	Accounting Process: Preparation of journal	R1 : Page No : 61 - 67
3	1	Passing Journal Entries – Capital, Drawing, Purchase, Sale, Salary, Rent, Trade Discount, Cash Discount	R1 : Page No : 68 - 71
4	1	TUTORIAL - Posting to Ledger, Trial balance – Debit Balance, Credit Balance	R1 : Page No : 72 - 85

5	1	Subsidiary Books – Purchase Book, Sales Book, Purchase Return Book, Sales Return Book	R1 : Page No : 92 - 98
6	1	Final Accounts – Meaning, Trading and Profit and Loss Account. Trading Account – Items to be posted to the debit side and credit side of Trading Account	T : Page No : 1.88 – 1.97
7	1	TUTORIAL - Profit and Loss Account – Expenses to be shown and not shown in Profit and Loss Account Balance Sheet – Classification of Assets , Classification of Liabilities	T : Page No : 1.98 – 1.114
8	1	Recapitulation and discussion of important questions	
Total Number of hours planned for Unit II			**8**
UNIT III			
1	1	Depreciation – Meaning, Definition, Depreciable asset and causes of depreciation	T: Page No : 1.140 – 1.144
2	1	Depreciation as apportionment of cost and Need for providing depreciation	W3
3	1	Basis factors taken into consideration while calculating the depreciation expenses	T: Page No : 1.144 – 1.147
4	1	TUTORIAL - Methods of recording depreciation - Straight Line Method	T: Page No : 1.147 – 1.149
5	1	Methods of recording depreciation - Diminishing Value Method	T: Page No : 1.149 – 1.154
6	1	Sum of Digit Method, Annuity Method, Machine Hour Rate Method	T: Page No : 1.154 – 1.157
7	1	TUTORIAL - Depreciation Fund Method, Insurance Policy method, Revaluation Method, Depletion Method	T: Page No : 1.157 – 1.159
8	1	Recapitulation and discussion of important questions	
Total Number of hours planned for Unit III			**8**
UNIT IV			
1	1	Inventory – Meaning, Definition, Features , Basics of Inventory, Inventory Accounting System	W4
2	1	Inventory Valuation – Meaning, Importance	R2 : Page No : 1082 - 1084
3	1	Methods of taking inventories – Periodic and Perpetual inventory method	R2 : Page No : 1084 - 1086
4	1	TUTORIAL - Methods of valuation of inventory – FIFO	R2 : Page No : 1087 - 1090
5	1	LIFO, average cost, HIFO	R2 : Page No : 1090 - 1093
6	1	Base stock method, Inflated price method, market Price method	R2 : Page No : 1093 - 1094
7	1	TUTORIAL - Inventory and its impact on financial statement	R2 : Page No : 1094 -

			1096
8	1	Recapitulation and discussion of important questions	
Total Number of hours planned for Unit IV			**8**
UNIT V			
1	1	Partnership Accounts – Meaning, Definition. Features, Treatment of Goodwill, Methods of valuation of Goodwill	T : Page No : 3.1 – 3.15 W5
2	1	Admission of a partner- Calculation of Net Profit-Sharing Ratio, Revaluation of Assets and Liabilities, Preparation of Realization, Capital and Balance sheet	T : Page No : 3.16 – 3.31
3	1	Retirement of a partner - Calculation of Net Profit-Sharing Ratio, Revaluation of Assets and Liabilities	T : Page No : 3.32 – 3.57
4	1	TUTORIAL - Death of a partner - Calculation of Net Profit-Sharing Ratio, Revaluation of Assets and Liabilities, Revaluation Account, Paying a partners loan in installments	T : Page No : 3.81 – 3.119
5	1	Recapitulation and discussion of important questions	
6	1	Discussion of previous ESE question papers	
7	1	Discussion of previous ESE question papers	
8	1	TUTORIAL - Discussion of previous ESE question papers	3
Total Number of hours planned for Unit 5 and discussion of previous year ESE Question papers			**8**
Total Number of hours allotted for all five units			**40**

SUGGESSTED READINGS

TEXT BOOKS

T - Maheshwari, S.N., Suneel, K., Maheshwari, & Sharad, K., Maheshwari. (2018). Financial Accounting, 6th Edition, Vikas Publishing House Pvt., Ltd., New Delhi

REFERENCES

R1 – R. Narayanaswamy (2017). *Financial Accounting: A Managerial Perspective*. 6th Edition, PHI Learning Pvt., Ltd., New Delhi

R2 - Jain, S.P., and Narang K.L.. (2016). *Financial Accounting*, Kalyani Publishers. New Delhi

WEBSITES

W1 - www.taxmann.com/bookstore/bookshop/bookfiles/samplechapter3.pdf

W2 - www.toppr.com/guides/accountancy/theory-base-of-accounting/systems-and-basis- of-accounting

W3 - www.yourarticlelibrary.com/accounting/depreciation/depreciation-causes-needs-and-consequences/50610

W4 - www.myaccountingcourse.com/inventory

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

Semester – I

18BAU201 **FINANCIAL ACCOUNTING** 4H – 4C

Instruction Hours / week: L: 3 T: 1 P: 0 Marks: Internal: 40 External: 60 Total: 100

End Semester Exam: 3 Hoi

COURSE OBJECTIVES :

To make the students

1. To understand the accounting concepts, convention and accounting standards.
2. To acquire the knowledge to prepare the final accounts.
3. To understand the depreciation methods.
4. To know the inventory valuation techniques.
5. To acquire the knowledge of the partnership accounting.

COURSE OUTCOMES:

Learners should be able to

1. Comprehend the accounting concepts, principles and to comply the accounting standards.
2. Prepare the final accounts.
3. Calculate the asset depreciation using different methods
4. Evaluate the inventory value using different methods.
5. Demonstrate capabilities as problem-solving, critical thinking, and communication skills related to the accounting discipline.

UNIT I Accounting concepts, convention and standards

Meaning & Concept of Financial Accounting – Historical trace of Accounting - Functions and Sub fields of Accounting - Accounting Cycle – Accounting Concepts & Conventions and Generally Accepted Accounting Principles (GAAP),their implications on accounting system; IFRS –International Financial Reporting Standards

UNIT II Final accounts

Double entry system - Classification of Accounts - Accounting Equation – Golden Rules of Accounting.

Journal, Ledger –Subsidiary ledgers - Trial Balance – Preparation of Final Accounts; Trading, Profit and Loss Account – Balance Sheet.

UNIT III Depreciation

Meaning – Need for Depreciation – Causes – Methods: Straight Line Method, Diminishing balance Method and Annuity Method – Their impact on measurement of Business Accounting.

UNIT IV Inventory

The basics of inventory - Inventory accounting systems - Inventory valuation methods - Inventory and its impact on financial statements

UNIT V Partnership Accounting

Fundamentals of Partnership – Definition, meaning and features of a Partnership. Preparation of Profit and Loss Appropriation Account and Capital Accounts. Reconstitution of Partnership – Admission, Change in profit sharing ratio, Retirement and death of a partner, Dissolution of a Partnership firm.

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

SUGGESTED READINGS:

1. Maheshwari, S.N., Suneel, K., Maheshwari, and Sharad, K., Maheshwari. (2018). Financial Accounting, 6th edition, Vikas Publishing House Pvt., Ltd, New Delhi.
2. R. K. Arora (2018), Financial Accounting: Fundamentals, Analysis and Reporting, Wiley, New Delhi.
3. R. Narayanaswamy, R. (2017). Financial Accounting: A Managerial Perspective. 6th Edition, PHI Learning Pvt. Ltd, New Delhi.
4. Asish K. Bhattacharyya (2017), Essentials of Financial Accounting, 4th edition, PHI Learning Private Limited, New Delhi.
5. Jain, S.P.,and Narang K.L. (2016).Financial Accounting, Kalyani Publishers. New Delhi

UNIT-I–Accounting Concepts and Conventions

SYLLABUS

Accounting Concepts, Conventions and Standards: Meaning and concept of financial Accounting – Historical trace of Accounting – Functions and sub-fields of accounting – Accounting cycle – Accounting concepts and Conventions and Generally Accepted Accounting Principles (GAAP), their implications on Accounting system, IFRS – International Financial Reporting Standards

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 needthe information for decision making. It identifies transactions and events of a specificentity. A transaction is an exchange in which each participant receives or sacrificesvalue (e.g. purchase of raw material). An event (whether internal or external) is ahappening of consequence to an entity (e.g. use of raw material for production). Anentity means an economic unit that performs economic activities.

DEFINITION OF ACCOUNTING

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

OBJECTIVE OF ACCOUNTING

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

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 TaxAct.

IMPORTANCE OF ACCOUNTING (USERS OF ACCOUNTING INFORMATION)

i) Owners: The owners provide funds or capital for the organization. Theypossess curiosity in knowing whether the business is being conducted on sound linesor not and whether the capital is being employed properly or not. Owners, beingbusinessmen, always keep an eye on the returns from the investment. Comparing theaccounts of various years helps in getting good pieces of information.

ii) Management: The management of the business is greatly interested inknowing the position of the firm. The accounts are the basis; the management canstudy the merits and demerits of the business activity. Thus, the management isinterested in financial accounting to find whether the business carried on is profitableor not. The financial accounting is the "eyes and ears of management and facilitatesin drawing future course of action, further expansion etc."

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

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

v) Investors: The prospective investors, who want to invest their money in afirm, of course wish to see the progress and prosperity of the firm, before investingtheir amount, by going through the financial statements of the firm. This is tosafeguard the investment. For this, this group is eager to go through the accountingwhich enables them to know the safety of investment.

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

vii) Consumers: These groups are interested in getting the goods at reducedprice. 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 theconsumers. Researchers are also interested in accounting for interpretation.

viii) Research Scholars: Accounting information, being a mirror of thefinancial performance of a business organization, is of immense value to the researchscholar 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 scholarneeds detailed accounting information relating to purchases, sales, expenses, cost ofmaterials used, current assets, current liabilities, fixed assets, long-term liabilities andshare-holders funds which is available in the accounting record maintained by thefirm.

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 accountingbecomes compulsory to comply with legal requirements. Accounting is a base andwith its help various returns, documents, statements etc., are prepared.

iv) Language of Business: Accounting is the language of business. Varioustransactions are communicated through accounting. There are many parties-owners,creditors, government, employees etc., who are interested in knowing the results of thefirm and this can be communicated only through accounting. The accounting shows areal 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 theclose of a year and its financial conditions. The basic function ofaccounting is to supply meaningful information about the financialactivities 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, expensesetc., with those of the previous years.

v) It supplies information useful in judging the management's ability toutilize enterprise resources effectively in achieving primary enterprisegoals.

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

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

LIMITATIONS OF ACCOUNTING

i) Accounting is historical in nature: It does not reflect the current financialposition 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 excludesqualitative elements like management, reputation, employee morale, labour strike etc.

iii) Facts recorded in financial statements are greatly influenced byaccounting conventions and personal judgments of the Accountant orManagement. Valuation of inventory, provision for doubtful debts andassumption about useful life of an asset may, therefore, differ from one business house to another.

iv) Accounting principles are not static or unchanging-alternativeaccounting 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 astrong limitation of accounting.

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

METHODS OF ACCOUNTING

Business transactions are recorded in two different ways.

Single Entry System

Double Entry System

Single Entry System: 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 System: It this system every business transaction is having a two foldeffect of benefits giving and benefit receiving aspects. The recording is made on thebasis of both these aspects. Double Entry is an accounting system that records theeffects of transactions and other events in at least two accounts with equal debits andcredits.

STEPS INVOLVED IN DOUBLE ENTRY SYSTEM

(a) Preparation of Journal: Journal is called the book of original entry. Itrecords the effect of all transactions for the first time. Here the job of recording takesplace.

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

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

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

Advantages of Double Entry System

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

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

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

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

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

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

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

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

ix) No scope for fraud: The firm is saved from frauds and misappropriationssince 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 andcredit relating to accounts. Both debit and credit may represent either increase ordecrease, depending upon the nature of account.

MEANING AND DEFINITION OF BOOK- KEEPING

Book- keeping includes recording of journal, posting in ledgers and balancingof accounts. All the records before the preparation of trail balance is the whole subjectmatter of book- keeping. Thus, book- keeping many be defined as the science and artof 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 becorrectly ascertained. Here it is important to note that only those transactions relatedto business are recorded which can be expressed in terms of money.

DEFINITION

"Book- keeping is the art of recording business transactions in a systematicmanner". A.H.Rosenkamph.

"Book- keeping is the science and art of correctly recording in books ofaccount all those business transactions that result in the transfer of money or money'sworth". 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 abilitieson a particular date.

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

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

v) It is a method gives opportunities to review the business policies in the lightof 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.

BRANCHES OF ACCOUNTING

The changing business scenario over the centuries gave rise to specializedbranches of accounting which could cater to the changing requirements. The branchesof 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 andfinancial results of operations is known as Financial Accounting. It is the originalfrom of accounting. It is mainly concerned with the preparation of financialstatements for the use of outsiders like creditors, debenture holders, investors andfinancial institutions. The financial statements i.e., the profit and loss account and thebalance sheet, show them the manner in which operations of the business have beenconducted during a specified period.

Cost Accounting

In view of the limitations of financial accounting in respect of informationrelating to the cost of individual products, cost accounting was developed. It is thatbranch of accounting which is concerned with the accumulation and assignment ofhistorical costs to units of product and department, primarily for the purpose ofvaluation of stock and measurement of profits. Cost accounting seeks to ascertain thecost of unit produced and sold or the services rendered by the business unit with aview to exercising control over these costs to assess profitability and efficiency of theenterprise. It generally relates to the future and involves an estimation of future coststo be incurred. The process of cost accounting based on the data provided by thefinancial accounting.

Management Accounting

It is an accounting for the management i.e., accounting which providesnecessary information to the management for discharging its functions. According tothe Anglo-American Council on productivity, "Management accounting is thepresentation of accounting information is such a way as to assist management in thecreation of policy and the day-to-day operation of an undertaking."

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

ACCOUNTING PRINCIPLES

The word ‘Principle’ has been differently viewed by different schools ofthought. The American Institute of Certified Public Accountants (AICPA) has viewedthe 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 whichrepresent a consensus view by those indulging in good accounting practices andprocedures. Canadian Institute of Chartered Accountants defined accounting principleas “the body of doctrines commonly associated with the theory and procedure ofaccounting, serving as an explanation of current practices as a guide for the selectionof conventions or procedures where alternatives exist. Rules governing the formationof accounting axioms and the principles derived from them have arisen from commonexperiences, historical precedent, statements by individuals and professional bodiesand regulations of Governmental agencies”. To be more reliable, accounting
statements are prepared in conformity with these principles. If not, chaotic conditionswould result. But in reality as all the businesses are not alike, each one has its ownmethod of accounting. However, to be more acceptable, the accounting principlesshould satisfy the following three basic qualities, viz., relevance, objectivity andfeasibility. The accounting principle is considered to be relevant and useful to theextent that it increases the utility of the records to its readers. It is said to be objectiveto the extent that it is supported by the facts and free from personal bias.
It isconsidered to be feasible to the extent that it is practicable with the least complicationor cost. Though accounting principles are denoted by various terms such as concepts,conventions, doctrines, tenets, assumptions, axioms, postulates, etc., it can beclassified 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., basicassumptions or conditions upon the edifice of which the accounting super-structure isbased. The following are the common accounting concepts adopted by many businessconcerns.

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 personsestablished to accomplish an economic goal. Business entity concept implies that thebusiness unit is separate and distinct from the persons who provide the requiredcapital to it. This concept can be expressed through an accounting equation, viz.,

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

ii) Money Measurement Concept: In accounting all events and transactionsare recode in terms of money. Money is considered as a common denominator, bymeans of which various facts, events and transactions about a business can beexpressed in terms of numbers. In other words, facts, events and transactions whichcannot be expressed in monetary terms are not recorded in accounting. Hence, theaccounting 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 arerecorded assuming that the business will exist for a longer period of time, i.e., abusiness unit is considered to be a going concern and not a liquidated one. Keepingthis in view, the suppliers and other companies enter into business transactions withthe business unit. This assumption supports the concept of valuing the assets athistorical cost or replacement cost. This concept also supports the treatment ofprepaid 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 everydebit has a corresponding and equal amount of credit. This is the underlyingassumption of this concept. The accounting equation viz.,

Assets = Capital +Liabilities or Capital = Assets – Liabilities, will further clarify this concept, i.e., at anypoint 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 ownersare considered as capital.

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

vi) Historical Cost Concept: According to this concept, the transactions arerecorded 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 toacquire the same and that cost is considered to be the base for all future accounting. Itmeans that the asset is recorded at cost at the time of purchase but it may bemethodically reduced in its value by way of charging depreciation. However, in thelight of inflationary conditions, the application of this concept is considered highlyirrelevant for judging the financial position of the business.

vii) Matching Concept: The essence of the matching concept lies in the viewthat all costs which are associated to a particular period should be compared with therevenues 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 forrecording outstanding expenses, prepaid expenses, outstanding incomes, incomesreceived in advance, etc., during the course of preparing the financial statements at theend of the accounting period.

viii) Realization Concept: This concept assumes or recognizes revenue whena sale is made. Sale is considered to be complete when the ownership and propertyare 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 systemwhere 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 wholecontract 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 onits realization and not on its actual receipt. Similarly the costs are recognized whenthey are incurred and not when payment is made. This assumption makes it necessaryto give certain adjustments in the preparation of income statement regarding revenuesand costs. But under cash accounting system, the revenues and costs are recognizedonly when they are actually received or paid. Hence, the combination of both cashand accrual system is preferable to get rid of the limitations of each system.

x) Objective Evidence Concept: This concept ensures that all accountingmust be based on objective evidence, i.e., every transaction recorded in the books ofaccount must have a verifiable document in support of its, existence. Only then, thetransactions can be verified by the auditors and declared as true or otherwise. Theverifiable evidence for the transactions should be free from the personal bias, *i.e.*, itshould 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 accountingrules, concepts, principles, practices and conventions being observed and appliedconstantly, i.e., from one year to another there should not be any change. Ifconsistency is there, the results and performance of one period can he compared easilyand meaningfully with the other. It also prevents personal bias as the persons involvedhave to follow the consistent rules, principles, concepts and conventions. Thisconvention, however, does not completely ignore changes. It admits changes whereverindispensable and adds to the improved and modern techniques of accounting.

ii) Disclosure: The convention of disclosure stresses the importance ofproviding accurate, full and reliable information and data in the financial statementswhich is of material interest to the users and readers of such statements. Thisconvention is given due legal emphasis by the Companies Act, 1956 by prescribingformats for the preparation of financial statements. However, the term disclosure doesnot mean all information that one desires to get should be included in accountingstatements. It is enough if sufficient information, which is of material interest to theusers, is included.

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

BASES OF ACCOUNTING

There are three bases of accounting in common usage. Any one of thefollowing 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 receivedor paid. No entry is passed when a payment or receipt becomes due. Income undercash basis of accounting, therefore, represents excess of receipts over payments duringan accounting period. Government system of accounting is mostly on cash basis.

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

Accrual Basis of Accounting or Mercantile System

Under accrual basis of accounting, accounting entries are made on the basis ofamounts having become due for payment or receipt. Incomes are credited to the periodin which they are earned whether cash is received or not. Similarly, expenses andlosses were detailed to the period in which, they are incurred, whether cash is paid ornot. The profit or loss of any accounting period is the difference between incomesearned and expenses incurred, irrespective of cash payment or receipt. Alloutstanding expenses and prepaid expenses, accrued incomes and incomes received inadvance are adjusted while finalizing the accounts. Under the Companies Act 1956, allcompanies are required to maintain the books of accounts according to accrual basisof accounting.

Mixed or Hybrid Basis of Accounting

When certain items of revenue or expenditure are recorded in the books ofaccount on cash basis and certain items on mercantile basis, the basis of accounting soemployed is called 'hybrid basis of accounting'. For example, a company may followmercantile system of accounting in respect of its export business. However,government subsidies and duty drawbacks on exports to be received from governmentare recorded only when they are actually received i.e., on cash basis. Such a methodcould be adopted because of uncertainty with respect of quantum, amount and time ofreceipt of such incentives and drawbacks. Such a method of accounting followed bythe company is called the hybrid basis of accounting. In practice, the profit or lossshown under this basis will not be realistic. Conservative people who preferrecognizing income when received but cautious to provide for all expenses, whetherpaid 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 inbusiness world. These terms are called accounting terminology.

Transaction

"An event the recognition of which gives rise to an entry in accountingrecords. 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 meansthe exchange of money or money's worth from one account to another account Eventslike purchase and sale of goods, receipt and payment of cash for services or onpersonal 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 orpaid, for something given or received respectively, but gives rise to debtor andcreditor relationship. Non-cash transaction is one where the question of receipt orpayment 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 ofgoods is called a debtor. For example, when goods are sold to a person on credit thatperson pays the price in future, he is called a debtor because he owes the amount tothe 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) whichthe proprietor has invested in the firm or can claim from the firm. It is also known asowner'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 theproprietors. In the words of Finny and Miller, "Liabilities are debts; they are amountsowed 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 otherwords, an asset is that expenditure which results in acquiring of some property orbenefits 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. Itis defined as the inflow of assets which result in an increase in the owner's equity. Itincludes all incomes like sales receipts, interest, commission, brokerage etc.,However, receipts of capital nature like additional capital, sale of assets etc., are not apant of revenue.

Expense

The terms 'expense' refers to the amount incurred in the process of earningrevenue. If the benefit of an expenditure is limited to one year, it is treated as anexpense (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 ofgoods is expenditure, where as cost of goods sold is an expense. Similarly, if an assetis acquired during the year, it is expenditure, if it is consumed during the same year, itis also an expense of the year.

Purchases

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

Sales

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

Stock

The goods purchased are for selling, if the goods are not sold out fully, a partof the total goods purchased is kept with the trader unlit it is sold out, it is said to be astock. 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 forhis domestic or personal use. It is usually subtracted from capital.

Losses

Loss really means something against which the firm receives no benefit. Itrepresents money given up without any return. It may be noted that expense leads torevenue 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 andthe firm. It can also be expressed as a clear and concise record of the transactionrelating to a person or a firm or a property (or assets) or a liability or an expense or anincome.

Invoice

While making a sale, the seller prepares a statement giving the particulars suchas the quantity, price per unit, the total amount payable, any deductions made andshows 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 aparticular transaction has taken place for the value stated in the voucher. Voucher isnecessary to audit the accounts.

