SYLLABUS

Course Name: Accounting for Managers

Course Code: MS 102

Course Objective- To enable student to acquire the skills necessary to use, interpret and analyse accounting data and to make them acquainted with decision making capability for effective financial control in an organisation.

Block I: Introduction to Accounting

Unit I Introduction to Accounting

Concept, Importance and Scope of Accounting

Unit II Accounting Principles

Accounting Principles, Concepts and Conventions

Unit III Forms and Types of Accounting

Forms and Types of Accounting, Users of Accounting Information

Unit IV Double Entry System

Accounting Equation, Rules of Recording Business Transactions

Block II Accounting Process

Unit V Journalizing and Posting

Preparation of Journal and Classification of Journals, Ledger

Unit VI Trial Balance

Preparation of Trial Balance

Unit VII Final Accounts

Preparation of Profit and Loss Account and Balance Sheet- with Adjustment Entries

Block III Cost Accounting

Unit VIII Introduction to Cost Accounting

Meaning, Significance and Elements of Cost, Distinction between Cost and Financial Accounting

Unit IX Standard Costing and Variance Analysis

Unit X Process Costing and Single and Output Costing

Unit XI Activity-Based Costing and Service Costing

Block IV Management Accounting

Unit XII Introduction to Management Accounting

Meaning, Nature and Significance of Management Accounting

Unit XIII CVP Analysis

Cost-Volume- Profit Analysis

Unit XIV Budgeting

Budget- Budgetary Control and Framework for Budgeting, Performance Budgeting and Zero-Base Budgeting

Unit XV Responsibility and Human Resource Accounting

Block V Analysis of Financial Statements

Unit XVI Financial Analysis

Nature, Methods and Tools of Financial Analysis

Unit XVII Interpretation of Financial Statements

Unit XVIII Ratio Analysis

Financial Analysis and Control: Ratio Analysis

Unit XIX Statement of Changes in Financial Position-I

Statement of Changes in Financial Position: Funds Flow Statement

Unit XX Statement of Changes in Financial Position-II

Cash Flow Statement

Unit XXI Accounting and Financial Information System

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UNIT 1 INTRODUCTION TO ACCOUNTING

STRUCTURE

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1.1 INTRODUCTION

Accounting is the systematic and comprehensive recording of financial transactions pertaining to a business, and it also refers to the process of summarizing, analyzing and reporting these transactions to oversight agencies and tax collection entities.

1.2 OBJECTIVES

After reading this unit you will be able to understand:

- Meaning of Accounting
- Concept of Accounting
- Importance of Accounting
- Scope of Accounting

1.3 MEANING AND DEFINITIONS OF ACCOUNTING

Accounting is an art and science of providing meaningful information about financial activities of the company's as a tool for management. This is used by a business for maintaining financial records on cash basis or accrual basis.

Accounting is an important part of information system. It is an important profession. Study of accounting is must for all the people concerned with business, trade and commerce.

According to Encyclopedia Britannica, "Generally, accountancy may be described as being the science by means of which all operations, as far as they are capable of being shown in figures, are accurately recorded and their results ascertained and stated. It is a science by means of which all mercantile and financial transactions, whether in money or money's worth, including operations completed to engagements undertaken to be fulfilled at once or in future, however remote, may be recorded; and this science comprises a knowledge of the methods of preparing statistics, whether relating to finance or to any transactions or circumstances which can be stated by numeration, and of ascertaining and estimating on correct basis, is the cost of any operation whether in money, in commodities, in time, in life or in any wasting property".

In order to achieve the above purposes it is necessary to record business transactions according to a specified system. In a practical manner we call this system as "Accounting". The process of identifying, recording, classifying and presenting the information relating to the business is called Accounting

Definitions

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

According to the ***American Accounting Association***, (AAA) "Accounting is the process of identifying, measuring and communicating economic information to permit informed judgments and decisions by users of the information".

Smith and Ashburne defines accounting as, "the science of recording and classifying business transactions and events, primarily of financial character, and the art of making significant summaries, analysis and interpretations of those transactions and events and communicating the results to persons who must make decisions or form judgements".

According to ***R.N. Anthony,*** "Nearly every business enterprise has accounting system. It is a means of collection, summarizing, analyzing and reporting in monetary terms, informations about business rested to make decisions or form judgements."

1.4 CONCEPT OF ACCOUNTING

The main goal of every business organization is to make profits. Further, every business concern must know its financial position i.e., assets, liability and its own investment in the business (i.e., its own capital) making profit by a business firm through different types of business transaction such as, goods purchase, goods sales, payment of expenses, receipt of income, taken loan, give interest etc., Similarly, assets are held and liability are incurred by a business firm through purchase of plant and machinery by cash, borrowing loan. Here, the business man wants to know what is the financial position of their company and he must remember all the transactions of his business firm for the year. But human memory cannot record properly so he need some book where he can systematically recorded the business transaction, whenever he required information about his business he can get this early and firstly. So, accounting was introduced as an aid to human memory. It helps permanent and systematic record of business firm to contains all transaction would help the businessman to know early and readily. He can understand their profit and loss, and financial position of the business.

It also need for planning and decision making to the business firm. In other words it can be used as language to communicate the financial information about a business to a number of parties who are interested in the business, such as share holders, debenture holders, employees, government, customers, consumers, creditors, financial institute, general public, stock exchanges and Bank etc.

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1.5 OBJECTIVES OF ACCOUNTING

The main objectives of accounting are –

(i) To give the meaningful and accurate information about the financial activities of a business.

(ii) To keep the records in a systematic manner.

(iii) To measure the Profit or Loss for knowing performance of the business.

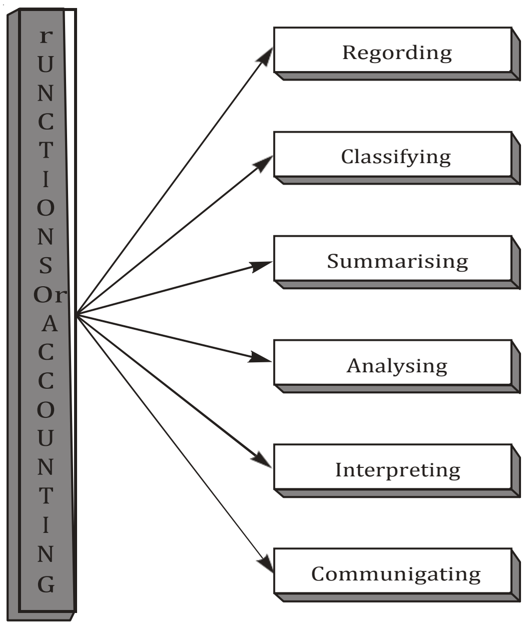
(iv) To ascertain the financial position of the business (i.e., show the assets, liabilities and capital)

(v) To provide the financial information to internal users (office manager, staff) and external users (owners, creditors etc.)

1.6 FUNCTIONS OF ACCOUNTING

The following functions of Accounting:

(i) ***Recording:*** Recording is the basic function of financial accounting. It is essentially concerned with not only ensuring that all but also business transactions of financial character. It may be further sub-divided into cash journal, purchases journal, sales journal.



(ii) ***Classifying:*** It is concerned with the systematic analysis of the recorded data. Classification is done in the book of "Ledger". This book contains on different pages individual account heads under which all financial transactions of similar nature are collected. It may have separate account heads for traveling expenses, printing and stationary, advertising etc.

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(iii) ***Summarising:*** Summarising involves presenting the classified data in a manner which is understandable and useful to the internal as well as external end users of accounting statements. Trial Balance, Income statement and Balance Sheet are prepared with the help of this process.

(iv) ***Analysing:*** All the recorded financial data are analysed for making a meaningful judgment about the financial condition and profitability of the business operations. Its purpose is to identify the financial weakness and strengths. It is also concerned with the establishment of relationship between the various items taken from income statement.

(v) ***Interpreting:***After analysis is concerned with significance of the relationship and establishment, the accountant interpret the statement in a useful way to the users. He is also explained what has happened? Why it is happened? What is likely to happen under present conditions?

(vi) ***Communicating:*** This is final function of accounting. It includes the usual income statement and the balance sheet, additional information in the form of accounting ratios, graphs, diagrams, funds flow statement etc. In this step accountant getting the help of innovation, imagination and initiative for future.

1.7 IS ACCOUNTING A SCIENCE OR AN ART OR BOTH?

Accounting is not only science but also an art. Any organized knowledge based on certain basic principles is a 'Science'. It is an organized knowledge based on scientific principles, which have been developed as result of study and experience. Accounting cannot be termed as a "perfect science" like physics and chemistry where experiments can be carried and perfect conclusions can be drawn.

It is a social science depending much on human behaviour and other social and economic factors. It establishes relationship of cause and effect about any occurrence or happening. Scientific knowledge is based on observation, experiments and testing of facts.

Accounting is a science because recording, classifying and summarizing of business transactions is done on the basis of certain principles such as principles of double entry system, which are universally applicable.

Art is the technique, which helps us in achieving our desired objectives. It helps in achieving our desired objective of maintaining proper accounts i.e., to

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know the profitability and the financial position of the business, by maintaining proper accounts.

Accounting is based on certain concepts and conventions and is subject to some limitations. It is influenced by bias and personal judgment of the accountant. Since accounting has to be applied in different organizations and varied situations, it has not been possible to develop principles, which have universal applicability. From the above explanations, it is clear that accounting is both a science as well as an art.

1.8 MEANING AND DEFINITIONS OF BOOK-KEEPING

Book-keeping is a process of accounting. It is concerned with recording transactions in the books of accounts. That is writing journal entries, entering the same into ledger accounts, balancing the ledger accounts, preparing the trial balance and preparing the final accounts. Accounting is a broader term. It includes not only recording the transactions in the books of accounting but also their interpretation.

Book-keeping is the art and science of recording, classifying and summarizing business transactions in money or money's worth accurately and systematically so that the businessman may be able to know his their profit or loss during a specified period and also his their financial position on a particular date. In other words Book-keeping is the science and art of correctly recording in books of accounts all those transactions that result in the transfer of money or money's worth.

Definitions

According to **J.R. Batliboi**, “Book-keeping may be defined as the science as well as the art of recording business transactions under appropriate accounts”.