Proprietor

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

Discount

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

Solvent

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

Insolvent

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

International Financial Reporting Standards

OVERVIEW OF IFRS

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. They are a consequence of growing international shareholding and trade and are particularly important for companies that have dealings in several countries. They are progressively replacing the many different national accounting standards. The rules to be followed by accountants to maintain books of accounts which is comparable, understandable, reliable and relevant as per the users internal or external. IFRS began as an attempt to harmonize accounting across the European Union but the value of harmonization quickly made the concept attractive around the world. They are sometimes still called by the original name of International Accounting Standards (IAS). IAS were issued between 1973 and 2001 by the Board of the International Accounting Standards Committee (IASC). On 1 April 2001, the new International Accounting Standards Board (IASB) took over from the IASC the responsibility for setting International Accounting Standards. During its first meeting the new Board adopted existing IAS and Standing Interpretations Committee standards (SICs). The IASB has continued to develop standards calling the new standards "International Financial Reporting Standards". In the absence of a Standard or an Interpretation that specifically applies to a transaction, management must use its judgement in developing and applying an accounting policy that results in information that is relevant and reliable.

In making that judgement, IAS 8.11 requires management to consider the definitions, recognition criteria, and measurement concepts for assets, liabilities, income, and expenses in the Framework.

Criticisms of IFRS are

(1) that they are not being adopted in the US (see GAAP),

(2) a number of criticisms from France and (3) that IAS 29 Financial Reporting in Hyperinflationary Economies had no positive effect at all during 6 years in Zimbabwe´s hyperinflationary economy. The IASB offered responses to the first two criticisms, but 3 has offered no response to the last criticism while IAS 29 is currently (March 2014) being implemented in its original ineffective form in Venezuela and Belarus. Globalization of financial markets has meant an increased focus on international standards in accounting and has intensified efforts towards a single set of high quality, globally acceptable set of accounting standards. Financial statements prepared in different countries according to different set of rules, mean numerous national sets of standards, each with its own set of interpretation about a similar transaction, making it difficult to compare, analyse and interpret financial statements across nations. A financial reporting system supported by strong governance, high quality standards, and firm regulatory framework is the key to economic development. Indeed, sound financial reporting standards underline the trust that investors place in financial reporting information and thus play an important role in contributing to the economic development of a country. Needless to mention, internationally accepted accounting standards play a major role in this entire process. It is in this context that the role of an independent, global standard-setting body such as the International Accounting Standards Board (IASB) is of critical importance.

The principal objectives of the IASB are:

- To develop a single set of high quality, understandable, enforceable and globally accepted international financial reporting standards (IFRSs) through its standard-setting body, the IASB;
- To promote the use and rigorous application of those standards;
- To take account of the financial reporting needs of emerging economies and small and medium-sized entities (SMEs); and
- To bring about convergence of national accounting standards and IFRSs to high quality solutions. Converging to global accounting standards i.e. IFRS facilitates comparability between enterprises operating in different jurisdictions. Thus, global accounting standards would remove a frictional element to capital flows and lead to wider and deeper investment in markets. Convergence

with IFRS is also in the interest of the industry since compliance with them would be able to create greater confidence in the mind of investors and reduce the cost of raising foreign capital. It is also burdensome and costly 4 for enterprises operating across several countries to comply with a multitude of national accounting standards and convert them to a single standard for group reporting purposes. Convergence would thus help reduce both the cost of capital and cost of compliance for industry. In pursuit of its objectives, the IASB works in close cooperation with stakeholders around the world, including investors, national standard-setters, regulators, auditors, academics, and others who have an interest in the development of high-quality global standards. Progress toward this goal has been steady. All major economies have established time lines to converge with or adopt IFRSs in the near future and more than hundred countries require or permit the use of IFRSs. Though Indian Accounting Standards are framed based on standards issued by the IASB, there are certain differences due to the legal and regulatory environment prevailing in the country, conceptual issues and the economic environment. In 2007 the ICAI decided that India should converge towards IFRS in a definite time frame in the wake of developments taking place in other major jurisdictions which had set up time schedules for migrating towards IFRS. 1.2 Importance of Accounting Standards Accounting as a "Language of Business" communicates the financial results and health of an enterprise to various interested parties by means of periodical financial statements. Like any other language accounting should have its grammar and these sets of rules are Accounting Standards. The objective of Accounting Standards is three-fold. Firstly, they help to standardize the diverse accounting policies and eliminate the incomparability of financial statements within an entity and across entities. Secondly, they facilitate the presentation of high quality, transparent and comparable information in financial statements. Thirdly, they reduce to accounting alternatives and thereby eliminate the element of subjectivity in financial statements. India has a long tradition of framing accounting standards in the country. The Institute of Chartered Accountants of India (ICAI) set up under an act of Parliament had constituted an Accounting Standards Board (ASB) in April 1977 and the ASB has been framing the Indian Accounting Standards for the last three decades. 5 The importance of international accounting practice studies has grown over the past few years in order to meet economic agent demands and to facilitate international business practices. It is essential to understand that international accounting convergence is an important topic for capital market regulators, investors, markets, governments and all others who deal with financial information of public companies. This brings out the importance of accounting as being an essential fiscal tool for various economic agents. The merit of international accounting convergence lies in its ability to minimize negative effects resulting from diversity of accounting practices in different countries (Cordeiro et al. 2007). In such a scenario, the introduction of International Financial Reporting Standards (IFRS) for listed companies in many countries around the world is viewed as one of the most significant regulatory changes in accounting history (Daske et al. 2008). IFRS issued by the International Accounting Standards Board (IASB) are now being recognized as the premier global reporting standards of accounting information world over. Today, more than hundred nations demand or permit the use of IFRS in their countries. Many countries have already announced their willingness to adopt IFRS in their countries. This is becoming the most popular and commonly accepted financial reporting model around the world, such as, European Union, Australia, New Zealand and Russia. The legal frameworks currently permit the use of IFRS in their countries. The importance of IFRS grew as they provide greater comparability of financial information for investors and also encourage them to invest across borders. Studies show that, IFRS adoption help in lowering the cost of capital for the companies and benefits more efficient allocation of capital. Levitt (1998) in his paper on the importance of high-quality accounting standards emphasized the need for harmonization of accounting standards to deliver credible information grounded in transparent financial reporting.

RELEVANCE And the relevance of the IFRS can be mentioned as a substantial advantage due to the following reasons:

- The new IFRS reflects on economic substance more than legal form. This helps the companies and other stakeholders to have true and fair view of the companies' transactions.
- The way IFRS reflects to gains and losses in a timely manner puts IFRS in a more reliable and credible position than the GAAP in terms of reporting standards 32
- The balance sheets prepared under IFRS tends to be more useful due to its layout and the consistency, and the level of complexity compared to GAAP that tended to be more detailed
- The manipulation by managers by creating hidden reserves is not allowed any more under new IFRS, so less manipulative and more shareholders oriented Moreover, other benefits as mentioned during the interview are cost saving with new IFRS especially for multinational

corporations. However, before companies can start enjoying the cost savings, they have to spend considerable amount of money as a transitional costs.

Disadvantages of IFRS

- The most noteworthy disadvantage of IFRS relate to the costs related to the application by multinational companies which comprise of changing the internal systems to make it compatible with the new reporting standards, training costs and etc.
- The issue of regulating IFRS in all countries, as it will not be possible due to various reasons beyond IASB or IASC control as they cannot enforce the application of IFRS by all countries of the world.
- Issues such as extraordinary loss/gain which are not allowed in the new IFRS still remain an issue.
- Another major disadvantage of converting to IFRS makes the IASB the monopolist in terms of setting the standards. And this will be strengthened if IFRS is adopted by the US companies. And if there is competition, such IFRS vs. GAAP, there is more chance of having reliable and useful information that will be produced during the course of competition.
- The total cost of transition costs for the US companies will be over $8 billion and one off transition costs for small and medium sized companies will be in average $420,000, which is quite a huge amount of money to absorb by companies.
- And even though the companies and countries are incurring huge transitional costs, the benefits of IFRS cannot be seen until later point due to the fact that it takes some years for the harmonization and to have sufficient years of financial statements to be prepared under IFRS to improve consistency.
- They key problem in conversion to IFRS that has stressed with high importance is the use of fair value as the primary basis of asset and liability measurements. And the interviewers think that this principle will bring increased volatility as the assets are reported.
- And another disadvantage of IFRS is that IFRS is quite complex and costly, and if the adoption of IFRS needed or required by small and medium sized businesses, it will be a big disadvantage for SMEs as they will be hit by the large transition costs and the level of complexity of IFRS may not be absorbed by SMEs.

- And moreover, one of the aims of European Union from applying and standardizing the reporting standards was to increase the international comparability of financial statements; however, only over 7000 listed companied adopted IFRS from 2005, there were still more than 7000,000 SMEs in EU, which preferred their national version of reporting standards. This contradicts the aim of the EU and partly of IFRS in implementing single international reporting standards.

Advantages of converting to IFRS

By adopting IFRS, a business can present its financial statements on the same basis as its foreign competitors, making comparisons easier. Furthermore, companies with subsidiaries in countries that require or permit IFRS may be able to use one accounting language company-wide. Companies also may need to convert to IFRS if they are a subsidiary of a foreign company that must use IFRS, or if they have a foreign investor that must use IFRS. Companies may also benefit by using IFRS if they wish to raise capital abroad.

Disadvantages of converting to IFRS

Despite a belief by some of the inevitability of the global acceptance of IFRS, others believe that U.S. GAAP is the gold standard, and that a certain level of quality will be lost with full acceptance of IFRS. Further, certain U.S. issuers without significant customers or operations outside the United States may resist IFRS because they may not have a market incentive to prepare IFRS financial statements. They may believe that the significant costs associated with adopting IFRS outweigh the benefits.

KARPAGAM ACADEMY OF HIGHER EDUCATION

DEPARTMENT OF MANAGEMENT

I BBA - (2018 - 2021 BATCH)

II SEMESTER

FINANCIAL ACCOUNTING (18BAU201)

UNIT I

POSSIBLE QUESTIONS

Part A (ONE Mark)

Multiple Choice Questions

Online Examination

PART B

1. Define book keeping
2. Explain the Going Concern Concept?
3. Write a short note on importance of accounting?
4. Distinguish between bookkeeping and accounting?
5. List out the three branches in accounting?
6. Define accounting
7. List out the branches of accounting
8. What is meant by basis of accounting?
9. Who are the users of accounting?
10. Write any two current assets?

***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. Explain the objects of accounting?
3. Discuss the functions of accounting?
4. Describe the merits and demerits of accounting?
5. Explain the accounting cycle stages with suitable illustration?
6. Describe the importance of IFRS?
7. Explain the users of accounting information?
8. Describe the branches of accounting with suitable examples?
9. Explain the importance of basis of accounting?
10. Discuss the importance of accounting cycle?

***CIA- 3 X 8 = 24 (EITHER OR TYPE)**
****ESE- 5 X6 = 30 (EITHER OR TYPE)**

QUESTIONS	OPTION 1	OPTION 2	OPTION 3	OPTION 4	ANSWER
_______ is the method of summarizing and classifying the record of financial transaction in monetary terms	Book keeping	Auditing	Accountancy	ost Accountin	Accountancy
Which of the following is not available in the financial statements of a company _________________	Sales	Purchase	Management decisions	Cash	Management decisions
Which of the following event is subject matter of accounting___________	Death if key executive of the business/company	Strike of workers	Payment of Rs. 10,000 to bank in discharge of outstanding loan	Marriage of the daughter of the managing director of the company	Payment of Rs. 10,000 to bank in discharge of outstanding loan
Management Accounting is primarily concerned with the supply of information which is useful to ___________	Suppliers	Employees	Management	Supervisors	Management
The Primary functions of cost accounting is to ascertain________	st of a product	Administrate Management	Recorded transaction	Maintain book	ost of a product
Mention the branches of accounting________________	Cost and Financial accounting	Cost and Management Accounting	Financial and Management Accounting	Financial, Cost and Management Accounting	Financial, Cost and Management Accounting
When does an accountant record a transaction___________	If it is materialized by a concrete document	If it has a tax implication	On managers' demand	On the demand of material	If it is materialized by a concrete document
Accounting is the process of matching___________	nefits and Costs	Revenue and Expense	Cash inflows and Outflows	Potential and real performance	Revenue and Expense

The concept that recognizes revenue and expense as they are earned or incurred is ________________	Cost	Realization	Accrual	Matching	Matching
Furniture is a ______________	Fixed asset	Current asset	Liquid assets	Tangible assets	Fixed asset
While putting the value or price of an entity in financial records the lowest price is recorded, not the current price or current market value. This is known as____________	Business Entity Concept	Conservatism	Cost Concept	Money Measuremen t Concept	Cost Concept
The Financial record should always be published in a definite time period according to ____________	Accounting Period Concept	Cost Concept	Money Measureme nt Concept	Consistency	Accounting Period Concept
The main objective of accounting is to see organisations ____________	Financial position	Position of the cash book	Position of purchases	Position of sales	Financial position
____________ is a current asset	Cash balance	Furniture	Investments	Debenture	Cash balance
Mention the two accounting principles___________	Accounting Concepts and practice	Accounting Terms and Conditions	Accounting Period and Realization	Accounting Concepts and Convention	Accounting Concepts and Convention
Which of the following group use accounting information _________________	Management, employees, shareholders and Government	Management	Employers	Shareholder s	Management, employees, shareholders and Government
A business was commenced on 1st January and its purchased 5 vehicles, each costing Rs. 5000. During the year the business managed to sell 2 vehicles at the price of Rs. 12000. How should the remaining 3 vehicles be valued if the business is going to continue its operations in the next year_____________	At the breakup value	On the basis of going concern	Liquidation value	More than market value	On the basis of going concern

The example of intangible asset is____________	Land	Building	Furniture	Patents	Patents
An entry required for transferring an account from one ledger to another is _______________	Single entry	Transfer entry	Double entry	Single entry	Transfer entry
All transactions are first recorded in ______________	Journal	Ledger	Trial Balance	Subsidiary books	Journal
The transactions are posted in the ______ from the books of original entry	Journal	Ledger	Trial Balance	Subsidiary books	Ledger
Purchases return and sales return accounts are____________ account	Real	Nominal	Personal	Single	Real
Expenses like wages, salaries, lighting are ________	Nominal account	Real account	Personal account	Cash account	Nominal account
An example which increase the debtors is ______	Credit sale	Credit purchase	Purchase return	Sales return	Credit sale
Which of the following is real account	Drawings	Cash	Rent	Salary	Cash
An example of nominal account is ________	Freight Charges	Good will	Sales	Purchase	Freight Charges
Total purchase is equal to cash purchase plus _________	Credit purchase	Credit sale	Cash sale	Creditors	Credit purchase
The total assets of a proprietor are Rs.5,00,000. His liabilities Rs. 3,50,000. Then his capital in the business is Rs. ________	Rs. 1,00,000	Rs.1,50,000	Rs.3,00,000	Rs. 2,50,000	Rs.1,50,000
Cash purchases at Rs.9,000 and credit purchases at Rs.11,000, then total purchases is _______________	Rs. 20,000	Rs.10,000	Rs.30,000	Rs.11,000	Rs. 20,000
Total sales at Rs. 8,000 and cash sales at Rs. 5,000 then credit sales is _______	Rs.13,000	Rs.8,000	Rs.3,000	Rs.5,000	Rs.3,000
Credit sales can be ascertained as the balancing figure in the___________	Creditors a/c	Debtors a/c	Profit & Loss a/c	Balance sheet	Debtors a/c
Credit purchase can be ascertained as the balancing figure in the ___________________	Creditors a/c	Debtors a/c	Profit & Loss a/c	Balance sheet	Creditors a/c

Commission received is _____________	Expenditure for the business	Income for the business	No income and expenditure	loss to the business	Income for the business
Commission paid is _________	Expenditure for the business	Income for the business	No income and expenditure	loss to the business	Expenditure for the business
The primary function of accounting is ______________	Recording financial data	Recording non-financial transactions	Recording and classifying business operations	Recording of transactions	Recording financial data
Financial accounting deals with ________________	Determination of profit	Determination of price	Determination of cost	Determination of value	Determination of profit
Every debit must have a corresponding credit is the concept in ______________	Single entry system	Double entry system	Incomplete records	Book Keeping	Double entry system
Non-financial quantitative information is not recorded in accounts is the ________________	Dual concept	Money measurement concept	Accrual concept	Periodic concept	Money measurement concept
Financial accounts record only ____________	Actual figures	Budgeted figures	Standard figures	Market cost	Actual figures
Dividend received is a	Gain	Expenses	Asset	Liability	Gain
The modern double entry accounting system was introduced in the year____________	1949	1494	1946	1926	1946
The Book-Keeping is mainly concerned with ________	Collection of data	Recording the financial data relating to business operations	Record non-monetary transactions	Collection of Information	Recording the financial data relating to business operations
The concept of treating the business as a separate entity is called __________________	Money measurement concept	Dual aspect concept	Business entity concept	Matching concept	Business entity concept
Which of the following shows chronological records of transaction __________________	Ledger	Trial Balance	Journal	Subsidiary books	Trial Balance

The sales made to surya for cash should be debited______	Cash account	Purchases account	Sales account	Surya account	Cash account
An irrecoverable debt is called _____________	Bad debts	Doubtful debts	Debt	Provisions	Bad debts
Single entry system is a ____________	Complete double entry system	Incomplete double entry system	Incomplete single entry system.	Complete single system.	Incomplete double entry system
In single entry system, _________ is ascertained by deducting the total liabilities from total assets	Profit	Loss	Capital	Assets	Capital
In ______ system , only personal and cash accounts are maintained	Single entry	Net worth	Double entry	Self balancing	Single entry
The capital in the beginning of the accounting year is ascertained by preparing_______________	Cash a/c	Opening statement of affairs	Total creditors a/c	Statement of profit	Opening statement of affairs
______ can be found by preparing a statement of affairs at the beginning of the year	Opening capital	Closing capital	Drawings	Profit and loss account	Opening capital
____________is a fixed asset	Plant	Cash balance	Sundry Debtors	Bank balance	Plant
____________is a intangible asset	Goodwill	Machinery	Plant	Building	Goodwill
____________is a fixed asset	Cash balance	Machinery	Sundry Debtors	Bank balance	Machinery
____________is a current liability	Plant	Machinery	Outstanding Expenses	Building	Outstanding Expenses
Accounting cycle has ___________ stages	Two	Three	Four	Five	Three
There are ____________ system of accounting	Two	Three	Four	Five	Two
The origin of a transaction is derived from the ______	source document	journal	accounting equations	Ledger	source document
A written document in support of a transaction is called ______________	Receipt	credit note	voucher	Debit note	voucher
Amount spent on acquiring a copy right is an example for ___________	Capital expenditure	Revenue expenditure	Deferred revenue expenditure	Expenses	Capital expenditure

UNIT-II – Final Accounts

SYLLABUS

Final Accounts: Double entry System – Classification of Accounts – Accounting Equation – golden Rules of Accounting
Journal, Ledger – subsidiary ledgers – Trial Balance – Preparation of final Accounts; Trading, profit and Loss Account – Balance sheet

CLASSIFICATIONS OF ACCOUNTS

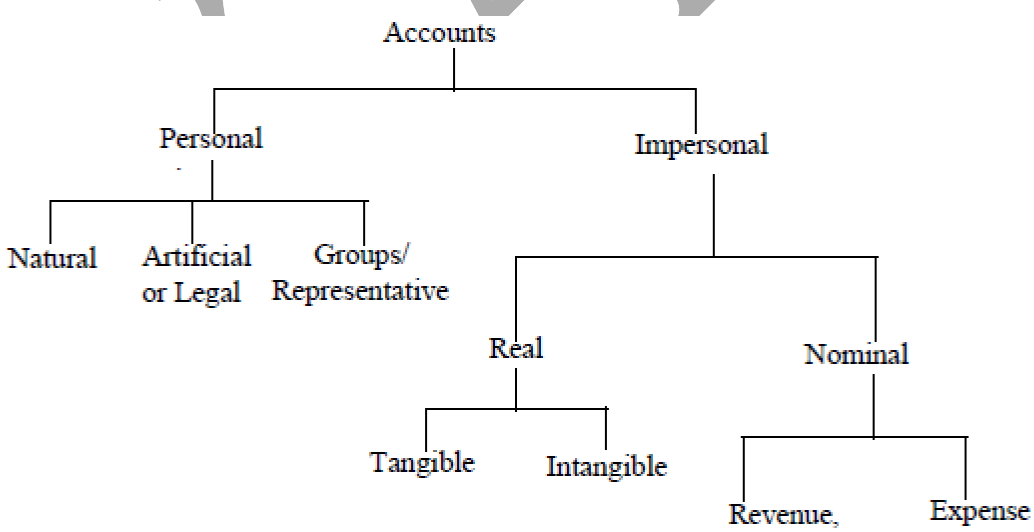
The object of book-keeping is to keep a complete record of all the transactions that place in the business. To achieve this object, business transactions have been classified into three categories:

(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

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

Sometimes 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:

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.			500	
	To Love's Account				500
	(Being in amount received in cash from Love)				
7	Purchases Account Dr.			500	
	To Cash Account				500
	(Being entry for goods purchased from Mr. Deepu from in cash received from Love)				
8	Cash Account Dr.			5,000	
	To Proprietor's Capital Account				5,000
	(Being amount invested in business out of the sale process of the owner's personal car)				
9	Proprietor's Capital Account/Drawing A/c Dr.			180	
	To Cash Account				180
	(Being the amount paid to Manpreet for goods purchased for his personal use)				
10	Cash Account Dr.			450	
	Bad Debts Account Dr.			250	
	To Gobind's Account				700
	(Being the amount received from Gobind in full settlement of his debts)				
11	Narinder Dr.			2,000	
	To Mohinder				2,000
	(Being cash paid by Mohinder to Narinder)				

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

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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 To Prem's A/c (Cash received from Prem)	Dr.		2,480	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

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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	Dr.		800	
		To Vimal's A/ c				300
		To Kamal's A/c				500
		(Purchased goods from Vimal and Kamal on credit				
June	3	Balram's A/c	Dr.		1,000	
		Dhanram A/c	Dr.		700	
		To Sales A/c				1,700
		(Sales of goods to Balram and Dhanram)				
June	5	Cash A/c	Dr.		1,700	
		To Ramasamy's A/c				900
		To Krishnasamy's A/c				800
		(Cash received from Ramasamy and Krishnasamy)				
June	7	Pradeep's A/c	Dr.		800	
		Kuldeep's A/c	Dr.		500	
		To Cash A/c				1,300
		(Paid Pradeep and Kuldeep)				
June	9	Cash A/c	Dr.		600	
		Drawings A/c	Dr.		300	
		To Bank A/c				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: 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 Madhu Rs. 2,000.

Credit Balances on Jan. 1, 2006: Sundry Creditors- Anand Rs. 5,000; Loan from Bablu Rs. 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 Ratan Rs. 2,000

Jan. 21: Paid Anand Rs. 4,800 in full settlement.

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

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

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.

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.

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.

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: 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: 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 Bros.			
		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.

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.