“Book-keeping is the science of recording transactions in money or money's worth in such a manner that, at any subsequent date, their nature and effect may be clearly understood and, when required, a combined statement of their result may be prepared”. **– L.C. Cropper**

“Book-keeping is the recording of the financial transactions of a business in a methodical manner so that information on any point in relation to them may be quickly obtained”. **–A.J. Farell**

In the words of **A.H. Rosenkampff**, “Book-keeping is the art of recording business transactions in a systematic manner”.

1.9 ADVANTAGES AND DISADVANTAGES OF BOOK-KEEPING

Advantages of Book-Keeping

The advantages are as follows.

(i) It is a permanent record for the present and future references.

(ii) As it is a complete record, the business concern maintains information about its expenses and losses at the end of the year.

(iii) When a business concern keeps book-keeping records, it has a complete records of what it owns (i.e., its assets), what it owes (i.e., its liabilities) so it can know financial position at the end of the year.

(iv) A Book-keeping system will simplify auditing and final accounts preparation.

(v) It is easy to compare the results of its business from year to year and ascertain the progress.

(vi) Book-keeping records enable a business concern to over come from fraud and cash embezzlement.

(vii) Transactions recorded in books of account act as evidence to the business concerns for both creditors and debtors.

(viii) Book-keeping will help to find out the liability from time to time based on their production and sales.

Disadvantages of Book-Keeping

Book-keeping suffers from certain disadvantages, they are as follows:

(i) Book-keeping is of monetary concept. That means, only monetary (i.e., Transactions which can be measured in terms of money worth) transactions will be entered in books of accounts.

(ii) Some times Accountants enter the approximate information about transactions. This value depends on personal judgement, so we cannot ascertain accurate figures from books of accounts.

(iii) Final accounts do not provide timely information of business position. Since, final account are prepared only at the end of financial year.

(iv) It is time consuming. It consumes more time for entering each and every transaction.

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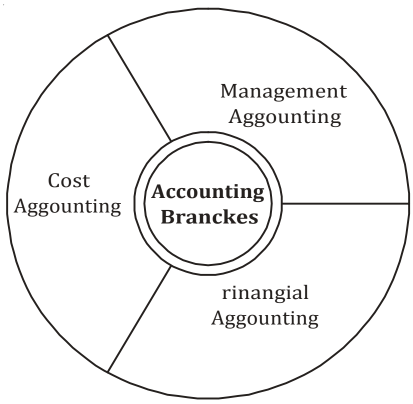
1.10 ACCOUNTING BRANCHES

The different Accounting Branches are as follows:



Financial Accounting: The main purpose of the Financial accounting is to ascertain profit or loss during a specific period, to show financial position of the business on a particular position of the business on a particular date and to have control over the firms property. Such accounting records are used to impart useful information to outsiders and to meet the legal requirements.

According to the **American Accounting Association**, (AAA) "Accounting is the process of identifying, measuring and communicating economic information to permit informed judgments and decisions by users of the information".

Cost Accounting: Terminology of cost accounting defines cost as the "The amount of expenditure, actual or notional, incurred on or attributable, to a given thing." Costing as the technique and process of ascertaining cost. Cost accounting is "The process of accounting for cost from the point at which expenditure is incurred or committed to the business concern of its ultimate relationship with cost centers and cost units".

According to **H.J. Wheldown**, cost accounting is "The classifying, recording and appropriate allocation of expenditures for the determination of the costs of products or services, the relation of those costs to sales values, and ascertainment of profitability".

Management Accounting: Management Accounting is that branch of accounting which provides information to the management according to its needs. It is most concerned with information which helps it in basic functions of planning, organizing and control.

According to **Charles T. Homgren,** "Management Accounting is the process of identification, measurement, accumulation, analysis, preparation, interpretation and communication of information that assists executives in fulfilling business concern objectives".

1.11 IMPORTANCE OF ACCOUNTING

Importance of Accounting can be summarized as follows:

1. Assistance to management: Accounting provides information to the management to enable it to do its work properly. Such information helps in the Planning, Decision making and controlling.

2. Comparative study: A systematic record enables a business to compare one year's results with those of other years and locate significant factors leading to the change if any.

3. Evidence in the court: Systematic record of transactions is often treated by the courts as good evidence.

4. Creating historic financial documentation: Accounting helps for-profit and not-for-profit organizations maximize the value they create by using historic financial documentation to report and project the health of an organization. However, these reports and projections can often overlook non-monetary contributions to performance, resulting in decisions based on misleading or incomplete information.

5. Analysis Tool: Accounting reports can be analyzed to provide management with financial information that can be used to run a business, plan ahead and to make changes when business is not going as expected.

1.12 SCOPE OF ACCOUNTING

Accounting has got a very wide scope and area of application. Its use is not confined to the business world alone, but spread over in all the spheres of the society and in all professions. Now-a-days, in any social institution or professional activity, whether that is profit earning or not, financial transactions must take place. So there arises the need for recording and summarizing these transactions when they occur and the necessity of finding out the net result of the same after the expiry of a certain fixed period. The need for interpretation and communication of that information are to the appropriate persons. Only accounting use can help overcome these problems.

In the modern world, accounting system is practiced not only in all the business institutions but also in many non-trading institutions like Schools, Colleges, Hospitals, Charitable Trust Clubs, Co-operative Society etc. and also Government and Local Self-Government in the form of Municipality, Panchayat. The professional persons like Medical practitioners, practicing Lawyers, Chartered Accountants etc. also adopt some suitable types of accounting methods. As a matter of fact, accounting methods are used by all who are involved in a series of financial transactions.

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The scope of accounting as it was in earlier days has undergone lots of changes in recent times. As accounting is a dynamic subject, its scope and area of operation have been always increasing keeping pace with the changes in socio-economic changes. As a result of continuous research in this field the new areas of application of accounting principles and policies are emerged. National accounting, human resources accounting and social Accounting are examples of the new areas of application of accounting systems.

1.13 SUMMARY

Accounting is the language of business. The main objectives of Accounting are to safeguard the interests of the business, its proprietors and others connected with the business transactions. This is done by providing suitable information to the owners, creditors, shareholders, Government, financial institutions and other related agencies.

According to AICPA (American Institute of Certified Public Accountants) it is defined as "the art of recording, classifying and summarizing in a significant manner and in terms of money, transactions and events which are in part at least of a financial character and interpreting the result thereof. Recording is all the transactions in subsidiary books for purpose of future record or reference. Classifying is all recorded transactions in subsidiary books are classified and posted to the main book of accounts. It is known as "Ledger." Summarizing: All recorded transactions in main books will be summarized for the preparation of Trial balance.

Interpreting: Interpreting refers to the explanation of the meaning and significance of the result of final accounts and balance sheet so that parties concerned with business can determine the future earnings, ability to pay interest, liquidity and profitability of a sound dividend policy.

Book-keeping may be defined as "the art of recording the business transactions in the books of accounts in a systematic manner." A person who is responsible for and who maintains and keeps a record of the business transactions is known as Book-keeper. His work is primarily clerical in nature.

Financial Accounting is prepared to determine profitability and financial position of a concern for a specific period of time.

Cost Accounting is the formal accounting system setup for recording costs. It is a systematic procedure for determining the unit cost of output produced or service rendered.

Management Accounting is concerned with presentation of accounting information to the management for effective decision making and control.

Cost control is operated through setting standards of targets and comparing actual performance therewith, a view to identify deviations from standards and taking corrective action in order to ensure that future performance confronts to standards or norms.Budgetary control and standard costing are essential tools and techniques of cost control. There are several district tool and techniques of cost reduction such as value engineering and work study, standardization, simplification, variety reduction, quality measurement and research, operation research, market research, job evaluation, merit rewards, incentives improvement in design, automation etc.

Product design offers the greatest scope for cost reduction of a permanent nature. The impact of decision made at the beginning stage on costs can be revealed at every stage of manufacture or processing of the product in the factory. The design function therefore offers an extremely important area of cost reduction action.

1.14 GLOSSARY

a) Accounting: Accounting provides suitable information to the owners, creditors, shareholders, Government, financial institutions and other related agencies.

b) Interpreting: Interpreting refers to the explanation of the meaning and significance of the result of final accounts and balance sheet.

c) Book-keeping: Book-keeping may be defined as the art of recording the business transactions in the books of accounts in a systematic manner.

d) Financial Accounting: Financial Accounting is prepared to determine profitability and financial position of a concern for a specific period of time.

e) Cost control: Cost control is operated through setting standards of targets and comparing actual performance.

1.15 ANSWER TO CHECK YOUR PROGRESS/ POSSIBLE ANSWERS TO SAQ

Short answer questions

1. Give the meaning of Accounting.
2. Define the term Accounting.
3. What is Book Keeping?
4. What is Financial Accounting?

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Extended answer questions

1. Discus the concept of Accounting.
2. Explain importance of Accounting.
3. Discuss scope of Accounting.

True-false

1. Accounting provides suitable information to the owners, creditors, shareholders, Government, financial institutions and other related agencies.

2. Recording refers to the explanation of the meaning and significance of the result of final accounts and balance sheet.

3. Book-keeping may be defined as the art of recording the business transactions in the books of accounts in a systematic manner.

4. Financial Accounting is prepared to determine profitability and financial position of a concern for a specific period of time.

5. Cost control is operated through setting standards of targets and comparing actual performance.

Multiple-choice

1. What provides suitable information to the owners, creditors, shareholders, Government, financial institutions and other related agencies?

   a) Management

   b) Accounting

   c) Production

   d) All the above

2. Interpreting refers to the explanation of the meaning and significance of the result of final accounts and……………..

   a) Balance Sheet

   b) Profit and Loss A/C

   c) Both a and b

   d) None of the above

Fill-in-the-blanks

1. provides suitable information to the owners, creditors, shareholders, Government, financial institutions and other related agencies.

2. refers to the explanation of the meaning and significance of the result of final accounts and balance sheet.

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3. Book-keeping may be defined as the art of recording the business transactions in the books of accounts in a…………...

4.is prepared to determine profitability and financial position of a concern for a specific period of time.