FINAL ACCOUNTS

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

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

But, if the business concern is a manufacturing concern, it has to prepare 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 Gross Loss. Profit and Loss Account discloses net profit or net loss of the business. Balance sheet shows the financial position of the business on a given date. For preparing final accounts, certain accounts representing incomes or expenses are closed either by transferring to Trading Account or Profit and Loss Account. Any Account which cannot find a place in any of these two accounts goes to the Balance Sheet.

TRADING ACCOUNT

After the preparation of trial balance, the next step is to prepare Trading Account. Trading Account is one of the financial statements which shows the result of buying and selling of goods and/or services during an accounting period. The main objective of preparing the Trading Account is to ascertain gross profit or gross loss during the accounting period. Gross Profit is said to have made when the sale proceeds exceed the cost of goods sold. Conversely, when sale proceeds are less than the cost of goods sold, gross loss is incurred. For the purpose of calculating cost of goods sold, we have take into consideration opening stock, purchases, direct expenses on purchasing or manufacturing the goods and closing stock. The balance of this account i.e. gross profit or gross loss is transferred to the Profit and Loss Account. The specimen of a Trading 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			
To 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 the end of previous accounting period which has been brought forward in the current accounting period. This is shown on the debit side of the Trading Account.

Closing stock refers to the stock of unsold goods at the end of the current accounting period. Closing stock is valued either at cost price or at market price whichever is less. Such valuation of stock is based on the principle of conservatism which lays down that the expected profit should not be taken into account but all possible losses should be duly provided for.

Closing stock is an item which is not generally available in the trial balance. If it is given in Trial Balance, it is not to be shown on the credit side of Trading Account but appears only in the Balance Sheet as an asset. But if it is given outside the trial balance, it is to be shown on the credit side of the Trading Account as well as on the asset side of the Balance 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 items are 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 attributable to 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 the godown is treated as carriage inward and it is debited to Trading Account.

(b) Freight and insurance: Freight and insurance paid for acquiring goods or making them saleable is debited to Trading Account. If it is paid for the sale of goods, then it is to be charged (debited) to Profit and Loss Account.

(c) Wages: Wages incurred in a business is direct, when it is incurred on manufacturing or merchandise or on making it saleable. Other wages are indirect wages. Only direct wages are debited to the Trading Account. Other wages are debited to the Profit and Loss Account. If it is not mentioned whether wages are direct or indirect, it should be assumed as direct and should appear in the Trading Account.

(d) Fuel, Power and Lighting Expenses: Fuel and power expenses are incurred for running the machines. Being directly related to production, these are considered as direct expenses and debited to Trading Account. Lighting expenses of factory is also charged to Trading Account, but lighting expenses of administrative office or sales office are charged to Profit and Loss Account.

(e) Octroi: When goods are purchased within municipality limits, generally octroi duty has to be paid on it. It is debited to Trading Account.

(f) Packing Charges: There are certain types of goods which cannot be sold without a container or proper packing. These form a part of the finished product. One example is ink, which cannot be sold without a bottle. These type of packing charges are debited to Trading Account. But if the goods are packed for their safe dispatch to customers, i.e. packing meant for transportation or fancy packing meant for advertisement will appear in the Profit and Loss Account.

(g) Manufacturing Expenses: All expenses incurred in manufacturing the goods in the factory such in factory rent, factory insurance 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. If royalty is paid on the basis of production, it is debited to Trading Account and if it is paid on the basis of sales, it is debited to Profit and Loss Account.

4. Sales

Sales include both cash and credit sales of those goods which were purchased for resale purposes. Some customers might return the goods sold to them (called sales return) which are deducted from the sales in the 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, it should not be included in sales.

(b) Goods sold on consignment or on hire purchase or on sale or return basis should be recorded separately.

(c) If goods have been sold but not yet dispatched, these should not be shown under sales but are to be included in closing stock.

(d) Sales of goods on behalf of others and forward sales should also be excluded from sales.

Illustration: From the following balances extracted from the books of Mr. Bansi Lal, prepare the Trading Account for the year ending 31st 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 materials into finished goods, are interested to knowing the cost of production of the goods produced. The cost of the goods produced cannot be obtained from the Trading Account. So, it is desirable to prepare a Manufacturing Account prior to be preparation of the Trading account with the object of ascertaining 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 as follows:

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 taken to the Profit and Loss Account which will be prepared in the usual way as explained in the following pages.

PROFIT AND LOSS ACCOUNT

Trading Account results in the gross profit/loss made by a businessman on purchasing and selling of goods. It does not take into consideration the other operating expenses incurred by him during the course of running the business. Besides this, a businessman may have other sources of income. In order to ascertain the true profit or loss which the business has made during a particular period, it is necessary that all such expenses and incomes should be considered. Profit and Loss Account considers all such expenses and incomes and gives the net profit made or net loss suffered by a business during a particular period.

All the indirect revenue expenses and losses are shown on the debit side of the Profit and Loss Account, where as all indirect revenue incomes are shown on the credit side of the Profit and Loss Account.

Profit and Loss Account measures net income by matching revenues and expenses according to the accounting principles. Net income is the difference between total revenues and total expenses. In this connection, we must remember that all the expenses, for the period are to be debited to this account - whether paid or not. If it is paid in advance or outstanding, proper adjustments are to be made (Discussed later). Likewise all revenues, whether received or not are to be credited.

Revenue if received in advance or accrued but not received, proper adjustment is required.

A proforma of the Profit and Loss Account showing probable items therein 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 distribution of sold goods. Example of such expenses are go down rent, carriage outwards, advertisement, cost of after sales service, selling agents commission, etc.

2. Management Expenses

These are the expenses incurred for carrying out the day-to-day administration of a business. Expenses, under this head, include office salaries, 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 the administrative office in a good condition. They include repairs and renewals, etc.

4. Financial Expenses

These expenses are incurred for arranging finance necessary for running the business. These include interest on loans, discount on bills, etc.

5. Abnormal Losses

There are some abnormal losses that may occur during the accounting period. All types of abnormal losses are treated as extra ordinary expenses and debited to Profit and Loss Account. Examples are stock lost by fire and not covered by insurance, loss on sale of fixed assets, etc.

Following are the expenses not to appear in the Profit and Loss Account:

(i) Domestic and household expenses of proprietor or partners.

(ii) Drawings in the form of cash, goods by the proprietor or partners.

(iii) Personal income tax and life insurance premium paid by the firm on behalf of proprietor or partners.

6. Gross Profit

This is the balance of the Trading Account transferred to the Profit and Loss Account. If the Trading Account shows a gross loss, it will appear on the debit side.

7. Other Income

During the course of the business, other than income from the sale of 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 to employees and investment in debentures of companies. Similarly, dividend on investment in shares of companies and units of mutual funds are also known as non-trading incomes and shown in Profit and Loss 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 a separate 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 and Loss Account)

(ii) For transfer of various incomes and gains to Profit & Loss A/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 : 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 Loss Account

	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 business concern at a given date. It is called a Balance Sheet because it is a sheet of balances of those ledger accounts which have not been closed till the preparation of Trading and Profit and Loss Account. After the preparation of Trading and Profit and Loss Account the balances left in the trial balance represent either personal or real accounts. In other words, they either represent assets or liabilities existing on a particular date. Excess of assets over liabilities represent the capital and is indicative of the financial soundness of a company.

A Balance Sheet is also described as a "Statement showing the Sources and Application of Capital". It is a statement and not an account and prepared from real and personal accounts. The left hand side of the Balance Sheet may be viewed as description of the sources from which the business has obtained the capital with which it currently operates and the right hand side as a description of the form in which that capital is 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. It has no debit side or credit side. The headings of the two sides are 'Assets' and 'Liabilities'.

(b) A Balance Sheet is prepared at a particular point of time and not for a particular period. The information contained in the Balance Sheet is true only at that particular point of time at which it is prepared.

(c) A Balance Sheet is a summary of balances of those ledger accounts which have not been closed by transfer to Trading and Profit and Loss Account.

(d) A Balance Sheet shows the nature and value of assets and the 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 amount due 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 the conduct of business operations and not for reselling to earn profit are called fixed assets. These assets are not readily convertible into cash in the normal course of business operations. Examples are land and building, furniture, machinery, etc.

(b) Current Assets

All assets which are acquired for reselling during the course of business are to be treated as current assets. Examples are cash and bank balances, inventory, accounts receivables, etc.

(c) Tangible Assets

There are definite assets which can be seen, touched and have volume such as machinery, cash, stock, etc.

(d) Intangible Assets

Those assets which cannot be seen, touched and have no volume but 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 represented by any tangible possession. They appear on the asset side simply because of a debit balance in a particular account not yet written off e.g. provision for discount on creditors, discount on issue of shares etc.

(f) Wasting Assets

Such assets as mines, quarries etc. that become exhausted or reduce in value by their working are called wasting assets.

(g) Contingent Assets

Contingent assets come into existence upon the happening of a certain event or the expiry of a certain time. If that event happens, the asset becomes available otherwise not, for example, sale agreement to acquire some property, hire purchase contracts etc.

In practical no reference is made to contingent assets in the Balance Sheet. At the most, they may form part of notes to the Balance Sheet.

Liabilities

A liability is an amount which a business is legally bound to pay. It is a claim by an outsider on the assets of a business. The liabilities of a business concern may be classified as:

(a) Long Term Liabilities

The liabilities or obligations of a business which are not payable within the next accounting period but will be payable within next five to ten 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 one year are current liabilities. This includes trade creditors, bills payable etc.

(c) Contingent Liabilities

A contingent liability is one which is not an actual liability. They become actual on the happenings of some event which is uncertain. In other words, they would become liabilities in the future provided the contemplated 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 of a footnote below the Balance Sheet.

Marshalling of assets and liabilities

The arrangement of assets and liabilities in a particular order is called marshalling of the Balance Sheet. Assets and liabilities can be arranged 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 their reliability and payment preferences, such an order is called liquidity order. Such arrangement is given below in Balance Sheet (a). When the order is reversed from that what is followed in liquidity, it is called order of permanence. In other words, assets and liabilities are listed in order of permanence. This order of Balance Sheet is given below in Balance Sheet (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 : The following balances are extracted from the books of Kautilya & Co. on 31st March, 2006. You are required prepare the Trading 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

Illustration : From the following Trial Balance of Mr. Garg as on 31st March, 2006, prepare Trading Account, Profit and Loss Account and Balance 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

KARPAGAM ACADEMY OF HIGHER EDUCATION

DEPARTMENT OF MANAGEMENT

I BBA - (2018 - 2021 BATCH)

II SEMESTER

FINANCIAL ACCOUNTING (18BAU201)

UNIT I

POSSIBLE QUESTIONS

Part A (ONE Mark)

Multiple Choice Questions

Online Examination

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 Ganesan Rs. 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. . Post the following transaction in the ledger:

May 2014

04 Purchased goods from rajesh Rs. 2, 500

05 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

5. 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

6. 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

7. Mention the types of subsidiary book?
8. Bring out the importance of maintain cash book?
9. 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

10. 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

11.Write a short note about Trading Account?

12 .List out the indirect expenses incurred in the business?

13. Bring out the need of preparing the Profit and Loss account?

14. Mention the importance of preparing the importance of Balance Sheet?

***CIA - 3 X 2 = 6 (ANSWER ALL THE QUESTIONS)**
****ESE - 5 X 2 = 10 (ANSWER ALL THE QUESTIONS)**

PART C

1. 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

2. 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

3. Journalize the following transaction of Arun &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 rajesh Rs. 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

4. 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

5. 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

6. 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

7. 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

8. 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 cheque Rs. 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 nithin Rs. 500 Discount allowed Rs. 50	
28	Cash purchase paid by cheque	800
29	Paid salary by cheque	1, 200

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

11. 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 Perara Rs. 12,000

6 Sold goods on credit to Ravindar Rs. 16,000

8 Received from Ravindar Rs. 12,000

10 Paid to Perara Rs. 7,500

25 Bought furniture for cash Rs. 4,500

12. 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.

13. 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

14. Describe the importance of preparing Trading and Profit and Loss account?

15. 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.

16.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.

17. 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

18. 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.

19.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

20. 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

21. Elucidate the need for preparing the Trading and profit and loss account?
22. Describe the contents of Financial Statements of a Joint Stock Company as per Companies Act 2013?
23. Elaborate the importance of Corporate Annual Report?

***CIA - 3 X 8 = 24 (EITHER OR TYPE)**
****ESE - 5 X6 = 30 (EITHER OR TYPE)**

QUESTIONS	OPTION 1	OPTION 2	OPTION 3	OPTION 4	ANSWER
The book used for recording transactions relating to return of goods to the business______________	Cash book	Sales book	Purchase book	Sales return book	Sales return book
Cash sales are recorded in _____________	Cash book	Purchase book	Sales return book	Purchase return book	Cash book
Credit Purchases are recorded in ____________	Cash book	Purchase book	Sales return book	Purchase return book	Purchase book
Credit Sales are recorded in ________________	Cash book	Purchase book	Sales book	Purchase return book	Sales book
Return of goods sold is recorded in______________	Sales return book	Sales book	Purchase book	Creditors book	Sales return book
Purchase Book is kept to record all ______________ purchases.	Cash	Credit	Revenue	Payment	Credit
__________ are prepared for the purpose of presenting a periodic review by the management	Sales book	Purchase book	Financial Statement	Sales return book	Financial Statement
Purchases Book, Sales Book, Purchase Return Book and Sales Return Book are ____________	Day book	Cash book	Subsidiary book	Debtors book	Subsidiary book
The book that records all small payments is called as_____	Cash book	Purchase book	Petty cash book	Creditors book	Petty cash book
Contra entries are _________________	Entries of contracts in the books of accounts	Entries of contracting nature in the ledger.	Entries for recording affecting both the sides of the cash book.	Not recorded in cash book	Entries for recording affecting both the sides of the cash book.
Credit transactions are entered in ____________	Cash book	Subsidiary book	Day books	Debtors book	Subsidiary book
The Cash book records __________	All cash receipts	All cash payments	All cash receipts and cash payment	Credit payment	All cash receipts and cash payment
Reserves are shown in the _________________ side of the balance sheet	Liability	Asset	Credit	Debit	Debit
______ is suitable for all types of traders	Single entry	Double entry	Triple entry	Personal entry	Double entry
The amount of opening stock can be ascertained by preparing _______________	Memorandum trading a/c	Creditors a/c	Debtors a/c	Statement of profit	Memorandum trading a/c
An example for direct expenses is ________	Interest	Income tax	Depreciation	Wages	Wages
An example for indirect expenses is _________.	Wages	Carriage inward	Freight	Salaries	Salaries
Opening stock + Purchases – Closing stock = _________	Purchases	Cost of goods sold	Stock	Debtor	Cost of goods sold
Exchange of goods or services to gain profit or loss in a business activity is known as ______________	Business transaction	Banking transaction	Transaction	Entries	Business transaction

The amount which the proprietor has invested in the business is ____________	Capital	Liabilities	Assets	Fund	Capital
The closing stock at the end of the year is the _________for the subsequent year	Opening stock	Closing stock	Average Stock	Stock	Opening stock
The balance of unsold goods is known as _____________	Stock	Assets	Liabilities	Profit	Stock
___________enables the trader to find out Gross Profit or Loss	Trading account	Profit and loss account	Cash book	Balance Sheet	Trading account
_____________enables the trader to find out Net Profit or Loss	Profit or loss account	Trading account	Balance Sheet	Purchase book	Profit or loss account
___________shows the financial position of a trader	Balance sheet	Bank reconciliation statement	Cash book	Asset	Balance sheet
Outstanding expenses are shown on the _____________of the balance sheet.	Liability side	Asset side	Debit side	Debit and credit side	Liability side
Income received in advance will be shown on the ___________side of the balance sheet	Asset side	Both Liability and Asset side	Trading account	Liability side	Liability side
Opening stock is to be ___________	Debited in trading account	Credited in trading account	Debited in P/L a/c	Credited in P/L a/c	Debited in trading account
Balance sheet is a ___________	Statement	Account	Ledger	Transaction	Statement
Current liabilities are recorded in the balance sheet on _______	Liability side	Asset Side	Profit and Loss account	Trading account	Liability side
Capital are recorded in the balance sheet on_______	Liability side	Asset Side	Both Liability and Asset side	May not appear in the balance sheet	Liability side
Purchase of raw materials will be recorded in the ______________	Trading a/c	Creditors a/c	Profit and Loss a/c	Debtors a/c	Trading a/c
Rent paid are apportioned on the basis of ________	Sales ratio	Floor area	Light points	Purchase value	Floor area
Fixed assets are recorded in the balance sheet on_______	Liability side	Asset Side	Both Liability and Asset side	May not appear in the balance sheet	Asset Side
Fictitious assets are recorded in the balance sheet on_______	Liability side	Asset Side	Both Liability and Asset side	May not appear in the balance sheet	Asset Side
Tangible assets are recorded in the balance sheet on_______	Liability side	Asset Side	Both Liability and Asset side	May not appear in the balance sheet	Asset Side
Long term liabilities are recorded in the balance sheet on_______	Liability side	Asset Side	Both Liability and Asset side	May not appear in the balance sheet	Liability side
An example for direct expenses is _______	Interest	Income tax	Depreciation	Freight	Freight
An example for indirect expenses is ________	Wages	Carriage inward	Freight	Printing and stationery	Printing and stationery

In ________ , capital is added with net profit	Balance sheet	Bank reconciliation statement	Trading account	Statement of affairs	Balance sheet
Prepaid expenses are shown on the ____________of the balance sheet	Liability side	Asset side	Both Liability and Asset side	May not appear in the balance sheet	Asset side
An example for indirect expenses is ________	Wages	Carriage inward	Freight	Office expenses	Office expenses
Unexpired expenses are shown on the ____________of the balance sheet	Liability side	Asset side	Both Liability and Asset side	May not appear in the balance sheet	Asset side
Discount allowed will be recorded in the ___________	Trading account	Profit and loss account	Purchase account	Purchase return account	Profit and loss account
Discount received will be recorded in the _____________	Trading account	Profit and loss account	Sales account	Sales return account	Profit and loss account
Building owned by the concern will be recorded in the balance sheet on_______	Liability side	Asset Side	Both Liability and Asset side	May not appear in the balance sheet	Asset Side
An example for direct expenses is _______	Interest	Income tax	Depreciation	Motive Power	Motive Power
An example for indirect expenses is ________	Wages	Carriage inward	Freight	Advertisement	Advertisemen t
Journal is a book of ___________	Original entry	Secondary entry	Petty cash transaction	Credit records	Original entry
The process of recording the journal is called__________	Journalising	Costing	Ledger	Posting	Journalising
Debtors ledger is also known as ____________	Customers ledger	General ledger	Suppliers ledger	Specific ledger	Customers ledger
A statement below the journal is _________	Narration	Description	Transaction	Descriptive	Narration
The process of recording in the ledger is ____________	Posting	Ledger	Journalising	Summarizing	Posting
Cash account is a ___________	Personal account	Nominal account	Real account	Book	Real account
Trial Balance is prepared to find out_________	Financial position of the business	Arithmetic accuracy of the business	Profitability position of the business	Inaccuracy of accounts	Financial position of the business
Trial Balance is prepared with the principle of__________	Single entry system of book-keeping	Double entry system of book-keeping	Transaction	Jouranlising	Double entry system of book-keeping
The accounting equation is concerned with ________	Assets only	Liabilities only	Assets and Liability	Assets, Liabilities and Capital	Assets, Liabilities and Capital
Which of the following is correct___________	Asset = Liabilities – Capital	Capital = Assets – Liabilities	Capital = Assets + Liabilities	Capital = Asset	Capital = Assets – Liabilities
A firm has assets worth Rs.60,000 and capital worth Rs.45,000, then its liabilities is__________	Rs.10,000	Rs.15,000	Rs.20,000	Rs.25,000	Rs.15,000
__________ is a long term liability	Plant and Machinery	Furniture	Debenture	Debtors	Debenture

UNIT-III – Depreciation

SYLLABUS

Depreciation: Meaning – Need for Depreciation – Causes – Methods: Straight Line Method, Diminishing balance Method and Annuity Method – Their impact on measurement of Business Accounting

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,"

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

Depreciation includes amortisation of assets whose useful life is pre determined."

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 Amortisation: The terms depreciation, depletion and amortisation 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 man made fixed assets to operation (and not with determination of asset value for the balance sheet). In other words, the term 'depreciation' is used when expired utility of physical asset (building, machinery, or equipment) is to be recorded.

Depletion: This term is applied to the process of removing an available but irreplaceable resource such as extracting coal from a coal 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, depreciations 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 than its physical life. The physical life is based mostly on internal policies such as intensity of use, repairs, maintenance and replacements. The economic life, on the other hand, is based mostly on external factors such as obsolescence from technological changes.
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 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.

1. 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 calculating depreciation 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:

Depreciation = Rs.4,800

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: 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 31st December. 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.

2. 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:

Depreciation = Rs. 10 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.

3. 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:

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

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 : 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	To Balance b/d	11250	1993	By Depreciation	2812.5 8437.5
		11250			11250

1. 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:

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

4. Annuity Method

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 asset

Asset Account Dr.

To Bank

(ii) For Charging interest

Asset 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
		6445.97			6768.29
1993 Jan.1	To balance b/d		1993	By Depreciation	9000
Dec.31	To Interest	322.30	Dec.31	By Balance c/d	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

5. 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 realised on the sale
of investments is utilised 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 installment 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

(i) 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 utilised for the purchase of new asset.

Illustration: Amitabh Company Ltd. purchased 4 year lease on January , 1990 for Rs. 60,000. The company decided to charge depreciation according to depreciation fund method. It is expected that investments will earn interest @5% p.a. Sinking Fund Table shows that Rs. 0.232012 invested each year will produce Rs. 1 at the end of 4 years at 5% p.a. At the expiry of lease , the Depreciation Fund Investments were sold for Rs. 45200. A new lease is purchased for Rs. .... on

1.1.1994. Show the journal entries and prepare the necessary accounts in the book the company.

JOURNAL

Date	Particulars		Debit	Credit
1.1.1990	Lease A/c	Dr.	60,000	
	To Bank A/c			60,000
	(Being the purchase of lease)			
31.12.90	Depreciation A/c	Dr.	13920.7	
	To Depreciation Fund A/c			13920.7
	(Being annual amount of depreciation as per sinking fund tables)			
31.12.90	Depreciation Fund Investment A/c	Dr.	13920.7	
	To Bank A/c			13920.7
	(Being purchase of the investments against the depreciation fund)			
1.1.1990	Lease A/c	Dr.	60,000	
	To Bank A/c			60,000
	(Being the purchase of lease)			
31.12.90	Depreciation A/c	Dr.	13920.7	
	To Depreciation Fund A/c			13920.7
	(Being annual amount of depreciation as per sinking fund tables)			
31.12.90	Depreciation Fund Investment A/c	Dr.	13920.7	
	To Bank A/c			13920.7
	(Being purchase of the investments against the depreciation fund)			
31.12.91	Bank A/c	Dr.	696.0	
	To depreciation fund A/c			696.0
	(Being the receipt of interest on depreciation fund investment A/c transfer to depreciation fund A/c			
31.12.91	Depreciation A/c	Dr.	13920.7	
	To Depreciation Fund A/c			13920.7
	(Being annual depreciation set-aside)			

31.12.91	Depreciation Fund Investment A/c Dr. To Bank A/c (Being purchase of the investments against the depreciation fund)	14616.7	14616.7
31.12.92	Bank Account Dr. To depreciation fund A/c Being receipt of interest and its transfer to depreciation fund A/c)	1426.9	1426.9

31.12.92	Depreciation A/c Dr. To depreciation fund A/c (Being annual depreciation set aside)	13920.7	13920.7
31.12.92	Depreciation Fund Investment A/c Dr. To Bank A/c (Being purchase of investments)	15347.6	15347.6
31.12.93	Bank A/c Dr. To depreciation fund A/c (Being receipt of interest on depreciation fund investment)	2194.3	2194.3
31.12.93	Depreciation A/c Dr. To depreciation A/c (Being annual depreciation set aside)	13920.7	13920.7
31.12.90	Bank A/c Dr. To depreciation fund investment A/c (Being sale of Dep fund investment A/c)	45200	45200
31.12.93	Depreciation Fund Investment A/c Dr. To depreciation fund A/c (Being profit on sale investment transferred)	1315.0	1315.0
31.12.93	Depreciation fund A/c Dr. To lease A/c (Being the transfer of depreciation fund A/c to lease A/c)	61315.0	61315.0

31.12.93	Lease A/c Dr. To pCL A/c (Being Balance of lease A/c transferred to place	1315.0	1315.0
1.1.94	Lease A/c Dr. To Bank A/c	70000.0	70000.0

DEPRECIATION FUND ACCOUNT

Date	Particulars	Rs.	Date	Particulars	Rs.
31.12.90	By Balance c/d	13920.7	31.12.90	By Dep. a/c	13920.7
		13920.7			13920.7
31.12.91	To Balance c/d	28537.4	1.1.91	By Balance b/d	13920.7
			31.12.91	By Bank A/c Int.	696.0
			31.12.91	By Dec. a/c	13920.4
		28537.4			28537.4
31.12.92	By Balance c/d	43885.0	1.1.92	By Balance c/d	28537.4
			31.12.92	By Bank A/c Int.	1426.9
			31.12.92	By Dep. A/c	13920.7
		43885.0			43885.0
31.12.93	To lease A/c	61315.0	1.1.93	By Balance b/d	43885.0
			31.12.93	By Bank Interest	3194.3
					61315.0
		61315.0			61315.0

LEASE ACCOUNT

Date	Particulars	Rs.	Date	Particulars	Rs.
1.1.90	To Bank A/c	60000	31.12.90	By Balance c/d	60000
		60000			60000
1.1.91	To Balance b/d	60000	31.12.91	By Balance c/d	60000
		60000			60000
1.1.92	To Balance b/d	60000	31.12.92	By Balance c/d	60000
		60000			60000
1.1.93	To Balance b/d	60000	31.12.93	By Balance c/d	60000
		60000			60000
31.12.93	To p & L A/c (profit)	1315			
		61315			61315

DEPRECIATION FUND INVESTMENT A/C

Date	Particulars	Rs.	Date	Particulars	Rs.
31.12.90	To Bank A/c	13920.7	31.12.90	By Balance c/d	13920.7
		13920.7			13920.7
1.1.91	To Balance b/d	13920.7	31.12.91	By Balance c/d	28537.4
31.12.92	To Bank A/c	14616.7			
		28537.4			28537.4
1.1.92	To Balance b/d	28537.4	31.12.92	By Balance c/d	43885.0
31.12.92	To Bank A/c	15347.6			
		43885.0			43885.0
1.1.93	To Balance b/d	43885.0	31.12.93	By Bank a/c	45200.0
	To Dep. Fund a/c	1315.0			
		45200.0			45200.0

7. 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.

8. 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

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

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 realised 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 and loss account.

Illustration: A company purchased a machinery costing Rs. 60,000 on 1.4.1990. The accounting year of the company ends on 31st December every year. The company further purchased machinery on 1st October, 1990 costing Rs. 40,000. On 1st January 1992, one-third of the machinery which was installed on 1.4.1990, became obsolete and was sold for Rs. 5000. Show how the machinery account would appear in the books of the company. The depreciation is to be charged at 10% p.a. on written down value method.

MACHINERY ACCOUNT

Date	Particulars	Rs.	Date	Particulars	Rs.
1.4.90	To Bank	60000	31.12.90	By Depreciation	45000
Oct. 1	To Bank	40000		on Rs. 60000 for 9 month	1000
				on Rs. 40000 for 3 month	
			Dec.31	By Balance c/d	94500
		100000			100000
1.191	To Balance b/d	94500	31.12.91	By Depreciation on Rs. 94500 for 1 year	9450
			Dec. 31	By Balance c/d	85050
		94500			94500
1.192	To Balance b/d	85050	31.12.91	By Bank (sale pro)	5000
			Jan. 1	By profit Loss account loss on sale (16650-5000)	11650
			Dec. 31	By Depreciation	6840
			Dec. 31	By Balance c/d	61560
		85050			85050

DEPRECIATION ON AN 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.

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

Illustration: Om Ltd. purchased a computer for Rs. 50,000 on 1.1.1993. It has five years life and a salvage value of Rs. 5,000. Depreciation was provided on straight line basis. With effect from 1.1.1995, the company decided to change the method of depreciation to Diminishing Balance method@20% p.a. prepare computer account from 1993 to 1996. Assume, the company prepare final accounts on 31st December every year.

COMPUTER ACCOUNT

Date	Particulars	Rs.	Date	Particulars	Rs.
1.1.93	To Cash A/c	50000	31.12.93	By Depreciation	9000
			“	By Balance c/d	41000
		50000			50000
1.1.94	To Balance b/d	41000	31.12.94	By Depreciation	9000
			“	By Balance c/d	32000
		41000			41000
1.1.95	To Balance b/d	32000	31.12.95	By Depreciation	6400
			“	By Balance c/d	25600
		32000			32000
1.1.96	To Balance b/d	25600	31.12.96	By Depreciation	5120
			“	By Balance c/d	20480
		25600			25600

Change in the Method of Depreciation from a back date

Sometimes a change in the method of depreciation is effected respectively. In such a case, the following steps are required:

(i)Find out the depreciation which has already been charged according to the old method or at the old rate.

(ii) Compute the amount of depreciation that is to be charged according to the new method form the back date upto the end of the previous year.

(iii) Find the difference, if any, under (i) and (ii) mentioned above.

(iv)In the current year in addition to the depreciation for the current year charge also the difference found under step (iii).

Illustration: Taking the facts as in the illustration 7, prepare computer account for 1995 and 1996, if the firm decides on 1.1.1995 to charge depreciation according to Diministing Balance method. Assume the change in the depreciation policy is efected by the firm since the date of purchase.

Solution

COMPUTER ACCOUNT

Date	Particulars	Rs.	Date	Particulars	Rs.
1.1.95	To Balance	32000	31.12.95	By Depreciation Difference for earlier year (1)	Nil
				Current year (2)	6400
			Dec. 31	By Balance c/d	25600
		32000			32000
1.1.96	To Balance	25600	31.12.96	By Depreciation	5150
			“	By Balance	20480
		25600			25600

KARPAGAM ACADEMY OF HIGHER EDUCATION

DEPARTMENT OF MANAGEMENT

I BBA - (2018 - 2021 BATCH)

II SEMESTER

FINANCIAL ACCOUNTING (18BAU201)

UNIT III

POSSIBLE QUESTIONS

Part A (ONE Mark)

Multiple Choice Questions

Online Examination

PART B

1. Define Depreciation
2. Give the meaning for depreciation?
3. What is meant by residual value?
4. Satifsan purchased an asset of Rs.20000 and he can use it for 4 years and after four year its scrape value will be Rs. 4000 . Calculate the amount of depreciation and rate of depreciation.
5. List out the main causes of depreciation?
6. What is the need for providing depreciation?
7. List out the basic factors to be taken into consideration while determining depreciation”
8. List out the problems for measurement of depreciation?
9. How many methods are there for recording depreciation?
10. List out the methods of recording depreciation in the books of accounts?
11. How many methods are there for providing provision for depreciation?
12. Write a short note on depletion
13. Machine was purchased at Rs. 50000 and if 10 % depreciation on machinery with diminishing balance method

14. On Jan 1, 2011 Company A purchased a vehicle costingRs.20,000. It is expected to have a value ofRs.5,000 at the end of 4 years. Calculate depreciation expense on the vehicle for the year ended Dec 31, 2011.
15. 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, calculate the amount of depreciation per hour
16. 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, Calculate the amount and rate of depreciation.
17. Asset having an effective life of 5 y ears 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,
18. Write any two merits and demerits of diminishing balance method
19. Write a short note on revaluation method
20. 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, Calculate the rate of depreciation under depletion method.
21. Machine costing Rs.20,000 is estimated to have a life of 10 years and scrap value is estimated Rs.1,000 at the end of the life. Calculate the amount of depreciation and rate of depreciation
22. Machine was purchased for Rs.60,000 on 1st January 2008. Its useful life to be 3 years. Calculate the amount of depreciation using sum of digits method.
23. Machine costing Rs.50,000 is estimated to have a life of 4 years Calculate the amount of depreciation for 4 years @ 10 % under diminishing balance method.

***CIA - 3 X 2 = 6 (ANSWER ALL THE QUESTIONS)**
****ESE - 5 X 2 = 10 (ANSWER ALL THE QUESTIONS)**

PART C

1. Why is it necessary to calculate depreciation? Discuss various factors which are considered for calculating depreciation?
2. Distinguish between the following:
   (a) Straight line method and diminishing balance method.
   (b) Annuity method and depreciation Fund method.
   (c) Depreciation and depletion
3. Explain the circumstances under which different methods of depreciation can be employed?
4. Discuss the advantages and disadvantage of Insurance policy Method and Straight Line Method.?
5. What is sum of the year-digits method do depreciation? In what way does it differ from sinking fund method or depreciation?
6. 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
7. 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.
8. 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 Diminishing 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 realized 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.

9. 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.

10. Chillies Ltd, acquired a long-term lease of property on payment of Rs. 60,000. A leasehold Redemption policy was taken out on which an annual premium of Rs. 1,440 was payable. The surrender value of the policy on 31st March, 1997 was Rs. 12,896 to which amount the policy account stood adjusted. Next premium was paid on 20th December, 1997 and the surrender value on 31st March, 1978 was Rs. 14,444.

    (i) Show the Redemption fund account and the policy account for the year ended 31st March, 1998

    (ii) Assuming that of maturity, a sum of Rs. 60,100 was received and the balance in policy account then stood at Rs. 59,920 give the ledger accounts showing the entries necessary to close the accounts concerned. (Ans. (i) Balance at the end of 1998 Fund A/c & policy A/c Rs. 14,444 (ii) Transfer to p & L a/c profit on maturity Rs. 100).

11. Machinery account of CSI Ltd. showed debit balance of Rs. 32,400 on 1st January, 1998. Depreciation was provided at 10% per annum. On 1st July 1998, a part of the machinery purchased for Rs. 10,000 on 1st January 1996 was sold for Rs. 7,000 and on the same date a new machinery which cost Rs. 20,000 was purchased. On 31st Dec. 1998 the company decided to change the method of depreciation from Diminishing Balance Method to Fixed Installment Method with effect from 1st January, 1996,

depreciation remaining at 10% per annum. Show Machinery account.

12. 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.
13. 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 31st December. prepare the machinery account for five years charging depreciation according to straight line method.
14. 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.
15. Amitabh Company Ltd. purchased 4 year lease on January , 1990 for Rs. 60,000. The company decided to charge depreciation according to depreciation fund method. It is expected that investments will earn interest @5% p.a. Sinking Fund Table shows that Rs. 0.232012 invested each year will produce Rs. 1 at the end of 4 years at 5% p.a. At the expiry of lease , the Depreciation Fund Investments were sold for Rs. 45200. A new lease is purchased for Rs.70,000 on1.1.1994. Show the journal entries and prepare the necessary accounts in the book the company.
16. On 1.1.1993, a firm purchased a lease for four years for Rs. 50,000. It decided to provide for its replacement by means of an insurance policy for Rs. 50,000. The annual premium is Rs. 11,000. On1.1.1997, the lease is renewed for a further period of 4 years for the same amount. Show the necessary ledger accounts
17. A company purchased a machinery costing Rs. 60,000 on 1.4.1990. The accounting year of the company ends on 31st December every year. The company further purchased machinery on 1st October, 1990 costing Rs. 40,000. On 1st January

1992, one-third of the machinery which was installed on 1.4.1990, became obsolete and was sold for Rs. 5000. Show how the machinery account would appear in the books of the company. The depreciation is to be charged at 10% p.a. on written down value method.

18. Om Ltd. purchased a computer for Rs. 50,000 on 1.1.1993. It has five years life and a salvage value of Rs. 5,000. Depreciation was provided on straight line basis. With effect from 1.1.1995, the company decided to change the method of depreciation to Diminishing Balance method@20% p.a. prepare computer account from 1993 to 1996. Assume, the company prepare final accounts on 31st December every year.
19. Taking the facts as in the illustration 7, prepare computer account for 1995 and 1996, if the firm decides on 1.1.1995 to charge depreciation according to Diminishing Balance method. Assume the change in the depreciation policy is effected by the firm since the date of purchase.
20. “Depreciation accounting is a process of allocation and not of valuation” Comment
21. A company, whose accounting year is the calendar year, purchased a machinery on 1-1-2003 for Rs.40,000. It purchased further machinery on 1-10-2003 for Rs.20,000 and on 1st July 2005 for Rs.10,000. On 1-7-2006, one-fourth of the machinery installed on 1-1-2003 became

obsolete and was sold for Rs.6,800. Show the machinery account for all the 4 years under fixed installment Method. Depreciation is to be provided at 10%p.a.

22. . On 1-1-2002, machinery was purchased for Rs.30,000. Depreciation at the rate of 10% on original cost was written off during the first two years. For the next two years 15% was written off the diminishing balance of the amount. The machinery was sold for rs.15,000 on 31.12.2005. Write up the machinery account for four years and close the same

***CIA - 3 X 8 = 24 (EITHER OR TYPE)**
****ESE - 5 X6 = 30 (EITHER OR TYPE)**

QUESTIONS	OPTION 1	OPTION 2	OPTION 3	OPTION 4	ANSWER
Depreciation means _______________value of an asset.	Residual	Increased	Actual	Net	Residual
All fixed asset should be shown at cost less _____________ in the balance sheet.	Reserve	Current asset	Depreciation	Floating asset.	Depreciation
The amount of depreciation is ____________under straight line method	Fixed	Vary	Semi-variable	Semi-fixed	Fixed
Under diminishing balance method the first year amount of depreciation is ______________	Small	Heavy	Uniform	Less	Heavy
Depreciation is a _____________	Cash expenditure	Non cash expenditure	Deferred revenue expenditure	Capital expenditure	Non cash expenditure
Depreciation is charged on _____________	All asset	Current asset	All asset including good will	Fixed asset excluding land and goodwill	Fixed asset excluding land and goodwill
Which of the following asset is not depreciable ___________	Land	Plant	Building	Furniture	Land
The main objective of accruing depreciation is ____________	To calculate true profit	To calculate loss	To find out the company's	To find out company's loss	To calculate true profit
Depreciation arises because of ______________	Fall in market value of asset	Physical wear and tear	Fall in value of money	Increase in money value	Physical wear and tear
Under straight line method, depreciation ___________	Increases every year	Decreases every year	Remains constant	Changes accrues	Remains constant
Under diminishing balancing method, depreciation is calculated on __________	Original cost	Written down value	Scrap value	Book value	Written down value
All assets whose benefit is derived for a ____________ period of time is called fixed assets	Long	Short	Middle	Not for a period	Long
Straight line method of depreciation is otherwise known as__________	Written value method	Insurance policy	Fixed instalment method	Annuity method	Fixed instalment method
_________________method of depreciation is calculated on the original cost of assets	Revaluation	Straight line	Diminishing balance	Depletion method	Straight line
_________ will not be disclosed in the balance sheet	Secret reserve	General reserve	Capital reserve	Reserve	Secret reserve
Depreciation is a process of _____________	Valuation	Allocation	Both valuation	Appreciation	Valuation
Under the straight line method of providing depreciation ______________	Increases every year	Constant every year	Decreases every year	Fluctuate every year	Constant every year
Under the diminishing balance method depreciation ___________	Increases every year	Constant every year	Decreases every year	Fluctuate every year	Decreases every year
Under the fixed instalment method of providing depreciation it is calculated on ___________	Original cost	Scrap value	Market value	On balance amount	Original cost

Under the diminishing balance method, depreciation is calculated on ____________	Original cost	Scrap value	Market value	Book value	Book value
The amount of depreciation charged on a machinery will be debited to ____________	Machinery a/c	Cash a/c	Depreciation a/c	Repair a/c	Depreciation a/c
The economic factors causing depreciation __________	Time factor	Obsolescence	Amortization	Money valuation	Obsolescence
Loss on sale of plant and machinery should be written off against ______	Premium a/c	Depreciation fund a/c	Asset a/c	Sale a/c	Depreciation fund a/c
Asset which have a limited useful life are termed as ___________	Limited asset	Unlimited asset	Depreciable asset	Asset	Depreciable asset
Process of becoming out of date or obsolete is termed as _________	Physical deterioration	Depletion	Obsolescence	Amortization	Obsolescence
Which of the term is used to write off in reference to tangible fixed assets ____________	Depletion	Obsolescence	Amortization	Depreciation	Depreciation
Profit prior to incorporation is an example of ___________	Capital reserve	Reserve	Revenue reserve	Secret reserve	Capital reserve
Total depreciation cannot exceed its ____________	Scrap value	Cost value	Market value	Depreciable value	Depreciable value
Depreciation value of an asset is equal to _____________	Cost + Scrap value	Cost - Scrap value	Cost - Market	Cost + Market value	Cost - Scrap value
Depreciation does not depend on fluctuations as ___________	Market value of asset	cost value of asset	Scrap value of asset	Future value of asset	Market value of asset
Depreciation is a _________	Asset	Liability	Loss	Profit	Loss
The book value of an asset is obtained by deducting depreciation from its ____________	Cost	Scrap	Market	Market + Scrap	Cost
Depreciation fund method is also known as _____________	Written value method	Insurance policy	Fixed instalment method	Sinking Fund method	Sinking Fund method
The method is especiallysuited to natural resources (mines, quarries, sand, pits etc.) is said to be ____________	Written value method	Depletion method	Fixed instalment method	Sinking Fund method	Depletion method
Double – declining method is often used in the __________	Pakistan	China	Japan	USA	USA
In the provision method of depreciation, the asset always appears at ________	Cost Price	Market price	scrap value	Historic value	Cost Price
Determination of ____________ of an asset is normally a difficult matter	Scrap value	Residual value	Market price	Depreciable value	Residual value
_________applies to fixed asset	Depletion	Obsolescence	Amortizatio	Depreciation	Depreciation
________applies to wasting assets	Depletion	Amortization	Depreciatio	Obsolescence	Depletion
________applies to intangible assets	Amortization	Depreciation	Obsolescenc	Depletion	Amortization
_______refers to cost allocation for natural resources such as oil and mineral deposits	Depreciation	Amortization	Depletion	Obsolescence	Depletion
_______is concerned with charging the cost of man made fixed assets to operations	Depletion	Obsolescence	Amortization	Depreciation	Depreciation

_______relates to cost allocation for intangible assets such as patent and leaseholds	Amortization	Obsolescence	Depletion	Depreciation	Amortization
_______is an allowable expenses for tax purposes	Obsolescence	Depreciation	Amortization	Depletion	Depreciation
When ____________is not provided the profit of the concern will be over stated	Depletion	Amortization	Depreciation	Obsolescence	Depreciation
The amount of _______ accumulated during the working life of the assets provides additional working capital	Depletion	Depreciation	Amortization	Obsolescence	Depreciation
Proper measurement of the _________at each accounting date must be made to ensure uniform rate of return	Depreciable asset	Scrap asset	Intangible asset	Current asset	Depreciable asset
Original cost method is known as _________	Written value method	Insurance policy method	Fixed instalment method	Annuity method	Fixed instalment method
Original cost method is known as _________	Written value method	Insurance policy method	Fixed percentage method	Annuity method	Fixed percentage method
Diminishing method value is known as ________	Reducing balance method	Insurance policy method	Fixed percentage method	Annuity method	Reducing balance method
In _______amount spent on the purchase of an asset is regarded as an investment	Reducing balance method	Insurance policy method	Fixed percentage method	Annuity method	Annuity method
_______is considered as a scientific method	Reducing balance method	Insurance policy method	Fixed percentage method	Annuity method	Annuity method
In _________ the amount of depreciation is kept aside and invested in readily saleable securities	Reducing balance method	Insurance policy method	Fixed percentage method	Depreciation fund method	Depreciation fund method
___________method is similar to depreciation fund method, arrangements are made with the insurance company	Reducing balance method	Insurance policy method	Fixed percentage method	Depreciation fund method	Insurance policy method
In _________ asset is revalued at the end of the accounting year	Reducing balance	Insurance policy method	Revaluation method	Depreciation fund method	Revaluation method
In ________re value of asset will be compared with value of the asset at the beginning of the year	Reducing balance method	Insurance policy method	Revaluation method	Depreciation fund method	Revaluation method
_________is used in case of bottles, corks, loose tools, live stock	Reducing balance	Insurance policy method	Revaluation method	Depreciation fund method	Revaluation method
___________is useful in case of machines	Reducing balance	Machine hour rate method	Revaluation method	Depreciation fund method	Machine hour rate method
In _________life of machine is fixed in terms of hours	Reducing balance	Machine hour rate method	Revaluation method	Depreciation fund method	Machine hour rate method
________ is created out of capital profit	Capital reserve	Revenue reserve	General reserve	Redemption reserve	Capital reserve

UNIT-IV – Inventory

SYLLABUS

Inventory – The basics of Inventory – Inventory Accounting System – Inventory Valuation Methods – Inventory and its Impact on Financial Statements

The literary meaning of the word inventory is stock of goods. To the finance manager, inventory connotes the value of raw materials, consumable, spares, work-in-progress, finished goods and scrap in which a company's funds have been invested. It constitutes the second largest items after fixed assets in the financial statements, particularly of manufacturing organisation. It is why that inventory valuation and inventory control have become very important functions of the accountants and finance managers. The persons interested in the accounting information assume that the financial statements contain accurate information. However, it is often observed that the financial statements don't provide actual information about some of the items, e.g. inventory and depreciation. This may be because of the variety of inventory valuation methods available with the accountant.