1.16 KEY TO CHECK YOUR ANSWER/ANSWER TO CHECK YOUR PROGRESS

1. True 2. False 3. True 4. True 5. True

1. (b) 2. (a)

1. (i) – (ii), (ii) – (iii), (iii) – (i)

1. Accounting 2. Interpreting 3. Systematic manner 4. Financial Accounting

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1.19 TERMINAL QUESTIONS

1. How the accounting concept is related to other areas of management activities? Discuss.

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UNIT 2 ACCOUNTING PRINCIPLES

STRUCTURE

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2.1 INTRODUCTION

Accounting principles are the body of doctrines commonly associated with the theory and procedure of accounting serving as an explanation of current practices and as a guide for the selection of conventions or procedures where alternatives exists. Rules governing the formation of accounting axioms and the principles derived from them have arisen from common experience, historical precedent statements by individuals and professional bodies and regulations of Governmental agencies.

2.2 OBJECTIVES

After reading this unit you will be able to understand:

Accounting Principles

Accounting Concepts

Accounting Conventions

2.3 ACCOUNTING PRINCIPLES

In the words of **A.W. Johnson** accounting principles are the assumptions and rules of accounting and the applications of these rules, methods and procedures to the actual practice of accounting. The terminology committee of **American Institute of Certified Public Accounts** defines "the term principles as a general law or rule adopted or preferred as a guide to action a settled ground or business of conduct or practice.

Accounting Principles

Accounting Concepts	Accounting Conventions
Money measurement concept	Convention of Consistency
Business entity concept	Convention of Disclosure
Going concern concept	Convention of Conservation
Cost concept	Convention of Materiality
Dual aspect concept	
Accounting period concept	
Matching concept	
Accrual concept	

2.4 ACCOUNTING CONCEPTS

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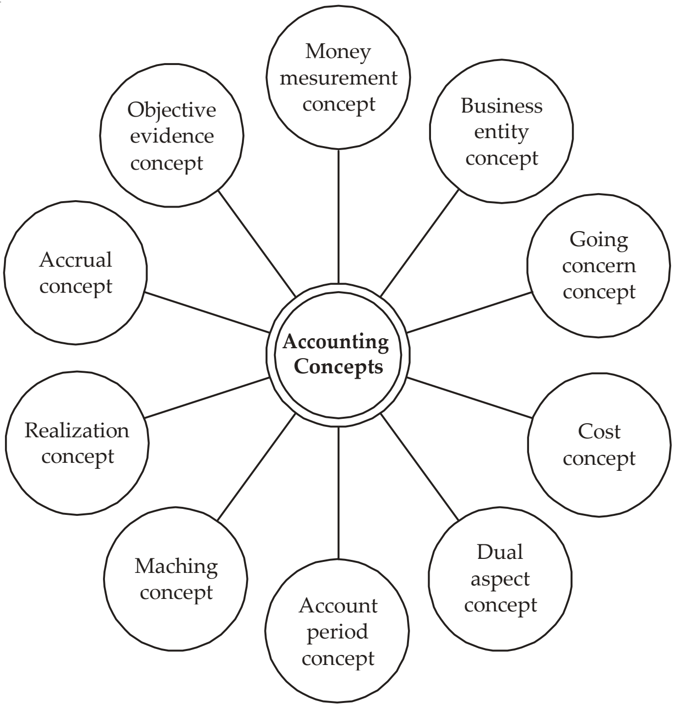
The term accounting concept refers to assumptions and conditions on which accounting system is based. It denotes the prepositions on which principles are formulated. The principles are formulated on the basis of economic and political environment of the business.



Money Measurement Concept

While preparing accounts in a business, only those transactions which can be express in terms of money alone are recorded other transactions which are not capable of measuring in this concept are not recorded. The money measurement concept helps a concern to express items of diverse nature, such as Bank balance, Machinery, Stock in trade, Furniture and so on in term of common denominator, viz., money and hold them up for the purpose of knowing the total value of assets in a particular period.

Example: A business concern has bank balance ₹ 1,00,000, 1000 tons of stock in trade, 2 type writers, 4 machines, and 2 buildings in the absence of a common denominator, viz., money, these diverse items cannot be added upto give any meaningful figure. But it can be expressed in term of money as bank balance ₹1,00,000, stock in trade ₹ 50,000, 2 typewriters ₹ 20,000, 4 machines ₹ 80,000 and 2 buildings ₹ 8,00,000. It is possible to add up the values of all assets to state the total worth of assets in the business of ₹ 10,50,000.

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Business Entity Concept

Under this concept the business transactions should be prepared completely separate from the private affairs of the proprietor because the business enterprise is totally separate organization and different from the owner of the business. This can enable the proprietor to ascertain the true picture of the business.

Going Concern Concept

While the accounts are maintained it is assumed that the business concern will continue to exist for an indefinite period of time. It facilitates classification of expenditure into capital expenditure and revenue expenditure. The capital expenditure benefits the business for a longer period and the revenue expenditure relates to short duration. The fixed assets are shown at their original cost, less its depreciation under this concept.

Cost Concept

Cost Concepts is of special significance only for fixed assets. Which is recorded in the books of account at cost i.e., at the price actually paid for acquiring the asset. Here, cost price is the actual price that is agreed upon by both the parties to a contract. (Than their practice contribution to true accounting records.) Finally, the cost concept prevents a concern from giving arbitrary value to an assets and the cost price of an assets is stable, where as the market price of assets is variable.

Example: A Machinery value ₹ 5,00,000 are purchased by a concern for ₹ 4,50,000, The machinery is recorded in the books of concern only at their cost price of ₹ 4,50,000 and not at their market price of ₹ 5,00,000.

Dual Aspect Concepts

In this concept, each and every transaction is split up into two aspects or equations, one aspect is related to the receiving of benefits and other aspect is related to the giving of benefits.

Example: Ananya purchased goods for cash, she receives goods of some value and gives cash of equal value.

This concept is based on the assumption that every for action, there is always equal and opposite reaction. According to this concept assets of a business will be equal to liabilities and capital, expressed in the form of equation:

Assets = Liabilities + Capital

Capital = Assets – Liabilities

Accounting Period Concept

When the business will exist for a longer duration it is necessary to maintain accounts with reference to a convenient period. So, that results are ascertained

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and financial position presented for that period, usually accounts are prepared for a period of one year which may be a financial year.

Accounting period is often, referred to as the accounting year. In English calendar year from 1^{st} January to 31^{st} December and according to financial year of the Government from 1^{st} April to 31^{st} March.

Matching Concept

One of the objectives of every business firm is to know its results for a given period time. In order to know the profit and loss of the business, the costs incurred during a given period of is matched against the revenue earned during that period. This helps to know the profit or loss of the business during a period of time. If the revenue exceeds the cost it represents the profits. On the other hand, if the cost exceeds the revenue, it represents the loss.

Accrual Concept

Accrual concept emphases the realization concept in regard to both revenues and expenses. Under this concept the accountant is required to treat as revenues all those items for which there is the legal right to receive, although cash might not have been received for them. If a revenue is earned, but no payment in received, the same should be recorded as revenue, when an expenses is incurred, but no payment is made, the same should be recorded as an expenses, this concept has led to the introduction of accrual system of accounting as opposed to cash system of accounting.

Realisation concept

In this concept the sale proceeds of goods and services are realised only when the buyer is legally bound to pay for the delivery of goods or rendering of services. Realisation concept is based on historical events of business transactions and therefore, it is also know as historical record concept.

For example, A businessman is reserved an order on 1st January 2005 and supplied goods on 14th January and he is received payment on 25th January. For this transaction, the revenue of sales of goods is recorded on 1st January but neither on 14th January nor on 25th January.

2.5 ACCOUNTING CONVENTIONS

Accounting Convention refers to the customs and traditions followed by Accountants as guidelines while preparing accounting statements. The important accounting conventions are as follows:

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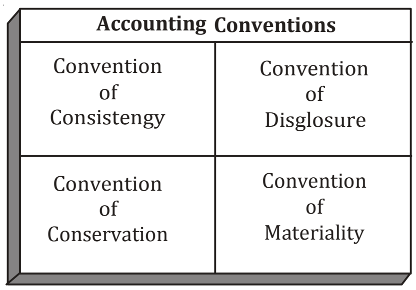

Convention of Consistency

Convention of consistency implies that the basis followed in different accounting period should be same. It also signifies that the accounting practices and methods should remain consistent from one accounting year to another. When once a particular method of depreciation is adopted for a particular fixed asset, the same method should be followed for that assets year after year.

Convention of Disclosure

Under the convention of disclosure all significant information about the business should be disclosed. This convention implies that the accounting records and statements conform to generally accepted accounting principle. As regards the investments, not only the various securities held by a concern should be disclosed, but also the mode of their valuation should be stated. Under this convention the financial statements should disclosed as much details as possible.

Convention of Conservation

Convention of conservation refers to the accounting records and in the financial statements of business, all the prospective losses, risks, and uncertainties should be taken note of and provided but prospective profits should be ignored. Such transactions related to provision for doubtful debts, provision for discount on Debtors etc. The importance of this convention is that the financial statements should indicate the actual position.

Convention of Materiality

Convention of Materiality implies that transactions which are more important to the business are recorded and which do not affect the result of the business drastically should be ignored as the cost of ascertaining such insignificant expenses is more than such a trivial expense incurred. A new pencil purchased and supplied to the office is, no doubt, an asset for the concern. Every day when someone in the office writes with the pencil, a portion of the pencil is used up, and as such the value of the pencil decreases. The pencil is taken as used up at the time it is purchased or at the time it is issued to the office

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2.6 SUMMARY

Accounting concepts mean and include necessary assumptions or postulates or ideas which are used to accounting practice and preparation of financial statements.

Accounting Convention implies that those customs, methods and practices to be followed as a guideline for preparation of accounting statements.

Separate entity concept implies that business unit or a company is a body corporate and having a separate legal entity distinct from its proprietors. The proprietors or members are not liable for the acts of the company.

The dual aspect concept is the basis of the double entry book keeping. Accordingly for every debit there is an equal and corresponding credit.

The term Capital refers to funds provide by the proprietor of the business concern. On the other hand, the term liability denotes the funds provided by the creditors and debenture holders against the assets of the business.

According to this concept, income or loss of a business can be analyzed and determined on the basis of suitable accounting period instead of wait for a long period, i.e., until it is liquidated.

Cost Concept implies that assets acquired are recorded in the accounting books at the cost or price paid to acquire it. And this cost is the basis for subsequent accounting for the asset. For accounting purpose the market value of assets are not taken into account either for valuation or charging depreciation of such assets.