According to the International Accounting Standard-2 (IAS-2), 'Inventories' mean tangible property held;

(a) for sale in the ordinary course of business,

(b) in the process of production for such sale, or

(c) for consumption in the production of goods or services for sale.

Hence, the term inventory includes stock of (i) raw material and components, (ii) work-in-progress and finished goods. In case of manufacturing concern, inventory consists of raw materials, components, stores, semi-finished products and finished goods in case of a trading concern inventory primarily consists of finished goods.

OBJECTIVES OF INVENTORY VALUATION

Following are the objectives of inventory valuation:

a) Determination of Income

A major objective of inventory valuation is the proper determination of income through the process of matching appropriate cost against revenues. Gross profit is found out by deducting cost of goods sold from sales. Cost of goods sold is purchases plus opening stock minus closing stock. Hence, closing stock must be properly valued and brought into accounts. Over valuation of closing stock leads to inflation of the current year profits and deflation of the profits of succeeding years. Similarly, undervaluation leads to deflation of current years profit and inflation of the profit of the succeeding years.

b) Determination of financial position

In the balance sheet, "inventory' is a very important item. It is to be shown as current asset in the balance sheet at the end of the year. If the inventory is not properly and correctly valued, to that extent the balance sheet does not give true and fair view of the financial position of the business. Keeping in view the above objectives the auditor's duty in relation to the verification and valuation of inventories becomes more important. Therefore, while verifying he should ensure that stock taking is done by responsible a officer, stock figures match with that of stock registers, and the basis of valuation has been consistently the same from year to year. Moreover, he should carry out test checks to ensure the accuracy of valuation.

METHODS OF RECORDING INVENTORY

The records of quantity and value of inventory can be made in two ways. These as follows:

(i) Periodic Inventory System
(ii) Perpetual Inventory System

Periodic Inventory System

Under this system the quantity and value of inventory is ascertained by physically counting the stock at the end of the year and as on the accounting date. In case of big business houses, annual stock taking may even take a week at the end of the year in finalising the stock in hand on continuous basis. In case of this system certain items are physically counted, while others are weighed in kilos or tonnes or measured in litters. For stock taking stock sheets are used. The firms evolve such a pro forma of stock sheet on which all the relevant information like particulars of inventory, numbers of units, price per unit, total value, etc. can be listed and added so as to get the figure of inventory. This method offers the advantage of simplicity. Also, there is no used to maintain the various records to be maintained under perpetual inventory system. However, the limitation of this method is that discrepancies and losses in inventory will never come to light as it makes no accounting for theft, losses, shrinkage and wastage.

Perpetual Inventory System

This system provides as running record of inventories on hand because under this method stock registers are maintained which will give the inventory balance at any time desired. According to the Institute of Cost and Management Accountants, London, it is "a system of records maintained by the controlling department which reflects the physical movement of stocks and their current balance." The stores ledger will give the balance of raw materials, work-in-progress and finished goods on hand. Because of this it is for the management to provide for continuous stock-taking, so that by comparing the physical balance with book balance, any discrepancies are ascertained immediately

In this system business need not be suspended for the purpose of stock taking. The main advantage of this method is that it provides details about the quantity and value of stock of each item all times. Thus it provides a basis for control. The main drawback of this system is that it requires elaborate organisation and records and, therefore, it is more expensive.

METHODS OF VALUATION OF INVENTORIES

The basic methods of valuation of inventories are as follows:

(a) Historical cost based method

(b) Sale price based method

(c) Lower of cost or sale price

Methods based on Historical cost

According to AS-2 historical cost is the aggregate of costs of purchases, costs of conversion and other costs incurred in the normal course of business in bringing the inventories to their present locations and condition. Cost of purchase comprises purchase price, duties and taxes, freight inwards and other expenditure directly attributable to acquisitions. However, selling expenses such as advertisement expenses or storage cost should not be included.

The valuation of inventory at cost price will be in consonance with the realisation concept. According to this concept, revenue is not realised until the sale is complete and the inventory is converted into either cash or accounts receivable. There can thus be no recognition of revenue accretion except at the point of sale.

This is a method with very high objectivity since the inventory valuer has to base it on a transaction which is completely verifiable. The main limitation of this method is its inability to distinguish operational gains from holding gains during period of inflation.

They may be attributed to the fact that this method matches the past inventories against revenues which have current relations. Thus, this system will result in the inclusion of “inventory profits” (i.e. holding gain) in the income statements during periods of rising prices. Now, we shall describe the various methods for assigning historical costs to inventory and goods sold.

1. First In First Out Method (FIFO)

This method is based on the assumption that the materials which are purchased first are issued first. Issues of inventory are priced in order of their purchases. Inventory issues/sales are priced on the same basis until the first lot of material of goods purchased is exhausted. Thus, units issued are priced at the oldest cost price listed on the stock ledger sheets. Under this system it is not necessary that the material which were longest in stock are exhausted first. But the use of FIFO necessarily mean that the oldest costs are first used for accounting purposes. In practice, an endeavour is made by most business houses to sell of oldest merchandise or materials first. Hence when this system is followed the closing stock does not consist of most recently purchased goods.

Advantages: The following are the advantages of this method:

(i) This method is easy to operate, provided the prices of materials do not fluctuate frequently.

(ii) It gives such a value of closing stock which is vary near to current market prices since closing inventory is made of most recently purchased goods.

(iii) It is a realistic method because it takes into account the normal procedure of issuing goods/inventory, i.e. the materials are issued to production in the order of their receipts.

(iv) As it is based on historical cost, no unrealised profit enters into the financial statements for the period.

Disadvantages: This method suffers from the following limitations:

(i) Because of violent changes in prices of materials, it involves somewhat complicated calculations and, therefore, it involves somewhat complicated calculations and, therefore, increase the changes of clerical errors.

(ii) The prices of issues of materials may not reflect current market prices and, therefore, during the period of inflation, the charge to production is unreasonably low.

(iii) Comparison between different jobs executed by the firm becomes sometimes difficult. A job commenced a few minutes before another job might have consumes the supply of lower priced stock. This is particularly because of that the fact the first job might have completely exhausted the supply of materials of a particular lot.

Suitability

FIFO method is considered more suitable during the periods of falling prices. The reason is that the higher price at which the purchase of materials was made earlier stands recovered in cost. This method is suitable when the size of purchases is large but not much frequent. The moderate fluctuations in the prices of materials, and easy comparison between different jobs are also the important conditions for the use of this method.

Illustration: The following is the record of receipts of certain materials during the month of January 2006:

Jan. 2	Received 500 Units	@ Rs.20 per unit
Jan. 3	Received 400 Units	@ Rs. 21 per unit

Jan. 15	Received 300 Units	@ Rs. 19 per unit
Jan. 28	Received 400 Units	@ Rs. 20 per unit

The physical inventory taken on 31st January, 2006 shows that there are 600 units in hand. Compute the inventory value on 31st January, 2006 by FIFO method.

Solution: Under FIFO method, closing inventory includes recent purchases at most recent prices. Hence, the value of the inventory on 31st January will be as follows:

January 28	Purchases	400 units @ Rs. 20 = Rs. 8000
January 15	Purchases	200 units @ Rs. 19= Rs. 3800
		Rs. 11, 800

Here, the value of inventory as on 31st January 2006 has been arrived as on the presupposition that the firm uses periodic inventory system, the value of inventory would remain the same even if the perpetual inventory system is in use. To take an example, if out of 1000 units issued, 300 units were issued on January 5, while 700 units were issued on January 16, the valuation of inventory using perpetual inventory system will be done as follows:

Date	**Receipts**			**Issues**			**Balance**	
	Qty.	**Rate**	**Amount (Rs.)**	**Qty.**	**Rate (Rs.)**	**Amount (Rs.)**	**Qty.**	**Amount**
Jan.2	500	20	10,000	--	--	--	500	10,000
Jan.3	400	21	8.400	--	--	--	900	18,400
Jan. 5	--	--	--	300	20	6000	600	12,400
Jan.l5	300	19	5,700	--	--	--	900	18,100
Jan.16	--	--	--	200	20	4,000		
				400	21	8,400		
				100	19	1,900	200	3,800
Jan.28	400	20	8,000	--	--	--	600	11,800

From the above stock ledger it is obvious that the value of ending inventory under FIFO method is same in case of both periodic and perpetual inventory systems.

2. Last in First Out Method (LIFO)

Under this method, it is assumed that the material/goods purchased in the last are issued first for production and those received first issued/sold last. In case a new delivery is received before the first lot is fully used, price become the 'last-in' price and is used for pricing issued until either the lot is exhausted or a new delivery is received.

As stated above, materials are issued to production at cost which may be vary near to current marked price. However, inventories at the end will be valued at old prices which may be out of tune with the current maket price.

Advantages:

(i) This method takes into account the current market circumstances while valuing materials issued to various jobs or ascertaining the cost of goods sold.

(ii) No unrealised profit or loss is usually made in case this method is followed.

Disadvantages:

(i) The stock in hand is valued at a price which have become out-of-date when compared with the current inventory prices.
(ii) This method may not be acceptable for taxation purposes since the value of closing inventory may be quite different from the current market value.
(iii) Comparison among similar jobs is very difficult because they may bear different issue prices for materials consumed.

Suitability: This method is most suitable for materials which are of a bulky and non-perishable type.

Illustration: With the information given in illustration (1), compute the inventory value on 31st Jan. 1998 by LIFO method. Also prepare a store ledger account showing how the receipts and issues on 5th Jan and 700 units issued on 16th January 2006.

Solution: Under LIFO method, closing inventory includes most old purchases remaining unissued till last date. Hence, valuation of inventory under periodic inventory system would be as follows:

2	Purchases200 units	@Rs.20 = Rs. 4,000	
Jan. 28*	Purchases	400 units	@Rs.20 = Rs.8,000
			Rs. 12,000

Valuation of Inventory under perpetual inventory system

Date	**Qty**	**Rate**	**Amt. (Rs.)**	**Qty**	**Rate (Rs.)**	**Amt. (Rs.)**	**Qty**	**Amt.**
Jan 2	500	20	10,000	-	-	-	500	10,000
Jan 3	400	21	8,400	-	-	-	900	18,400
Jan 5	-	-	-	300	21	6,300	600	12,100
Jan 15	300	19	5,700	-	-	-	900	17,800
Jan 16	-	-	-	300	19	5,700		
				100	21	2,100		
				300	19	6,000	200	4,000
Jan 28	400	20	8,000	-	-	-	600	12,000
Jan 31	-	-	-	-	-	-	600	12,000

Implications of FIFO and LIFO method in case of rising and falling prices: Both these methods value the products manufactured at true costs because both are based on actual cost. But in period of rising and falling prices both have conflicting result.

In periods of rising prices the cost of production will be lower in case of FIFO method. This is simply because of the lowest material cost. Contrary to this, LIFO method will result in charging products at highest materials cost. Thus in case of rising price the application of FIFO method will result in higher profitability, and higher income tax liability, whereas the application of LIFO method result in lower profitability, which in turn will reduce income tax liability.

In periods of falling market, the cost of product will tend to be low with reference to the overall cost of inventory in case material cost is to be charged according to LIFO method. Hence, this method will be resulting in inflating of profits and increasing the tax liability. The reverse will be the case if FIFO method is followed. Production will be relatively overcharged. This will deflate the profits and reduce the income tax liability.

In periods of falling prices the ending inventory will be valued in FIFO method at a price lower than in case of LIFO method. The reverse will be the case when the prices are rising. Interestingly, on the basis of above discussion, it may be concluded that in periods of falling prices, LIFO method tends to give a more meaningful balance sheet but less realistic income statement, whereas FIFO method gives a more meaningful income statement but a less realistic balance sheet. The reverse will be the situation in periods of rising prices.

Now the question arises about the superiority of the LIFO and FIFO methods. Based on forgoing discussion about implications of these methods in case of both rising and falling markets, it may be concluded that each method has its own merits and demerits depending upon the circumstances prevailing at a particular moment of time. Thus, no generalisation can be made regarding superiority of LIFO over FIFO or vice-versa.

3. Highest-in-First-our (HIFO)

According to this method, the highest priced materials are treated as being issued first irrespective of the date of purchase. In fact, the inventory of materials or goods are kept at the lowest possible price. In periods of rising prices the closing inventory is undervalued and thus secret reserves are created. However, the highest cost of materials is recovered first. Consequently, the closing inventory amount remains at the minimum value. Hence, this method is very appropriate when the prices are frequently fluctuating. As this method involves calculation more than that of LIFO and FIFO methods, it has not been adopted widely.

4. Base stock method

The base stock method assume that each business firm whether small or large must held a minimum quantity of materials finished foods at all times in order to carry on business smoothly. These minimum quantity of inventories are valued at the cost at which the base stock was acquired. It is assumed that the base stock is created out of the lot purchased. Inventories over and above the base stock are valued according to some other appropriate method such as FIFO, LIFO, etc.

AS-2 recommends the use of this method in exception circumstances only. This is because of the fact that a large number of companies customarily maintain a minimum stock level at all times irrespective of its requirement. Actually, sometimes base stock method is used without its justification. Therefore, this method requires a clear existence of the circumstances which require that a minimum level of charging out inventory of raw material and finished goods at actual cost along with merits and demerits of the method which is used for valuation other than the base stock method.

5. Specific Identification Method

Under this method, each item of inventory is identified with its cost. The value of inventory will be constituted by the aggregate of various cost so identified. This method is very suitable for job order industries which carry out individual or goods have been purchased for a specific job or customer. In other words, this method can be applied only where materials used can be specifically and big items such as high quality furniture, paintings, metal jewellery, cars, etc.

However, this method is not appropriate in most industries because of practical problems. For instance, in case of manufacturing company having numerous items of inventory, the task of identifying the cost of every individual item of inventory becomes very cumbersome. Also, it promotes the chances of manipulating the cost of goods sold. It can be done by selecting items that have a relatively high cost or a relatively low cost, as he desires.

Example: Suppose that following information is available from records:

Opening inventory of material as on Jan. 1 , 2000 at Rs.20 = 200 units. Purchases of materials as on Jan. 16, 2000 at Rs. 24 = 100 units. Purchases of materials as on Jan.26, 2000 at Rs.30 = 150 units
Total units available for sale = 450 units
Units sold during January = 260 units
Inventory of materials at January end = 190 units

Now, if it assumed that the firm selected 200 items of materials that had a unit cost of Rs. 20 and 60 units of items that had a unit cost Rs. 24, the cost of goods sold for the firm would be as follow:

Cost of 200 items =	200 × 20 =	Rs. 4000
Cost of 60 items =	60 × 24 =	Rs. 1440
		Rs. 5440

Whereas, if 260 items having highest cost are selected, then the cost of goods sold would be Rs. 7100 [(l50×30) + (l00×24) + (10×20)].

6. Simple average Price (SAP)

This is the average of prices of different lots of purchase. Under this method no consideration is given to the quantity of purchases in various lots. For example the purchases of 500 units of materials at Rs. 10 per unit are made as on 5th January, 1995 and 800 units of materials at Rs. 14 per unit on 10^{th} January. If at the end 200 units remains unissued/unsold, these will be valued at Rs. 12 = [(10 + 14)/2]per unit and hence, the closing inventory will be shown at Rs. 2400 (200 × 12 = 2400). In fact, this method operated on the principle that when items of materials are purchased in big lots and are put in godown, their identity is lost and, therefore, issues should be priced at the average price of the lots in godown.

7. Weighted Average Price (WAP)

Under this method, the quantity of material purchased in various lots of purchases is considered as weight while pricing the materials. Weighted average price is calculated by dividing the total cost of material in stock by the total quantity of material at the end. When this method is adopted, the question of profit or loss out of varying prices does not arise because it evens out the effect of widely fluctuating prices of different lots of purchases. This method is very popular because it reduces calculations and is based on quantity and value of material purchased.

Illustration: The following are the details of transactions regarding receipt and issue of materials:

Date	Quantity received	Rate	Quantity issued
Jan.2, 2006	100	Rs. 1.00	—
Jan.9, 2006	150	Rs. l.20	—
Jan.14, 2006	—	—	125
Jan.17, 2006	250	Rs. l.30	—
Jan.19, 2006	—	—	100

You are required to prepare a stock ledger pricing the issue at (i) Simple average price and

Solution:

Simple Average Price Method:

STOCK LEDGER

Date	Receipts			Issues			Balance	
2006	Qty.	Rate	Amount	Qty.	Rate	Amount	Qty.	Amount
Jan.2	100	l.00	100	—	—	—	100	100
Jan.9	150	1.20	180	—	—	—	250	280
Jan.14	—	—	—	125	1.10[a]	137.50	125	143
Jan.17	250	1.30	325	--	—	—	375	518
Jan.19	—	—	—	100	1.25[b]	125.00	275	393

Working Notes

Average price on 14.1.2006 = (1.00 + 1.20)/2

= Rs. 1.10

Average price on 19.1.2006 = (1.20 + 1.30)/2

= Rs. 1.25

The price of the purchases that were made on 2nd January has been ignored while computing average price on 19.1.2006 since we have assumed that issue of 125 units on 14.1.2006 comprises all the 100 units purchased on 2.1.2006.

Method Based on Sale Price

The inventories may be valued at marked or sale prices. Important among these prices are current selling prices, and net realisable value. Both of these are discussed as follows:

Method Based on Sale Price

1.Current Selling Prices: The method is used in case of the product of which market as well as prices are controlled by a Government. Marketing costs being negligible are ignored under this method. This method is followed in the case of sugar industries, metal industries, etc.

2. Net Realisable Value. According to IAS-2, the net realisable value means, “the estimate selling price in the ordinary course of business costs of completion and less costs necessarily to be incurred in order to make the sale.” Estimates of net realisable value should not be guided by temporary fluctuations in market prices. However, these should be arrived at after taking into consideration all expenses which

might have to be incurred for making sales. Such cases where it is difficult to estimate the appropriate costs, say agriculture output, inventory are valued consistently at market values. This procedure of valuation is accepted because of the saleability of the output at quoted prices.

The Lower of Cost or Market Price (LCM Rule)

This method is based on the accounting principle of conservatism according to which profits should not be anticipated but all losses foreseen should be provided for. For instance, the ending inventory consist of items purchased at cost of Rs.210 per unit. But the market price has fallen to Rs.200 per unit at the time of valuation of inventory. Hence, the items should be valued at Rs.200 per unit. This rule violate the matching concept which requires matching of revenues with the related product costs. This method also leads to inconsistency since in one year the valuation may be based on cost while in another it may be based on market price. However, even the critics of this rule favour the application of this rule for valuing obsolete or damaged inventories.

About inventories valuation AS-2, recommends that the general rule of valuing inventories should be at lower of historical cost and net realisable value subject to certain exceptions. The historical of the inventories should normally be determined by using 'FIFO', 'LIFO' or Average 'Cost' method. Inventory of by-products cannot be separately determined. It should be valued at net realisable value.

LCM rule can be applied in anyone of the following ways:

1. Aggregate/total inventory method: In this method, cost price of the total inventory is ascertained and then compared with total net realisable price to arise at stock valuation.

2. Group Method: Under this method, groups are formed of similar or interchangeable articles of inventory. The cost and the net realisable value of each group so formed are found out. The LCM rule is applied to each group.

3. Item-by-item-method: According to this method, the cost and net realisable prices of each item of inventory are found out and the lower of the figures is taken into account for valuation of inventory. Both IAS-2 and AS-2 have recommended the use of "Group method" and "Item-by-Item" method for valuation of inventory. The first method namely "Aggregate or Total Inventory method" have not been recommended by both the standards. The learner's will understand the difference between all the three methods from the following illustration.

VALUATION OF INVENTORY FOR BALANCE SHEET PURPOSE

In certain cases, it is not possible for the business to take inventory on the date of balance sheet. It might have been taken on a date earlier or later than the date of balance sheet. In such a case, when student are required to calculate the value of stock on the date of preparation of final accounts, then they should take into consideration information about additional transactions which occur during the period. For example, if value of stock on 28th March is given, then in order to find the value of stock on 31st March all purchases between these dates will be added. Likewise, if value of stock on 4th April is given and value of stock on the proceeding 31st March is required then purchases during the period will be deducted and issues/sales (at acquisition price) during this period will be added. Both of the above mentioned cases could be understood and elaborated as under:

(i) When the Position of stock is given on a date prior to the balance sheet date

In this case, the following adjustments will generally be required:

(a) Add purchases made during the period.

(b) Deduct purchases returns during the said period.

(c) Deduct inventory issued/sold between the two dates.

(d) Add sales returns between the two dates.

(ii) When the position of stock is given on a date after the balance sheet date

For example, if the balance sheet is to be prepared as on 31st March, 2005 and the stock position has been given as on 15th April, 2005 the following adjustments will be required:

(a) Less purchases made between 1st April, 2005 to 15th April, 2005.

(b) Add purchases returns between 1st April, 2005 to 15th April, 2005.

(c) Add sales (at cost price) between 1st April, 2005 to 15th April, 2005.

(d) Less sales returns between 1st April, 2005 to 15th April, 2005.

KARPAGAM ACADEMY OF HIGHER EDUCATION

DEPARTMENT OF MANAGEMENT

I BBA - (2018 - 2021 BATCH)

II SEMESTER

FINANCIAL ACCOUNTING (18BAU201)

UNIT IV

POSSIBLE QUESTIONS

Part A (ONE Mark)

Multiple Choice Questions

Online Examination

PART B

1. Define inventory
2. List out the methods of inventory valuation
3. What is meant by FIFO?
4. Give the meaning for periodic inventory system?
5. What is meant by perpetual inventory system?
6. Write any objectives of inventory valuation?
7. Write a short note on LUFO
8. What is meant by simple average method?
9. Give the meaning for weighted average method?
10. Write any two merits of inventory valuation?

***CIA - 3 X 2 = 6 (ANSWER ALL THE QUESTIONS)**
****ESE - 5 X 2 = 10 (ANSWER ALL THE QUESTIONS)**

PART C

1. What are the various methods of inventory valuation? Discuss the impact of each method on working results.
2. What is the principle behind valuation of inventory at cost or arket price whichever is lower?
3. What are the main recommendations of AS-2 regarding valuation of inventories?
4. Differentiate the following: (a) LIFO and FIFO method
5. What is the need of valuing inventory properly? Discuss. To what extent this need is fulfilled by various methods of valuing inventories.
6. Arvind Ltd. uses large quantities of a sweetening material for its products. The following figure relates to this material during the calendar year 1980:

Quarter ended (Tonnes)	Purchases	Invoice Cost per Tonne Rs.	Consumption (Tonnes)
March 31	1,000	620	600
June 30	2,100	630	1,200
September 30	700	640	1,500
December 31	1,200	670	1,350

The stock of material on December 31, 1979 was 1,000 tonnes valued for accounting purposes at cost of Rs. 600 a tonne. Delivery of goods to the factory is made on the first day of each quarter. You are required to compute the value of stock as on December 31, 2000 applying LIFO and FIFO methods.

7. Purchases of certain product during March, 1982 are set out below:

March 1	100 units	@ Rs. 10
12	100 units	@ Rs. 9.80

15	50 units	@ Rs. 9.60
20	100 units	@ Rs. 9.40

Units sold during the month were as follows:

March 10	80 units
14	100 units
30	90 units

No opening inventories

You are required to determine the cost of goods sold for March under three different valuation methods viz, FIFO, LIFO and Weighted Average Cost.

8. M/s Swadeshi Cotton Mills Ltd. take a periodic inventory of their stock of chemically at the end of each month. The physical inventory taken on 30 shows a balance of 1,000 litres of chemically in hand @ Rs. 2.28 per litre.

The following purchases were made during July:

July 1	14,000 litres	@ Rs. 2.30 per litre
July 7	10,000 litres	@ Rs. 2.32 per litre
July 1	14,000 litres	@ Rs. 2.30 per litre
July 25	5,000 litres	@ Rs. 2.35 per litre

A physical inventory on July 31 discloses that there is a stock of10,000 litres. You are required to compute the inventory value on July 31, by each of the following methods:

(i) First in First out; (ii) Last in First out; and (iii) Average cost method.

9. Following are the details regarding inventories of a manufacturing concern as on 31st December, 1981: Inventories categories Cost (Rs.) Market Prices (Rs.)

Category 1: A	6,000	9,000
B	10,000	9,500
Category 2: C	15,000	17,000

	D	20,000	14,000
Total		51,000	49,000

You are required to determine inventory value using "lower of cost or market value basis", according to each of the following methods:

(i) Aggregate or total inventory method; (ii) Group method; (iii) Itemby-item method.

***CIA - 3 X 8 = 24 (EITHER OR TYPE)**
****ESE - 5 X6 = 30 (EITHER OR TYPE)**

QUESTIONS	OPTION 1	OPTION 2	OPTION 3	OPTION 4	ANSWER
Any firm that a firm keeps to meet the future requirements of production and sale is called ____________	Inventory	Furniture	Land	Machinery	Inventory
The basic reason to hold ___________ is to keep up the production activities uninterrupted	Inventory	Furniture	Land	Machinery	Inventory
The Institute of Chartered Accountant of India defines inventories in ___________	AS 1	AS 2	AS 3	AS 4	AS 2
The principle types of inventories can be classified into _______________	Two	Three	Four	Five	Three
________ is the one of the principle type of inventories	Raw Materials	Machinery	Goodwill	patent	Raw Materials
________ is the one of the principle type of inventories	Work in Progress	Machinery	Goodwill	patent	Work in Progress
________ is the one of the principle type of inventories	Finished goods	Machinery	Goodwill	patent	Finished goods
________ represents goods kept by a manufacturing firm prior to their being utilised in the production process	Raw Materials	Machinery	Goodwill	patent	Raw Materials
__________ includes tools and consumables which are consumed in the production of goods and services	Supplies	Finished goods	patent	Technical knowhow	Supplies
_________ represent the semi finished goods	Work in Progress	Machinery	Goodwill	patent	Work in Progress
______ include those materials that have been constituted to production process but not yet have been converted to finished goods	Work in Progress	Machinery	Goodwill	patent	Work in Progress
_______________ are completed goods awaiting sale	Finished goods	Machinery	Goodwill	patent	Finished goods
In a manufacturing concern, ____________ are the final output of production process	Finished goods	Machinery	Goodwill	patent	Finished goods
In case of manufacturing unit, inventory will generally include _________	Work in Progress	Finished goods	Raw Materials	Raw Materials, Work in Progress and	Raw Materials, Work in Progress and Finished
In case of trading concern, inventory will generally include	Work in Progress	Finished goods	Raw Materials	Raw Materials, Work in	Finished goods
____________ needs proper control as it is one of the largest assets of a business	Debenture	Inventory	Debt	Loan	Inventory
To show the fair and true view of the financial position ________is included as asset in the balance sheet	Inventory	Sale	Expenses	income	Inventory
_________ valuation of inventory affect the operating results and financial position of the current period	Under	Over	Under or over	Standard	Under or over

Adequate _______ is essential for production sale process	Debenture	Inventory	Debt	Loan	Inventory
_________ of inventory amounts to window dressing which in turn give the wrong idea about the liquid position of the company	Under valuation	Over valuation	Standard valuation	Fixed valuation	Over valuation
There are ______ methods of ascertaining the value of stock	Three	Two	Four	five	Two
In __________ method value of stock is determined by physical counting of the stock on the accounting date	Periodic inventory	Perpetual inventory	Standard inventory	Fixed inventory	Periodic inventory
____________ of stock at the end of the year is also known as annual stock taking	Periodic inventory	Perpetual inventory	Standard inventory	Fixed inventory	Periodic inventory
_______ is the simple and economical method of stock taking	Periodic inventory	Perpetual inventory	Standard inventory	Fixed inventory	Periodic inventory
______ method can be adopted in small concerns	Periodic inventory	Perpetual inventory	Standard inventory	Fixed inventory	Periodic inventory
______ method does not provide basis of contro1	Periodic inventory	Perpetual inventory	Standard inventory	Fixed inventory	Periodic inventory
__________ method is a system of records maintained by the controlling department, which reflects the physical movement of stocks and their current balance	Periodic inventory	Perpetual inventory	Standard inventory	Fixed inventory	Perpetual inventory
Under ________ method stock registers are maintained to make a record of physical movement of stocks	Periodic inventory	Perpetual inventory	Standard inventory	Fixed inventory	Perpetual inventory
Continuous stock taking is an external features of the _______	Periodic inventory	Perpetual inventory	Standard inventory	Fixed inventory	Perpetual inventory
______ system provide a running record of inventories on hand at any time	Periodic inventory	Perpetual inventory	Standard inventory	Fixed inventory	Perpetual inventory
_______ means system of stock records	Periodic inventory	Perpetual inventory	Standard inventory	Fixed inventory	Perpetual inventory
_________ based on physical stock taking	Periodic inventory	Perpetual inventory	Standard inventory	Fixed inventory	Periodic inventory
________ based on records	Periodic inventory	Perpetual inventory	Standard inventory	Fixed inventory	Perpetual inventory
_______ directly determines stock	Periodic inventory	Perpetual inventory	Standard inventory	Fixed inventory	Periodic inventory
_____ directly determines cost of sales	Periodic inventory	Perpetual inventory	Standard inventory	Fixed inventory	Perpetual inventory
In ________ method cost of sales includes lost goods	Periodic inventory	Perpetual inventory	Standard inventory	Fixed inventory	Periodic inventory
In _________ method inventory includes lost goods	Periodic inventory	Perpetual inventory	Standard inventory	Fixed inventory	Perpetual inventory

_______ provides basis for control of inventory	Periodic inventory	Perpetual inventory	Standard inventory	Fixed inventory	Perpetual inventory
______ is an expensive method	Periodic inventory	Perpetual inventory	Standard inventory	Fixed inventory	Perpetual inventory
_____method will be adopted in big concern	Periodic inventory	Perpetual inventory	Standard inventory	Fixed inventory	Perpetual inventory
________ is valued at cost or market price which ever is lower	Inventory	Sale	Expenses	income	Inventory
_________ means taking the gloomy view of a situation	Conservatism	Consignme nt	Joint Venture	firm	Conservatis m
______ will affect the profit of the firm	Gain	Income	Revenue	Valuation of inventory	Valuation of inventory
FIFO -	First in First Out	Flat In First out	First in Free Out	Flash In First Out	First in First Out
In ____ method, the oldest items in the inventory are used	LIFO	FIFO	HIFO	Average Stock	FIFO
_______ method is very useful when prices are falling	LIFO	FIFO	HIFO	Average Stock	FIFO
_____ is a logical method	LIFO	FIFO	HIFO	Averagfe Stock	FIFO
________ method of valuation of inventory is simple to understand and easy to operate	LIFO	FIFO	HIFO	Average Stock	FIFO
_______ method is useful when inventory is subj	LIFO	FIFO	HIFO	Average Stock	FIFO
_____ method is known as replacement cost method	LIFO	FIFO	HIFO	Average Stock	LIFO
In ________ method, materials are charged to production at the current cost	LIFO	FIFO	HIFO	Average Stock	LIFO
Average cost may be of _____ types	Two	Three	Five	Six	Two
_______ method of was first introduced in USA during the second world war to take the advantage of rising prices	LIFO	FIFO	HIFO	Average Stock	LIFO

_________ price is obtained in taking the average of the price without taking into consideration quantities of items in stock	Simple Arithmetic Average	Weighted Arithmetic Average	Average Stock	HIFO	Simple Arithmetic Average
________ price is calculated by dividing the total cost of items of stocks by the total quantity of items in hand	Simple Arithmetic Average	Weighted Arithmetic Average	Average Stock	HIFO	Weighted Arithmetic Average
______ method is based on the assumption that closing stock of material or finished goods should always remain at the minimum value	LIFO	FIFO	HIFO	Average Stock	HIFO
________ method is mainly used in case of cost plus contract or monopoly products	LIFO	FIFO	HIFO	Average Stock	HIFO
The minimum quantity maintained in a concern to meet emergency requirements	LIFO	FIFO	HIFO	Base stock	Base stock
Safety stock is also known as ______	LIFO	FIFO	HIFO	Base stock	Base stock
________ can be a replacement price or realisable price	Average price	Market price	Cost price	Historic price	Market price

UNIT-V – Partnership Accounting

SYLLABUS

Partnership Accounting: Fundamentals of partnership – Definition, Meaning and Features of partnership, Preparation of profit and Loss Account and Capital Account, Reconstitution of Partnership – Admission, change in Profit sharing Ratio, Retirement and Death of a Partner – Dissolution of a Partnership Firm

PARTNER SHIP ACCOUNTS

Basic Concept

A business can be organized in the form of a sole proprietorship, a partnership firm or a company. Earlier, you have studied how to prepare Profit and Loss Account and Balance Sheet of a sole proprietor. If one man was intelligent enough and commanded all the resources that he needed and also the necessary power to do everything, he would have carried on his business as an individual. Alas, this is not true in life. Every man needs help from others and this is true in business which requires huge resources for the ongoing expansion programmes. Therefore, one of the inevitable ways is to form partnership by joining hands with person(s) who can complement the efforts by bringing in the necessary intellectual as well as financial capital. This chapter is devoted to the basic aspects of partnership accounting dealing with the accountancy preparation of Profit and Loss Account and Balance Sheet of a partnership firm.

Although the basic accounting procedure is similar in all cases, there are certain special features in the accounts of a partnership firm. In the case of a partnership firm, for example, the special features relate to the distribution of profits, the maintenance of capital accounts and the adjustments required when the firm is reconstituted. In this chapter, we shall study the nature of partnership and discuss the basic aspects of partnership accounts like preparation of capital accounts, distribution of profits amongst partners and change in the profit sharing ratio of the existing partners along with preparation of Profit and Loss Account and Balance Sheet of the partnership firm.

NATURE OF PARTNERSHIP

The sole proprietorship has its limitations such as limited capital, limited managerial 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 and involves more risk, two or more persons join hands to run it. They agree to share the capital, the management, the risk and profits of the business. Such mutual economic relationship based on a written or an oral agreement amongst these persons is termed as 'partnership'. The persons who have entered into partnership are individually known as 'partners' and collectively as 'firm'.

The Indian Partnership Act, 1932 defines partnership as "the relation between persons who have agreed to share the profits of a business carried on by all or any of them acting for all". Based on this definition, the essential features of partnership are as follows:

1. Two or more persons:

To form a partnership, there must be at least two persons. There is, however, a limit on the maximum number of persons who constitute a partnership firm. It should not exceed 10 if the firm is carrying 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 Undivided Family nor by status. The agreement forms the basis of economic relationship amongst the partners. The agreement can be written or oral.

3. Business :

The agreement should be for carrying on some legal business. A joint ownership of some property by itself does not constitute partnership. However, the joint ownership of the property may be used for forming the partnership in order to pursue the business objectives for which the partnership is formed.

4. Sharing of profits :

The agreement should be to share the profits of the business. If some persons join hands to carry on some charitable activity, it will not be termed as partnership. Of course, the ratio in which the partners will share the profits is determined by the agreement or in the absence 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 business may 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 agency relationship. A partner is both an agent (he can, by his acts, bind the other partners) and a principal (he is bound by the acts of other partners). The implication of this is that partner binds others and others bind him in the same way. Further implication of this is that each partner is entitled to participate in the conduct of business affairs and act for and on behalf of the firm.

PARTNERSHIP DEED

A partnership is formed by an agreement. This agreement may be written or oral. Though the law does not expressly require that there should be an agreement in writing but the absence of a written agreement may be a source of trouble in managing the affairs of the partnership firm. Therefore, a partnership 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 of the 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 mutual relationship amongst the partners. But if the deed is silent on certain matters or in the absence of any deed or an express agreement, the relevant provisions of the Partnership Act shall become applicable. It is, therefore, necessary to know the provisions of the Act, which have a direct bearing on the accounting treatment of certain items. These are as follows:

1. Profit Sharing: The partners shall share the profits of the firm equally irrespective of their capital contribution.

2. Interest on Capital: No interest is allowed to partners on the capital contributed by them. Where, however, the agreement provides for interest on 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 allowed even if the agreement so provides.

3. Interest on Loan: If any partner, apart from his share of capital, advances money to the firm as a loan, he is entitled to interest on such amount at the rate of 6 per cent per annum. Such interest shall be paid even out of the assets of the firm. This means that interest on loan shall be paid even if there are losses. Implying, thereby, that it is a charge against the revenues.

4. Interest on Drawings: No interest will be charged on drawings made by the partners.

5. Remuneration to Partners: No partner is entitled to any salary or commission for participating in the business of the firm. It should be remembered that the above rules are applicable only in the absence 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 within the following chapters.

Partners' Capital Accounts

In case of partnership firm, the transactions relating to partners are recorded in their respective capital accounts. Normally, each partner's capital account is prepared separately. But these accounts can also be shown in a tabular form as shown later in this chapter.

There are two methods by which the capital accounts of partners can be maintained. These are:

Fluctuating Capital Method; and

Fixed Capital Method.

Fluctuating Capital Method

Under the fluctuating capital method, only one account *viz.*, the capital account for each partner, is maintained. It records all items affecting partner's account like 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, the balance in the capital account keeps on fluctuating.

The items that usually appear on the debit and the credit side of the Partners' 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 fixed unless some additional capital is introduced or some amount of capital is withdrawn by an agreement among the partners. Hence, all items like interest on capital, drawings, interest on drawings, salary, commission, and share of profit or loss are not to be shown in the capital accounts. For all these transactions, a separate account called 'Partner's Current Account' is opened.

Thus, under fixed capital method, two accounts are maintained for each partner viz., (i) Capital Account, and (ii) Current Account. It may be noted that the capital account will continue to show the same balance from year to year unless some amount of capital is introduced or withdrawn, while the balance of 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 drawings		* * * *		Salary		* * * *
			* * * *		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 (Fixed and Fluctuating Capital Account)

Amit and Sumit commenced business as partners on April 1, 2000. Amit contributed Rs. 40,000 and Sumit Rs. 25,000 as their share of capital. The partners decided to share their profits in the ratio of 2:1. Amit was entitled to a salary of Rs. 6,000 p.a. Interest on capital was to be provided @ 6% p.a. The drawings of Amit and Sumit for the year ending March 31, 2001were Rs. 4,000 and Rs. 8,000, respectively. The profits of the firm after providing Amit'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 on drawings) is to be shared by all the partners in the agreed profit sharing ratio. In the absence of any specific agreement to this effect, the profit 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 a partnership firm needs certain adjustments with regard to interest on capitals, interest on drawings, salary, commission to the partners, if provided, under the agreement. For this purpose, 'Profit and Loss Appropriation

Account' may be prepared. This is merely an extension of the profit and loss account and is prepared to show how net profit is to be distributed among the partners. This account is credited with net profit and interest on drawings, and debited with interest on capitals, salary or commission to partners. If, however, the profit and loss appropriation account shows a net loss, it will be shown on the debit side of the profit and loss appropriation account. After these adjustments have been made, the Profit and Loss Appropriation Account will show the amount of profit or loss, which shall be distributed among the partners in the agreed profit sharing ratio.

For preparing the profit and loss appropriation account, the following journal entries 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 against the 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, following entry 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 by recording 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 (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 (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 partnership deed provided that Ajit is to be paid a salary of Rs. 1,000 p.m. and Choudhary a commission of Rs. 5,000. It also provided that interest on capital be allowed @ 6% p.a. The drawings for the year were: Ajit Rs. 6,000, Choudhary Rs. 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 net amount of profit as per the profit and loss account for the year ended 2001 was Rs. 35,660.

You are required to record the necessary journal entries relating to appropriation of profit and prepare the profit and loss appropriation account and 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. Profit and Loss Appropriation a/c (Transfer of Profit to Profit and Loss Appropriation Account)		35,660	35,600
	Ajit's Salary a/c Dr. Ajit's Capital a/c (Amount of Ajit's Salary)		12,000	12,000
	Profit and Loss Appropriation a/c Dr. Ajit's Salary a/c (Transfer of Ajit's Salary to Profit and Loss Appropriation Account)		12,000	12,000
	Choudhary's Commission a/c Dr. Choudhary's Capital a/c (Amount of Choudhary's Commission)		5,000	5,000
	Profit and Loss Appropriation a/c Dr. Choudhary's Commission a/c (Transfer of Choudhary's Commission to Profit and Loss Appropriation Account)		5,000	5,000
	Interest on Capital a/c Dr. Ajit's Capital a/c Choudhary's Capital a/c Vishal's Capital a/c (Amount of interest on capital)		7,200	 3,000 2,400 1,800

	Interest on Capital a/c Dr. Ajit's Capital a/c Choudhary's Capital a/c Vishal's Capital a/c (Amount of interest on capital)		7,200	 3,000 2,400 1,800
	Profit and Loss Appropriation a/c Dr. Interest on Capital a/c (Transfer of Interest on Capital to Profit and Loss Appropriation Account)		7,200	7,200
	Ajit's Capital a/c Dr. Choudhary's Capital a/c Vishal's Capital a/c Interest on Drawings a/c (Amount of interest on drawings)		270 180 90	 540
	Interest On Drawings a/c Dr. Profit and Loss Appropriation a/c (Transfer of Interest on drawings to Profit and Loss Appropriation Account)		540	540

	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 (Distribution of profit)

Pawan and Purna are partners in a firm sharing profits in the ratio of 3:2. The balance in their capital and current accounts as on January1, 1998 were as under :

Pawan Purna

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. Where as Purna 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 and Purna 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' capital and 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 interest on the capital contributed by the partners, the same has to be allowed. Interest to be allowed on capital is to be calculated with respect to the time, rate and amount. Generally, following points are to be borne in mind while calculating the interest on capital:

1. Normally, interest on the opening balance at the beginning of the year is allowed for the whole accounting year.

2. If additional capital is invested during the year, interest for the relevant period is calculated.

3. If part of the capital is withdrawn during the year, interest on the part of the capital that was invested for the whole year, interest is calculated for the whole year and it is added with the amount of interest that is calculated on the remaining capital that was invested for the relevant period. For

example, Anmol has Rs. 30,000 as balance in his capital account at the beginning of the year. In the middle of the year he withdrew Rs.10,000 from 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 the amount 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 (Interest on Capital)

Mansoor and Reshma are partners in a firm. Their capital accounts showed the balance on Jan 1, 2000 as Rs. 20,000 and Rs. 15,000 respectively. During the 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. Interest is allowed @ 6% p.a. on the capitals. Calculate the interest to be paid on the 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 been specifically provided in the partnership deed. Interest on drawings is to be calculated with reference to the time period for which the money was withdrawn.

Following may be the possibilities requiring the different calculations of interest 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 calculation of 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 for that period will be charged:

a) If amount is withdrawn during the month (implicitly assumed to be in the middle of month), interest is calculated for six months;

b) If the withdrawal is made in the beginning of the month, interest is calculated for 6½ months (six and a half months), and

c) If withdrawal is made at the end of the month, interest is calculated for 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 case the interest is calculated on total drawings for a period of seven and a half months, and

(b) If amount is withdrawn at the end of each quarter, the amount of interest is calculated on total drawings for a period of four and a half months.

(5) Different amounts are withdrawn at different intervals: In this case, the sum of the product of amount withdrawn and the time is calculated 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. Interest on drawings is charged at 10% per annum. In this case, interest on drawings 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 :

$$\frac{\text{Rate of interest}}{100} \times \text{sum of products} \times \frac{1}{12}$$

= 6/100 × Rs. 1,69,000 × 1/12

= Rs. 845

Alternatively, interest can be calculated separately for each amount for the period involved and then totalled. In that case also, we shall arrive at the same amount of interest.

Illustration (Interest on drawings)

Amit and Sonu are partners sharing profits equally. Amit withdrew Rs. 1,000 p.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, 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 (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 less than 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 his share in the profits of the firm. Such a guarantee may be given to an existing partner or to a new partner at the time of admission. Such guaranteed amount shall be paid to partner when his share of profit, as calculated, according to his profit sharing ratio is less than the guaranteed amount. The deficiency of such guaranteed amount will be borne by the other 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 into the partnership firm. The profit sharing ratio is agreed as 3:2:1 with a guaranteed amount of Rs. 5,000 to Mary. For the year ended 2001, the business 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 of Rs. 5,000. Hence, Mary will get Rs. 4,000 as her share of the profit in the profit sharing ratio and the deficiency of Rs.1,000 (i.e. the amount by which Rs. 4,000 falls short of the guaranteed amount) shall be transferred to the credit of Mary by transfer from Soni and Mita in their profit sharing ratio, i.e. 3:2.

Illustration (Guarantee of Profit)

Mouse, Keyboard and Monitor are partners. They admit Printer as a partner with 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 the year ended 2002 were Rs. 96,000. Prepare the profit and loss appropriation account 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 given Rs. 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 the old partners or any of them in their new profit sharing ratio or an agreed basis.

In illustration, all the three partners have agreed to guarantee Printer for the minimum share of profit. Hence, these three divided the Printer's share in the ratio of 4:3:3. Suppose Mouse alone agrees to guarantee 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 (Guarantee of Profit)

Kim and Lal are partners in a firm sharing profit in the ratio of 2:1. They decide to admit Mohit with 1/4th share in profits with a guaranteed amount of Rs. 25,000. Kim undertook to meet the liabi.lity arising out of the guaranteed amount to Mohit. The profit sharing ratio between Kim, Lal and Mohit will be 2:1:1. The firm earned profit of Rs. 76,000 for the year ended March 31, 2001.