Matching Concept is closely related to accounting period concept. The chief aim of the business concern is to ascertain the profit periodically. To measure the profit for a particular period it is essential to match accurately the costs associated with the revenue. Thus, matching of costs and revenues related to a particular period is called as Matching Concept.

Realization Concept is otherwise known as Revenue Recognition Concept. According to this concept, revenue is the gross inflow of cash, receivables or other considerations arising in the course of an enterprise from the sale of goods or rendering of services from the holding of assets.

Accrual Concept is closely related to Matching Concept. According to this concept, revenue recognition depends on its realization and not accrual receipt. Likewise cost are recognized when they are incurred and not when paid. The accrual concept ensures that the profit or loss shown is on the basis of full fact relating to all expenses and incomes.

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The Convention of Consistency implies that accounting policies, procedures and methods should remain unchanged for preparation of financial statements from one period to another. Under this convention alternative improved accounting policies are also equally acceptable. In order to measure the operational efficiency of a concern, this convention allows a meaningful comparison in the performance of different period.

2.7 GLOSSARY

a) Accounting Concept: Accounting concepts mean and include necessary assumptions or postulates or ideas which are used to accounting practice and preparation of financial statements.

b) Accounting Convention: Accounting Convention implies that those customs, methods and practices to be followed as a guideline for preparation of accounting statements.

c) Dual aspect concept: The dual aspect concept is the basis of the double entry book keeping. Accordingly for every debit there is an equal and corresponding credit.

d) Cost Concept: Cost Concept implies that assets acquired are recorded in the accounting books at the cost or price paid to acquire it.

e) Convention of Consistency: The Convention of Consistency implies that accounting policies, procedures and methods should remain unchanged for preparation of financial statements from one period to another.

2.8 CHECK YOUR PROGRESS

Short answer questions

1. What is Accounting Concept?
2. What is Accounting Convention?
3. What is Dual aspect concept?
4. Give the meaning of Cost Concept.
5. What is Convention of Consistency?

Extended answer questions

1. Explain various Accounting Concepts with examples.
2. Discuss in details about various Accounting Conventions.

True-false

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1. Accounting concepts mean and include necessary assumptions or postulates or ideas which are used to accounting practice and preparation of financial statements.

2. Accounting Convention implies to the customs, methods and practices that are to be followed as a guideline for preparation of accounting statements.

3. The going concern concept is the basis of the double entry book keeping. Accordingly for every debit there is an equal and corresponding credit.

4. Cost Concept implies that assets acquired are recorded in the accounting books at the cost or price paid to acquire it.

5. The Convention of Consistency implies that accounting policies, procedures and methods should remain unchanged for preparation of financial statements from one period to another.

Multiple-Choice

1. Accounting concepts mean and include necessary assumptions or postulates or ideas which are used to..................

a) Accounting practice

b) Preparation of financial statements

c) Both a and b

d) None of the above

2. Customs, methods and practices to be followed as a guideline for preparation of accounting statements are the need as:

a) Accounting Concept

b) Accounting Convention

c) Cost Concept

d) None of the above

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Matching

i) Accounting concepts ii) Accounting Convention	i) It implies that those customs, methods and practices to be followed as a guideline for preparation of accounting statements. ii) It includes necessary assumptions or postulates or ideas which are used to accounting practice and preparation of financial statements.

Fill-in-the-blanks

1. Accounting concepts mean and include necessary assumptions or postulates or ideas which are used to accounting practice and preparation of ……………..

2. implies that those customs, methods and practices to be followed as a guideline for preparation of accounting statements.

3. The …………….is the basis of the double entry book keeping. Accordingly for every debit there is an equal and corresponding credit.

4. implies that assets acquired are recorded in the accounting books at the cost or price paid to acquire it.

2.9 KEY TO CHECK YOUR ANSWER/ANSWER TO CHECK YOUR PROGRESS

1. True 2. True 3. False 4. True 5. True

1. (c) 2. (b)

1. (i) – (ii), 2. (ii) – (i)

1. Financial statements 2. Accounting Convention 3. Dual aspect concept 4. Cost Concept

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2.12 TERMINAL QUESTIONS

1. Discuss various accounting principles with examples.

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2. How accounting concepts are useful for business organizations? Explain.

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UNIT 3 FORMS AND TYPES ACCOUNTING

STRUCTURE

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3.1 INTRODUCTION

Accounting is a vast and dynamic profession and is constantly adapting itself to the specific and varying needs of its users. Over the past few decades, accountancy has branched out into different types of accounting to cater for the diversity of needs of its users.

3.2 OBJECTIVES

After reading this unit you will be able to understand:

Forms and Types of Accounting,

Users of Accounting Information

3.3 FORMS OR TYPES OF ACCOUNTING

Main types of accounting are as follows:

1. Financial Accounting
2. Management Accounting
3. Cost Accounting
4. Governmental Accounting
5. Tax Accounting
6. Forensic Accounting
7. Project Accounting
8. Social Accounting

1. Financial Accounting

Financial Accounting, or financial reporting, is the process of producing information for external use usually in the form of financial statements. Financial Statements reflect an entity's past performance and current position based on a set of standards and guidelines known as GAAP (Generally Accepted Accounting Principles). GAAP refers to the standard framework of guideline for financial accounting used in any given jurisdiction. This generally includes accounting standards (e.g. International Financial Reporting Standards), accounting conventions, and rules and regulations that accountants must follow in the preparation of the financial statements.