You are required to prepare Profit and Loss Appropriation Account and show 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 (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 Asha's Capital a/c	Dr.	1,835	 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 in the 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 the differential profit capacity of a business". Thus, goodwill exists only when the firm earns super profits. Any firm that earns normal profits or is incurring losses 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 heavy customer traffic, the goodwill tends to be high.

3. Efficiency of Management : A well-managed concern usually enjoys the advantage of high productivity and cost efficiency. This leads to higher profits and so the value of goodwill will also be high.

4. Market situation : The monopoly condition or limited competition enables the concern to earn high profits which leads to higher value of goodwill.

5. Special Advantages : The firm that enjoys special advantages like import licenses, low rate and assured supply of electricity, long-term contracts for 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 a business. But, in case of a partnership firm it may also arise in the following circumstances:

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 agreed number of 'years' purchase of the average profits of the past few years. It is based on the assumption that a new business will not be able to earn any profits during the first few years of its operations. Hence, the person who purchases a running business must pay in the form of goodwill a sum which is equal to the profits he is likely to receive for the first few years. The goodwill, therefore, should be calculated by multiplying the past average profits by the number of years during which the anticipated profits are expected to accrue.

For example, if the past average profits of a business works out at Rs. 20,000 and it is expected that the same profits will be available in future, the value of goodwill will be Rs. 60,000 (Rs. 20,000 × 3), if three years, purchase of the past average profits constitute the basis of valuation of the goodwill.

Illustration (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 and year 2003 Rs. 5,00,000. Calculate goodwill of the firm on the basis of 4 years purchase 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**

$$\text{Average Profit} = \frac{\text{Total profit of last 5 years}}{\text{No. of years}} = \frac{\text{Rs. }21,93,000}{5} = \text{Rs. }4,38,600$$

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 (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
= Rs. 4,50,000 × 2 = Rs. 9,00,000

The above calculation of goodwill is based on the assumption that no change in the overall situation of profits is expected in the future.

1. Weighted Average Profit Method : This method is a modified version of the earlier method. Under this method each year's profit is multiplied by the respective number of weights i.e. 1,2,3,4 etc., in order to find out value of product and the total of products is then divided by the total of weights in order to ascertain the weighted average profits. Thereafter, the weighted average profit is multiplied by the agreed number to find out the value of goodwill.

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, Anu looses 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 - (2018 - 2021 BATCH)

II SEMESTER

FINANCIAL ACCOUNTING (18BAU201)

UNIT V

POSSIBLE QUESTIONS

Part A (ONE Mark)

Multiple Choice Questions

Online Examination

PART B

1. Bring out the basic concepts in Admission?
2. Mention the basic concepts in retirement?

3. List the aspects in profit sharing ratio among partners?
4. Write a short note of treatment of partnership account on death of a partner?
5. Write a short note of treatment of partnership account on retirement of a partner?
6. Explain the treatment of partnership account on including of goodwill?
7. 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.
8. Define Partnership
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?
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 1/5th 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. Elaborate the treatment of partnership account in retirement of partner?
8. Discuss the settlement of accounts in a partnership firm in case of a deceased partner?
9. X and Y Sharing profits in the proportion of 3/4 and 1/4 showed the following as their Balance Sheet as on 31^{st} December 2014.

Liabilities	Rs.	Assets	Rs.
Creditors	47,500	Cash at Bank	22,500
General Reserve	5,000	Bills Receivable	13,000
Capitals: X	30,000	Stock	21,000
Y	16,000	Debtors	16,000
		Furniture	1,000
		Buildings	25,000
	98,500		**98,500**

Adjustments:

They admit C into partnership firm on 1.1.2015 on the following terms:

a. C pays Rs.15,000 as his capital for 1/5th share in the future profit.

b. Goodwill account be raised in the books of a new firm at Value of Rs.10,000

c. Stock and furniture be reduced by 15% and a 10% reserve for doubtful debts be created for debtors.

d. Value of land and building be appreciated by 10%.

Give necessary ledger accounts and prepare new balance sheet.

10. Explain the treatment of goodwill at the time of retirement of a partner with suitable illustration.

***CIA - 3 X 8 = 24 (EITHER OR TYPE)**
****ESE - 5 X6 = 30 (EITHER OR TYPE)**

QUESTIONS	OPTION 1	OPTION 2	OPTION 3	OPTION 4	ANSWER
At the time of admission of a partner, goodwill brought in cash by the new partner is shared by the old partners in their _______________	Sacrificing ratio	Gaining ratio	Old ratio	New ratio	Sacrificing ratio
At the time of admission of a partner, goodwill brought in cash by the new partner is shared by the old partners in their sacrificing ratio, the method is known as __________	Goodwill method	Premium method	Revaluation method	Average method	Premium method
On the admission of a partner if goodwill account is raised, this should be debited to _______________	Partner account	New partner account.	Goodwill account.	Old partner account.	Goodwill account.
On the admission of a new partner the balance of the P & L adjustment account should be transferred to the capital account of old partners in their ___________	New profit sharing ratio.	Old profit sharing ratio	Sacrificing ratio	Gaining ratio	Old profit sharing ratio
On the admission of a new partner the decrease in value of asset is debited to _______________	Capital account	Balance sheet.	Revaluation account	P & L account	Revaluation account
The difference between total assets minus liabilities is _____	Net assets	Gross assets	Net liabilities	Gross liabilities	Net assets
Revaluation account is also known as _____________	Trading account	P & L account	P & L Appropriation account	Balance sheet	P & L Appropriation account
Profit or loss from revaluation account will be transferred to the partners ________________	Personal account	Current account	P & L account	Capital account	Capital account
Profit or loss from revaluation account will be transferred to the partners capital account in their ______________	New profit sharing ratio	Old profit sharing ratio	Sacrificing ratio	Gaining ratio	Old profit sharing ratio
At the time of admission of a new partner undistributed profits is credited to the old Partners ______________	Personal account	Current account	P & L account	Capital account	Capital account
partners capital account in _____________	New profit sharing ratio	Old profit sharing ratio	Sacrificing ratio	Gaining ratio	Old profit sharing ratio
At the time of admission of a new partner undistributed losses should be distributed to the old partners _____________	Personal account	Current account	P & L account	Capital account	Capital account
At the time of admission of a new partner undistributed losses should be distributed to the old partners capital account in ___________________	New profit sharing ratio	Old profit sharing ratio	Sacrificing ratio	Gaining ratio	Old profit sharing ratio
In the absence of an agreement, profit and losses are shared by partners ______________	Equally	Old profit sharing ratio	Sacrificing ratio	Gaining ratio	Equally
In the absence of an agreement, interest on capital is ____________	Allowed	Not allowed	Allowed after one year	Allowed after two year	Not allowed

Current account of the partners should be opened when the capital are ______________	Fixed	Fluctuating	Variable	Equal	Fixed
Revaluation account is a ____________	Personal account	Real account	Nominal account	Duplicate account	Nominal account
Goodwill is an ___________ it must be valued at the time of admission or retirement of partner	Liability	Capital	Nominal account	Intangible account	Intangible account
On the admission of a partner, the goodwill is raised at full value, it should be debited to _____________	Goodwill account	Current account.	P & L account	Capital account	Goodwill account
In the case of retirement of a partner, goodwill at its full value is credited to the account of ____________	New partner	Old partner	All partners	Working partner	All partners
Gaining ratio is calculated at the time of _________	Admission of a partner	Death of a partner	Insolvency of a partner	Leave of a partner	Death of a partner
The difference between new profit ratio and old profit ratio is _______________	New profit sharing ratio.	Old profit sharing ratio	Sacrificing ratio	Gaining ratio	Sacrificing ratio
In case of death of a partner, all accumulated profits are distributed among all partners in the ______________	New profit sharing ratio.	Old profit sharing ratio	Sacrificing ratio	Gaining ratio	Old profit sharing ratio
In case of death of a partner, all accumulated losses are distributed among all partners in the_____________	New profit sharing ratio.	Old profit sharing ratio	Sacrificing ratio	Gaining ratio	Old profit sharing ratio
How is the premium paid on the Joint Life Policy of partners treated?	Debited in Partners capital	Credited in Partners current	Debited in P&L	Credited in P&L	Debited in P&L
Creditors ledger is also called ___	Sales ledger	General ledger	Purchase ledger	Debtor ledger	Purchase ledger
____ are undistributed profits	Reserves	Provisions	Depreciation	Appreciatio n	Reserves
In the absence of an agreement, profits and losses are divided _____________	In the ratio of capitals, devoted by each partner	In the ratio of time	Equally	In the ratio of drawings	In the ratio of time
Current accounts for partners should be opened when___________	Capitals are fixed	Capitals are fluctuating	When capitals are either fixed or fluctuating	When capitals are neither fixed nor	Capitals are fixed
To which account would the interest on the capital accounts of the partners be credited?	Profit & Loss A/c	Partners capital A/c	Partners current A/c	Interest A/c	Partners capital A/c
When A and B sharing Profit and Losses in the ratio of 3:2, admit C as a partner giving him 1/5 share of profit. This will be given by A and B ___________	Equally	In the ratio of their profits	In the ratio of their capitals	In the ratio of their drawings	In the ratio of their profits
When a new partner gives cash for goodwill, the amount is credited to_____________	Goodwill account.	Capital account of the new partner	Cash account	Saving account	Cash account

A, B and C are equal partners. If A and B die together in a bus accident, this would result in the dissolution____________	Of the firm	Of the partnership	Of both the partnership and the firm	Of neither the partnership nor the firm	Of both the partnership and the firm
General Reserve at the time of admission of a new partner is transferred to ______________.	Profit and Loss Adjustment A/c	Partners Capital Accounts	Neither of the two	Balance Sheet	Partners Capital Accounts
If the goodwill account is raised for Rs.10,000, the amount is debited to ______________	The capital accounts of partners.	Goodwill account	Cash account	Balance Sheet	Balance Sheet
In case of admission of a partner the profit or loss on revaluation of assets and liabilities is shared by partners ______________	New	Old	Active	Sleeping	Old
Goodwill is withdrawn by the partner account is credited to _____________	Cash/Bank	Revaluation	Profit and Loss	Creditors	Cash/Bank
A partner who takes active part in the firms business is known as partner _____________	New	Active	Old	Chief	Active
Debit balance of current account of a partner will appear on the side of the Balance Sheet	Liabilities	Debit	Assets	Upper	Assets
Upon the dissolution of a firm, the profit or loss is shared by the partners_______________	In the profit sharing ratio	In the ratio of capital balance	Equally	Ratio	In the profit sharing ratio
Realization account is a _________ account	Personal.	Nominal	Real	Fictitious	Nominal
Reserves are debited to ____	Profit and loss account	Profit and Loss Appropriation account	Balance sheet	Asset	Profit and Loss Appropriation account
Whenever a new partner is admitted the Profit Sharing Ratio will change and the changed ratio will be known as________	p/v ratio	New ratio	Old ratio	Sacrificing ratio	New ratio
The ratio in which the old partners have agreed to sacrifice their charges in profit in favour of new partner is called the ____________	New ratio	Old ratio	Sacrificing ratio	p/v ratio	Sacrificing ratio
In the event of dissolution of partnership firm, the Provision for Doubtful Debts is transferred to___________	Sundry debtors A/c	Realization A/c	Revaluation A/c	Partners Capital A/c	Realization A/c
Unrecorded liability when paid on dissolution of a firm is debited to ________________	Realization A/c	Liability A/c	Partners Capital A/c	Revaluation A/c	Realization A/c
In the event of dissolution of a firm, the partners personal assets are first used for payment of ____________	Personal liabilities	Firms liability	Creditors	Real account	Personal liabilities

In the absence of any contract, to the contrary, on dissolution of the partnership firm the capital profit is credited to the partners ______________	In capital ratio.	In profit sharing ratio	Equally	Not equal	In profit sharing ratio
The sacrificing ratio is used at the time of _____________	Death of a partner	Admission of a partner	Retirement of a partner	Dissolution of a firm	Admission of a partner
General reserve at the time of admission of a partner is transferred to_____________	Revaluation a/c	Partners capital a/c	Profit and loss a/c	Creditors a/c	Partners capital a/c
All accumulated losses are transferred to the capital a/c partners in the _____________	New profit sharing ratio.	Old profit sharing ratio	Capital ratio	Profit ratio	Old profit sharing ratio
All such assets which have not been taken over by the new firm at the time of amalgamation will be transferred to ____________	Capital a/c of partners	Revaluation a/c	New firms a/c	Partners a/c	Capital a/c of partners
The balance in the revaluation a/c is transferred to capital a/c of the partners in the _____________	Profit sharing ratio	Capital ratio	Equally	Not equal	Profit sharing ratio
Partners salaries to be debited to __________	Trading account.	Profit and loss account	Profit and loss appropriation account	Partners account	Profit and loss appropriation account
Balance Sheet items like profit and loss account balance and general reserve must be transferred to _____________	Revaluation account.	Partners capital accounts	Realisation account	Drawings account	Partners capital accounts
In case of sale of partnership to a company, the profit or loss on the sale is ascertained through ____________	Revaluation method	Memorandum realization account	Realization account	Balance sheet	Realization account
An agreement of sale is made under _____________	A partner is insolvent	A partner has debit balance	The firm is insolvent	insolvent	The firm is insolvent
When goodwill is brought in cash by the new partner, the method is known as _____________	Revaluation Method.	Premium Method	Depreciation method	Solvent method	Revaluation Method.
The general reserve appearing in the books of partnership should be transferred to the old partners _____________	New profit sharing ratio.	Old profit sharing ratio	Capital ratio	Profit ratio	Capital ratio
The Profits of the business is to be shared among the partners , when the profit sharing term is silent ___________	Capital ratio	Equal ratio	Agreed ratio	Unequal ratio	Equal ratio

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(Established under section 3 of UGC Act 1956)
Coimbatore-641021
Department of Management

Name: **Dr.M.NANDHINI**
Department: **Management**
Subject Code: **18BAU201** Semester: **II** Year: **2018-2021 Batch**
Subject: **FINANCIAL ACCOUTNING**

ASSIGNMENT TITLE

S. No	Register No.	Name of the Student	Assignment Title
1	18BAU001	ABIESH A	Book Keeping
2	18BAU002	ADITYA RAVI	Accounting
3	18BAU003	AGATHIYAN M C	Accounting - Objects
4	18BAU005	AKASH S	Accounting - Functions
5	18BAU006	ANNAPOORANI K	Users of accounting information
6	18BAU007	ARAVINDHKUMAR B	Accounting – Advantages
7	18BAU008	ARJUN K	Accounting - Limitations
8	18BAU009	ARUMUGAM M	Basis of Accounting
9	18BAU010	ASHOK KANNAN M	Branches of Accounting
10	18BAU011	ASHOKAN S	System of Accounting
11	18BAU012	BALAJIE R	Classifications of Accounts
12	18BAU013	BHARATHIMEENA G	Accounting Principles
13	18BAU014	CHANDRALEKHA T	Accounting Concepts
14	18BAU015	DAYANITHI S R	Accounting Conventions

15	18BAU016	ENBARASAN E	Implications of Accounting System
16	18BAU017	ESAI VALAVAN S	Accounting Standards
17	18BAU018	HARI HARAN R	Accounting Cycle
18	18BAU019	HARIS C	International Financial Reporting System
19	18BAU020	JEEVA S	Financial Accounting - Scope
20	18BAU022	KALESWARAN M	Cost Accounting - Scope
21	18BAU023	KANISHKAR C	Management Accounting - Scope
22	18BAU024	KARTHIKEYAN K	Accounting Equation
23	18BAU025	KATHIREKODI VISHWA PRAKASH	Golden Rules of Accounting
24	18BAU026	KEERTHANA K	Journal
25	18BAU027	KRISHNAKUMAR M	Ledger
26	18BAU028	LAVIN KUMAR. C	Trial Balance
27	18BAU029	LEVIS R	Subsidiary Book – Purchase Book
28	18BAU030	LINGKESHWARAN T	Subsidiary Book – Sales Book
29	18BAU031	LOKESHKANNAN M	Subsidiary Book – Purchase Returns Book
30	18BAU032	MAHENDRA PRABHU S	Subsidiary Book – Sales Returns Book
31	18BAU033	MANIKANDA MANOJ PRABHU M	Final Accounts - Scope

32	18BAU034	MANIKANDAN J	Trading Account – Items appearing in the debit or credit side of Trading Account
33	18BAU035	MANIVENDHAN T	Profit and Loss Account – Items appearing in the debit or credit side of Profit and Loss Account
34	18BAU036	MOHAMMED RAFSIN A	Balance Sheet – Items appearing in the assets and liabilities side
35	18BAU037	MOHAMMED RISVAN	Depreciation - Need
36	18BAU038	NIHAD M N	Causes of depreciation
37	18BAU039	PRABU M	Methods of Depreciation – Straight Line Method
38	18BAU040	PRADEEP KUMAR S	Methods of Depreciation – Written Down Value
39	18BAU041	PRAKASH RAJ D	Methods of Depreciation –Annuity Method
40	18BAU043	RAJA PRABHU. A	Methods of Depreciation – Machine Hour Rate
41	18BAU044	RAJADURAI S	Impact of depreciation measurement of business
42	18BAU045	REVANTH R	Inventory – Importance
43	18BAU046	ROSHINI J	Inventory - Basis
44	18BAU047	RUBAN V	Inventory Accounting System

45	18BAU048	SABARESH S	Inventory Accounting System - Advantages
46	18BAU049	SADHAM K M	Inventory Accounting System - Limitations
47	18BAU050	SAKTHI SARAVANAN V	Inventory Valuation Method
48	18BAU051	SARATH M	FIFO
49	18BAU052	SARATH KUMAR A	LIFO
50	18BAU053	SENTHIL KUMAAR M	Average Method
51	18BAU054	SHURESH KA	Weighted Average Method
52	18BAU055	SOWFEQ AHAMED A	Inventory and its impact on Financial statement
53	18BAU056	SOWMIYA M	Partnership - Features
54	18BAU057	SREE DHARSHINI D G	Partnership Deed
55	18BAU058	SRIDHAR K	Partnership - Limitations
56	18BAU059	SRIDHAR S	Partnership – Admission
57	18BAU060	SURESH V	Profit sharing ratio
58	18BAU061	SURIYA KUMAR S	Admission - Revaluation account, Profit and Loss appropriation account
59	18BAU062	THIRUGNANASAMBANDAR T	Partnership - Retirement
60	18BAU063	VAISHNAVI R	Retirement - Revaluation account, Profit and Loss appropriation account
61	18BAU064	VASANTH K K	Partnership - Death

62	18BAU065	VENKATRAJ M	Partnership – settlements of Accounts
63	18BAU066	VIGNESHWAR. V	Dissolution of partnership
64	18BAU067	VIJAY KRISHNAN. P	Difference between Financial Accounting and Cost Accounting
65	18BAU068	YOGESHWARAN S	Difference between Financial Accounting and Management Accounting

Register No.: ……….
[18BAU201]

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(For the candidates admitted from 2018 onwards)

CIA I – DECEMBER 2018
I BBA - SECOND SEMESTER

FINANCIAL ACCOUNTING

Date:18.12.2018 - FN **Maximum: 50 Marks**
Time: 2 Hours

PART – A (20 X1 = 20 Marks)
ANSWER ALL THE QUESTIONS

1. The amount which the proprietor has invested in the business is ___________
   a. Capital b. Liabilities c. Assets d. Drawings
2. Current assets are recorded in the balance sheet on_______
   a. Liability side b. Asset Side c. Both Liability and Asset side d. Credit side
3. _______________is an intangible asset
   a. Copyright b. Land c. Building d. Cash
4. Bank account is a _____________
   a. Personal account b. Real account c. Nominal account d. Impersonal account
5. Which one of the following is correct?
   a. Capital = Assets + Liabilities b. Capital = Assets – Liabilities c. Assets = Liabilities - Capital
   d. Assets = Short term Liabilities + Long term Liabilities
6. When an asset is purchased for cash _________ account is debited
   a. Cash b. Bank c. Debtors d. Asset
7. Business transactions are first recorded in _____________
   a. Journal b. Ledger c. Trial Balance d. Subsidiary Book
8. ____________ is a Current asset
   a. Cash b. Furniture c. Machinery d. Building
9. ________ are the branches of accounting
   a. Cost and Financial accounting b. Cost and Management Accounting c. Financial and Management Accounting d. Financial, Cost and Management Accounting
10. Accounting is the process of matching___________
    a. Benefits and Costs b. Revenue and Expense c. Cash inflows and Outflows d. Potential and real account
11. ________ is a liability
    a. Land b. Furniture c. Sundry creditor d. Cash

12. Plant and Machinery is a ______________

a. Fixed asset b. Current asset c. Liquid asset d. Intangible asset

13. 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

14. The accounting equation is connected with __________

a. Assets b. Liabilities c. Assets, Liabilities and Capital d. Capital

15. The main objective of accounting is to analyze the organizations ____________

a. Financial position b. Position of the cash book c. Position of purchases d. Position of sales

16. Liabilities = Rs. 30,000; Capital = Rs.70,000; Assets = ?

a. Rs.70,000 b. Rs. 10,000 c. Rs. 40,000 d. Rs.1,00,000

17. The __________ column in ledger will link the entry with journal

a. L.F column b. J.F column c. G.F column d. P.F. column

18. Interest received and Commission earned are _______

a. Nominal account b. Real account c. Personal account d. Cash account

19. Cash sales made to Gautam, ______ account will be debited

a. Cash account b. Purchases account c. Sales account d. Gautam account

20. ____________ is the conditions or assumptions to be followed while recording the business transactions in books of accounts

a. Accounting Concept b. Accounting Principles c. Accounting Conventions d. Accounting Conservation

PART – B (3 X 2 = 6 Marks)

ANSWER ALL THE QUESTIONS

21. Write the golden rules of real account?

22. You are required to complete the gaps in the following table:

	Assets	**Liabilities**	**Capital**
	Rs.	**Rs.**	**Rs.**
a	?	35,400	75,800
b	2,40,000	50,800	?

23. Journalise the following transactions in the books of Jill Ltd.,

2018 Jan 7	Goods purchased for cash from Meera	Rs.4,500
8	Cash paid to Vikram	Rs.2,850

PART – C (3 X 8 = 24 Marks)

ANSWER ALL THE QUESTIONS

24. a. “The focus of the accounting is business enterprise for which the accounts are maintained and not the proprietors” Do you agree with this statement? Explain it.

Or

b. Journalise the following transactions in the books of Raj & co

Date (April 2017)	**Particulars**	**Rs.**
1	Raj commenced business with	2,21,000
2	Bought goods for cash	9,200
4	Sold goods to Kannan	5,600
5	Purchased goods from Mani	3,300
9	Received cash from Kannan	5,600
11	Paid Mani on accounts	3,300
16	Sold goods to Manohar	3,500
21	Cash Sales	7,500
26	Paid Mani	1,200
29	Received Cash from Manohar	3,500
30	Paid Rent Salary paid to Office Staff	450 700

25.a. Explain the objects and functions of accounting?

Or

b. The following trial balance has been prepared wrongly. You are asked to prepare the trial balance correctly.

Heads of Accounts	**Debit Balance Rs.**	**Credit Balance Rs.**
Capital	22,000	
Stock		10,000
Debtors	8,000	
Creditors		12,000
Machinery		20,000
Cash in hand		2,000
Bank overdraft	14,000	
Sales Returns		8,000
Purchases Returns	4,000	
Misc. Expenses	12,000	

Sales		44,000
Purchases	26,000	
Wages	10,000	
Salaries		12,000
Prepaid Insurance		200
Bills payable	10,800	
Outstanding salaries	1,400	
	1,08,200	**1,08,200**

26. a. Enter the following transactions in the books of journal and post them to Ledger for the month of January 2016 of Ben Ltd.,

			Rs.
Jan.	1	Ben started business with cash	3,00,000
	2	Purchased goods from Mohan	5,000
	3	Sold goods for cash	800
	10	Sold goods to Raman	1,500
	15	Purchased goods from Kannan	2,000
	31	Paid Salaries	50
	31	Paid Rent	25
	31	Commission received	30

Or

b. “Without accounting concepts and conventions, accounts cannot be maintained” Comment

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I Internal Examination, December - 2018
I BBA
II Semester
FINANCIAL ACCOUNTING
COURSE CODE: 18BAU201

ANSWER KEY

PART – A (20 X 1 = 20 Marks)

Q.No.	Answer
1	Capital
2	Asset side
3	Copyright
4	Personal Account
5	Capital = Asset – Liabilities
6	Asset
7	Journal
8	Cash
9	Financial, Cost and management Accounting
10	Revenue and Expenses

Q.No.	Answer
11	Sundry Creditor
12	Fixed Asset
13	Accounting Period Concept
14	Assets, Liabilities and Capital
15	Financial position
16	Rs.1,00,000
17	J.F. column
18	Nominal account
19	Cash account
20	Accounting Concept

PART – B (3 X 2 = 6 Marks)

ANSWER ALL THE QUESTIONS

21. Write the golden rules of real account?

Real Account – Debit what comes in, Credit what goes out

22. You are required to complete the gaps in the following table:

a. Assets - Rs. 1,11,200

b. Capital – Rs. 1,89,200

23. Journalise the following transactions in the books of Jill Ltd.,

Purchases a/c Dr 4,500

To Cash a/c 4,500

Vikram a/c Dr 2,850

To Cash a/c 2,850

PART – C (3X 8 = 24 Marks)

ANSWER ALL THE QUESTIONS

24. a. "The focus of the accounting is business enterprise for which the accounts are maintained and not the proprietors" Do you agree with this statement? Explain it.

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.

24. b. Journalise the following transactions in the books of Raj & co

Date (April 2017)	**Particulars**	**Rs.**
1	Cash a/c Dr To Rsj's Capital a/c	2,21,000
2	Purchases a/c Dr To cash a/c	9,200

4	Kannan a/c Dr To Sales a/c	5,600
5	Purchases a/c Dr To Mani a/c	3,300
9	cash a/c Dr To Kannan a/c	5,600
11	Mani a/c Dr To Cash a/c	3,300
16	Manohar a/c Dr To Sales a/c	3,500
21	Cash a/c Dr To Sales a/c	7,500
26	Mani a/c Dr To Cash a/c	1,200
29	Cash a/c Dr To Manohar a/c	3,500
30	Rent a/c Dr Salary a/c Dr To Cash a/c	450 700

25.a. Explain the objects and functions of accounting?

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

ii) To ascertain the results of the operation

iii) To ascertain the financial position of the business

iv) To portray the liquidity position

v) To protect business properties

vi) To facilitate rational decision – making

vii) To satisfy the requirements of law

25. b. The following trial balance has been prepared wrongly. You are asked to prepare the trial balance correctly.

TOTAL - 1,08,200

26. a. Enter the following transactions in the books of journal and post them to Ledger for thE month of January 2016 of Ben Ltd.,

Date (Jan 2016)	**Particulars**	**Rs.**
1	Cash a/c Dr To Ben's Capital a/c	3,00,000
2	Purchases a/c Dr To Mohan a/c	5,000
3	Cash a/c Dr To Sales a/c	800
10	Rahim a/c Dr To Sales a/c	1,500
15	Purchases a/c Dr To Kannan a/c	2,000
31	Rent a/c Dr Salary a/c Dr To Cash a/c	50 25
31	Cash a/c Dr To Commission a/c	30

26. b. "Without accounting concepts and conventions, accounts cannot be maintained" Comment

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:

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

ACCOUNTING CONVENTIONS

The following conventions are to be followed to have a clear and meaningful
information and data in accounting:

i) Consistency

ii) Disclosure

iii) Conservatism

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CONTINUOUS INTERNAL ASSESSMENT II – FEBRUARY 2019
BACHELOR OF BUSINESS ADMINISTRATION
SECOND SEMESTER

FINANCIAL ACCOUNTING

Time: 2 Hours **Maximum: 50 Marks**
Date: 05.02.2019 **Session: FN**

PART – A (20 X1 = 20 Marks)
ANSWER ALL THE QUESTIONS

1. Depreciation is a ____________
 a. Cash expenditure b. Non cash expenditure c. Deferred revenue expenditure
 d. Capital expenditure
2. Opening stock is ___________
 a. Debited in trading a/c b. Credited in trading a/c c. Debited in P&L a/c d. Credited in P&L a/c
3. The balance of unsold goods is known as ____________
 a. Stock b. Asset c. Liabilities d. Profit
4. Which of the following asset is not depreciable __________
 a. Land b. Plant c. Building d. Furniture
5. Reserves are recorded in the ________________ side of the balance sheet
 a. Expenses b. Income c. Liability d. Asset
6. The provision for doubtful debts is debited in ______________
 a. Sales a/c b. Purchases a/c c. Profit and Loss a/c d. Creditors a/c
7. All fixed asset should be shown at cost less _________ in the balance sheet
 a. Reserve b. Current asset c. Depreciation d. Provisions
8. Commission received will be treated as _________
 a. Liability b. Asset c. Expenses d. Income
9. Depreciation is a process of ____________
 a. Valuation b. Allocation c. Reduction d. Appreciation
10. Discount allowed will be recorded in the __________
 a. Trading account b. Profit and loss account c. Purchase account b. Sales account
11. Trading account is prepared to find out ____________
 a. Gross profit or loss b. Net profit or loss c. Income d. Expenses
12. An irrecoverable debt is called as ____________
 a. Bad debts b. Doubtful debts c. Debt d. Provisions
13. Outstanding expenses are shown on the ____________of the balance sheet
 a. Liability side b. Asset side c. Both Liability and Asset side d. May not appear in the balance sheet
14. Diminishing value method is also known as ____________ method
 a. Straight line b. Written down value c. Sum of digit d. Annuity
15. Goodwill are recorded in the balance sheet on_______
 a. Liability side b. Asset Side c. Both Liability and Asset side d. May not appear in the balance sheet

16. Original cost method is also known as ____________ method
    a. Straight line b. Written down value c. Sum of digit d. Annuity
17. ____________ account will be prepared to know the trading results of the business
    a. Trading b. Profit and Loss c. Purchases d. Sales
18. ______________ accounts will be prepared to achieve the objectives of accountancy
    a. Trading b. Final c. Purchase b. Sales
19. _____________ is a statement prepared with a view to measure the financial position of a business on a certain fixed date.
    a. Trend analysis b. Balance Sheet c. Marginal cost d. Standard cost
20. Depreciation is charged on the _____________
    a. Market value b. Book value c. Fair Market value d. Future value

PART – B (3 X 2 = 6 Marks)

ANSWER ALL THE QUESTIONS

21. Ascertain the Gross Profit of Ram & Co. for the year ending 31.03.2017 from the following figures:

	Rs.		**Rs.**
Opening Stock	18,550	Purchases	15,000
Sales	45,000	Purchases Returns	510
Sales Return	580	Wages	200
Closing stock	15,000		

22. Raj purchased an asset for Rs.40,000 and he used it for 4 years and after four year its scrap value is Rs.4,000. Calculate the amount of depreciation and rate of depreciation.
23. From the following information calculate Net Profit for the year ending 31.12.2014

	Rs.		**Rs.**
Gross Profit	35,000	Administrative expenses	3,500
Commission received	2,000	Stationery	650
Advertisement	1,800	Salaries	2,750

PART – C (3 X 8 = 24 Marks)

ANSWER ALL THE QUESTIONS

24. a. Why is it necessary to calculate depreciation? Discuss various factors which are considered for calculating depreciation?

Or

b. From the following Trial balance, prepare Trading and Profit and Loss Account and 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 31.12.2013 Rs. 78,400

b. Salaries outstanding Rs. 4,800

c. Rent paid in advance is Rs. 3,200

d. Prepaid Insurance Rs. 1,440

25.a. **"**Depreciation accounting is a process of allocation and not of valuation" Comment

Or

b. From the following Trial Balance of Ram Traders, prepare Trading Account and Profit & Loss Account and Balance sheet for the year ending 31st December 2006

Dr. Balance	Rs.	Cr. Balance	Rs.
Land & Building	60,000	Capital	96,000
Plant and Machinery	33,000	Sundry Creditors	15,000
Stock	12,000	Sales	60,000
Investment	15,000	Provision for Bad & Doubtful Debts	1,100
Purchases	45,000	Loan	20,000
Wages	2,000	Rent Received in advance	1,000
Carriage	2,000	Commission Received	3,000
Salary	5,000	Bills payable	15,000
Rent	2,000		
Cash at Bank	3,000		
Sundry Debtors	30,000		
Discount	300		
Bad Debt	500		
Sales Returns	1,300		
	2,11,100		**2,11,100**

Additional Information:

1. Closing stock valued at Rs. 12,000.
2. Bad Debt 500 and Provision for Bad & Doubtful Debts at 5%.
3. Salary outstanding Rs. 1000.
4. Commission Received in advance 1,000.

5. Depreciate Machinery @ 3% and land and Building @ 2%.

26. a. A company, whose accounting year is the calendar year, purchased a machinery on 1-1-2003 for Rs.40,000. On 1-7-2006, one-fourth of the machinery installed on 1-1-2003 became obsolete and was sold for Rs.6,800. Show the machinery account for all the 4 years under straight line method. Depreciation is to be provided at 10%p.a.

Or

b. "Balance sheet is not an account and it is only the list of balances" Elucidate

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I BBA
II Semester
FINANCIAL ACCOUNTING
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ANSWER KEY

PART – A (20 X 1 = 20 Marks)

Q.No.	Answer
1	Non cash expenditure
2	Debited in trading a/c
3	Stock
4	Land
5	Liability
6	Profit and Loss a/c
7	Deprecation
8	Income
9	Allocation
10	Profit and Loss account

Q.No.	Answer
11	Gross profit or loss
12	Bad debts
13	Liability side
14	Written down value
15	Asset side
16	Straight line
17	Trading
18	Final
19	Balance sheet
20	Book value

PART – B (3 X 2 = 6 Marks)

ANSWER ALL THE QUESTIONS

21. GROSS PROFIT = Rs.26,180

22. Amount of Depreciation = Rs.9,000

23. NET PROFIT = Rs.28,300

PART – C (3X 8 = 24 Marks)

ANSWER ALL THE QUESTIONS

ANSWER ALL THE QUESTIONS

24. a. Why is it necessary to calculate depreciation? Discuss various factors which are considered for calculating depreciation?

Depreciation is apportioning the cost of a fixed asset over a period of time instead of deducting the total cost as an expense upon purchase. Five factors are required in order to produce an accurate depreciation figure.

The 5 factors needed for depreciation:

1. Date placed in service
2. Acquisition value
3. Salvage value
4. Estimated useful life
5. Depreciation method

24. b. GROSS PROFIT = Rs.1,55,200

NET PROFIT = Rs.94,240

BALANCE SHEET = Rs.6,75,040

25.a. "Depreciation accounting is a process of allocation and not of valuation" Comment

In accounting terms, depreciation is defined as the reduction of recorded cost of a fixed asset in a systematic manner until the value of the asset becomes zero or negligible.

An example of fixed assets are buildings, furniture, office equipment, machinery etc.. A land is the only exception which cannot be depreciated as the value of land appreciates with time.

Depreciation allows a portion of the cost of a fixed asset to the revenue generated by the fixed asset. This is mandatory under the matching principle as revenues are recorded with their associated expenses in the accounting period when the asset is in use. This helps in getting a complete picture of the revenue generation transaction.

An example of Depreciation – If a delivery truck is purchased a company with a cost of Rs. 100,000 and the expected usage of the truck are 5 years, the business might depreciate the asset under depreciation expense as Rs. 20,000 every year for a period of 5 years.

There three methods commonly used to calculate depreciation. They are:

- Straight line method
- Unit of production method
- Double-declining balance method

25. b. GROSS PROFIT = Rs.9,700

NET PROFIT = Rs.11,890

BALANCE SHEET = Rs.1,48,810

26. a. Depreciation as on 31.12.2003 – Rs.4,000

Depreciation as on 31.12.2004 – Rs.4,000

Depreciation as on 31.12.2005 – Rs.4,000

Depreciation as on 31.12.2006 – Rs.3,000

Depreciation as on 31.06.2006 – Rs.1,000

Profit on sale of Machinery as on 1.07.2006 – Rs.300

26. b. "Balance sheet is not an account and it is only the list of balances" Elucidate

The accounting balance sheet is one of the major financial statements used by accountants and business owners. (The other major financial statements are the income statement, statement of cash flows, and statement of stockholders' equity) The balance sheet is also referred to as the statement of financial position.

The balance sheet presents a company's financial position at the end of a specified date. Some describe the balance sheet as a "snapshot" of the company's financial position at a point (a moment or an instant) in time. For example, the amounts reported on a balance sheet dated December 31, 2018 reflect that instant when all the transactions through December 31 have been recorded.

Because the balance sheet informs the reader of a company's financial position as of one moment in time, it allows someone—like a creditor—to see what a company owns as well as what it owes to other parties as of the date indicated in the heading. This is valuable information to the banker who wants to determine whether or not a company qualifies for additional credit or loans. Others who would be interested in the balance sheet include current investors, potential investors, company management, suppliers, some customers, competitors, government agencies, and labor unions.

Major components, elements, or major categories:

- Assets
- Liabilities
- Owner's (Stockholders) Equity

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CONTINUOUS INTERNAL ASSESSMENT III – MARCH 2019
BACHELOR OF BUSINESS ADMINISTRATION
SECOND SEMESTER

FINANCIAL ACCOUNTING

Time: 2 Hours **Maximum: 50 Marks**
Date: 12.03.2019 **Session: FN**

PART – A (20 X1 = 20 Marks)
ANSWER ALL THE QUESTIONS

1. The basic reason to hold __________ is to keep up the production activities uninterrupted
   a. Inventory b. Land c. Building d. Machinery
2. The difference between new profit ratio and old profit ratio is ______________
   a. New profit sharing ratio b. Old profit sharing ratio c. Sacrificing ratio
   d. Gaining ratio
3. ________ is the one of the principle type of inventories
   a. Cash b. Raw Materials c. Debtors d. Plant
4. In case of death of a partner, all accumulated profits are distributed among all partners in the ______________
   a. New profit sharing ratio b. Old profit sharing ratio c. Sacrificing ratio
   d. Gaining ratio
5. _________ represent the semi-finished goods
   a. Finished goods b. Raw Materials c. Work in process d. Patent
6. On admission of a partner, if goodwill account is raised, _________ should be debited.
   a. Partner account b. New partner account c. Goodwill account d. Old partner account.
7. Revaluation account is also known as ____________
   a. Trading account b. P & L account c. P & L Appropriation account d. Income Statement
8. ___________ needs proper control as it is one of the largest assets of a business
   a. Debenture b. Debt c. Creditor d. Inventory
9. There are ______ methods of ascertaining the value of stock
   a. Three b. Two c. Five d. Six
10. When goodwill is brought in cash by the new partner, this method is known as _________
    a. Revaluation Method b. Premium Method c. Depreciation method
    d. Solvent method
11. In __________ method, value of stock is determined by physical counting of the stock on the accounting

date

a. Periodic inventory b. Perpetual inventory c. Standard inventory d. Fixed inventory

12. Under ________ method, stock registers are maintained to make a record of physical movement of stocks

    a. Periodic inventory b. Perpetual inventory c. Standard inventory d. Fixed inventory

13. _________ means taking the gloomy view of a situation

    a. Conservatism b. Consignment c. Joint Venture d. Partnership

14. In ________ method, the oldest items in the inventory are used

    a. FIFO b. LIFO c. Average Cost d. HIFO

15. Average cost may be of __________ types

    a. Seven b. Two c. Five d. Six

16. Safety stock is also known as ______

    a. FIFO b. LIFO c. Base stock d. HIFO

17. The difference between total assets minus liabilities is _____

    a. Net assets b. Gross assets c. Net Liabilities d. Gross Liabilities

18. ________ can be a replacement price or realizable price

    a. FIFO b. LIFO c. Market price d. HIFO

19. In the absence of an agreement, profit and losses are shared by partners _____________

    a. Equally b. Old profit sharing ratio c. Sacrificing ratio d. Gaining ratio

20. ___________ is also known as partnership agreement

    a. Articles of association b. Document c. Partnership Deed d. Memorandum of Association

PART – B (3 X 2 = 6 Marks)

ANSWER ALL THE QUESTIONS

21. List out the methods of inventory valuation
22. Define partnership.
23. Following are the details regarding inventories of a manufacturing concern as on 31st December, 2011:

Inventories categories	Cost Price (Rs.)	Market Price (Rs.)
A	6,000	9,000
B	10,000	9,500
C	15,000	17,000
D	20,000	14,000

You are required to determine inventory value for each category

PART – C (3 X 8 = 24 Marks)

ANSWER ALL THE QUESTIONS

24. a. What is the principle behind valuation of inventory at cost or market price whichever is lower?

Or

b. A and B partners in a firm sharing profits in the ratio of 3 : 2. They surrender 1/2 of the respective shares in favour of new partner C. C is to bring his share of premium for goodwill in cash. The goodwill of the firm is estimated at Rs.40,000. Pass the necessary journal entries for recording the goodwill in the above case.

25.a. Explain the features of partnership.

Or

b. M/s Swadeshi Cotton Mills Ltd. take a periodic inventory of their stock of chemicals at the end of each month. The physical inventory taken on 1st July shows a balance of 1,000 litres of chemicals in hand @ Rs. 2.28 per litre.

The following purchases were made during July:

July 2	14,000 litres	@ Rs. 2.30 per litre
July 7	10,000 litres	@ Rs. 2.32 per litre
July 15	14,000 litres	@ Rs. 2.30 per litre
July 27	5,000 litres	@ Rs. 2.35 per litre

A physical inventory on July 31 discloses that there is a stock of 10,000 litres. You are required to compute the value of closing stock as on July 31, by each of the following methods:

(i) First in First out (ii) Last in First out and (iii) Average cost method.

26. a. Elaborate the treatment of partnership account while admitting a new partner.

Or

b. Purchases of certain product during March, 2012 are set out below:

Opening Stock 500 units @ Rs.11 per unit

Purchases

March 1	1,000 units	@ Rs. 10 per unit
12	1,000 units	@ Rs. 9.80 per unit
15	1,500 units	@ Rs. 9.60 per unit
20	1,300 units	@ Rs. 9.40 per unit

Sales Rs.32,000

Closing Stock 1,400 units

You are required to determine the cost of goods sold for March under FIFO and LIFO method.

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ANSWER KEY

PART – A (20 X 1 = 20 Marks)

Q.No.	Answer
1	Inventory
2	Sacrificing Ratio
3	Raw materials
4	Old profit sharing ratio
5	Work in process
6	Goodwill account
7	P & L appropriation account
8	Inventory
9	Two
10	Revaluation Account

Q.No.	Answer
11	Periodic Inventory
12	Perpetual Inventory
13	Conservatism
14	FIFO
15	Two
16	Base stock
17	Net assets
18	Market Price
19	Sacrificing Ratio
20	Partnership deed

PART – B (3 X 2 = 6 Marks)

ANSWER ALL THE QUESTIONS

21. List out the methods of inventory valuation

- FIFO
- LIFO
- HIFO
- Average cost
- Base stock
- Inflated price
- Market price

22. Define partnership.

According to Indian Partnership Act 1932, Section 4

"Partnership is the relation between persons who have agreed to share the profit of business carried on by all or any one of them acting for all."

23. Determine inventory value for each category

A – Rs.6,000

B – Rs. 9,500

C – Rs. 15,000

D – Rs.14,000

PART – C (3X 8 = 24 Marks)

ANSWER ALL THE QUESTIONS

24. a. What is the principle behind valuation of inventory at cost or market price whichever is lower?

Businesses that manage inventory must rely on generally accepted principles of accounting, or GAAP, to assess and plan for their stock levels. Without inventory valuation, it would be difficult for businesses to know how much new merchandise they need to order or how well their sales force is performing. Understanding the basics of inventory valuation and its uses is important for investors and managers of any sales business.

Inventory valuation is the total dollar amount that is attributed to the inventory on hand. Though there are three GAAP-approved ways to value inventory, in this lesson, we're going to discuss one of those: the lower of cost or market. The lower of cost or market, which is also known as LCM, is the inventory valuation method that records inventory value as the lower of cost or market.

Or

24. b. SACRIFICING RATIO – 3 : 2

NEW PROFIT SHARING RATIO - 9 : 6 : 5

JOURNAL ENTRY

Cash a/c Dr. Rs.20,000

To Goodwill a/c Rs. 20,000

Goodwill a/c Dr. Rs. 20,000

To A's Capital a/c Rs.12,000

To B's Capital a/c Rs. 8,000

25.a. Explain the features of partnership.

- More Persons
- Profit and Loss Sharing
- Contractual Relationship
- Existence of Lawful Business
- Utmost Good Faith and Honesty
- Unlimited Liability

Or

25.b. Value of closing stock as on July 31

First in First out - Rs.23,250

Last in First out - Rs.22,980

Average Cost Method

Simple average Method - Rs.23,100

Weighted average Method - Rs.23,100

26. a. Elaborate the treatment of partnership account while admitting a new partner.

- Adjustment in profit sharing ratio
- Adjustment in goodwill account
- Adjustment in evaluation of assets and liabilities
- Adjustment in reserves
- Adjustment in capital

Or

26. b. Determine the cost of goods sold for 31st March

FIFO - Rs.38,740

LIFO - Rs.37,420