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2. Management Accounting

Management Accounting produces information primarily for internal use by the company's management. The information produced is generally more detailed than that produced for external use to enable effective organization control and the fulfillment of the strategic aims and objectives of the entity. Information may be in the form budgets and forecasts, enabling an enterprise to plan effectively for its future or may include an assessment based on its past performance and results. The form and content of any report produced in the process is purely upon management's discretion.

3. Cost Accounting

Cost accounting is a process of collecting, recording, classifying, analyzing, summarizing, allocating and evaluating various alternative courses of action & control of costs. Its application is more suited to manufacturing concerns.

4. Governmental Accounting

Governmental Accounting, also known as public accounting or federal accounting, refers to the type of accounting information system used in the public sector. This is a slight deviation from the financial accounting system used in the private sector. The need to have a separate accounting system for the public sector arises because of the different aims and objectives of the state owned and privately owned institutions. Governmental accounting ensures the financial position and performance of the public sector institutions are set in budgetary context since financial constraints are often a major concern of many governments. Separate rules are followed in many jurisdictions to account for the transactions and events of public entities.

5. Tax Accounting

Tax Accounting refers to accounting for the tax related matters. It is governed by the tax rules prescribed by the tax laws of a jurisdiction. Often these rules are different from the rules that govern the preparation of financial statements for public use (i.e. GAAP). Tax accountants therefore adjust the financial statements prepared under financial accounting principles to account for the differences with rules prescribed by the tax laws. Information is then used by tax professionals to estimate tax liability of a company and for tax planning purposes.

6. Forensic Accounting

Forensic Accounting is the use of accounting, auditing and investigative techniques in cases of litigation or disputes. Forensic accountants act as expert witnesses in courts of law in civil and criminal disputes that require an assessment of the financial effects of a loss or the detection of a financial fraud. Common

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litigations where forensic accountants are hired include insurance claims, personal injury claims, suspected fraud and claims of professional negligence in a financial matter (e.g. business valuation).

7. Project Accounting

Project Accounting refers to the use of accounting system to track the financial progress of a project through frequent financial reports. Project accounting is a vital component of project management. It is a specialized branch of management accounting with a prime focus on ensuring the financial success of company projects such as the launch of a new product. Project accounting can be a source of competitive advantage for project-oriented businesses such as construction firms.

8. Social Accounting

Social Accounting, also known as Corporate Social Responsibility Reporting and Sustainability Accounting, refers to the process of reporting implications of an organization's activities on its ecological and social environment. Social Accounting is primarily reported in the form of Environmental Reports accompanying the annual reports of companies. Social Accounting is still in the early stages of development and is considered to be a response to the growing environmental consciousness amongst the public at large.

3.5 USERS OF ACCOUNTING INFORMATION

The progress and reputation of any business firm is built upon the sound financial footing. There are a number of parties who are interested in the accounting information relating to business. Accounting is the language employed to communicate financial information of a concern to such parties.

According to Slawin and Reynolds, “Conceptually, accounting is the discipline that provides information on which external and internal users of the information may base decisions that result in the allocation of economic resources in society”. That is, users of accounting information may be grouped into two classes, viz., Internal users and External users.

(A) Internal Users:

Internal users of accounting information are those persons or groups which are within the organization. Following are such internal users:

1. Owners:

The owners provide funds or capital for the organization. They possess curiosity in knowing whether the business is being conducted on sound lines or not and whether the capital is being employed properly or not.

Owners, being businessmen, always keep an eye on the returns from the investment. Comparing the accounts of various years helps in getting good pieces of information. Properly kept accounts are good proof in dispute, they determine the amount of goodwill and facilitate in assessing various taxes.

2. Management:

The management of the business is greatly interested in knowing the position of the firm. The accounts are the basis; the management can study the merits and demerits of the business activity. Thus, the management is interested in financial accounting to find whether the business carried on is profitable or not. The financial accounting is the "eyes and ears of management and facilitates in drawing future course of action, further expansion etc."

3. Employees:

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

(B) External Users:

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

1. Creditors:

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

2. Investors:

The prospective investors, who want to invest their money in a firm, of course wish to see the progress and prosperity of the firm, before investing their amount, by going through the financial statements of the firm. This is to safeguard the investment. For this, this group is eager to go through the accounting which enables them to know the safety of investment.

3. Government:

Government keeps a close watch on the firms which yield good amount of profits. The State and Central Governments are interested in the financial statements

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to know the earnings for the purpose of taxation. To compile national accounts the accounting is essential.

4. Consumers:

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

5. Research Scholars:

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

To make a study into the financial operations of a particular firm the research scholar needs detailed accounting information relating to purchases, sales, expenses, cost of materials used, current assets, current liabilities, fixed assets, long-term liabilities and shareholders' funds which is available in the accounting records maintained by the firm.

6. Financial Institutions:

Bank and financial institutions that provide loan to the business are interested to know credit-worthiness of the business. The groups, who lend money need accounting information to analyse a company's profitability, liquidity and financial position before making a loan to the company. Further, they keep constant watch on the operating results and financial position of the business through accounting data.

7. Regulatory Agencies:

Various Government departments such as Company Law department, Reserve Bank of India, Registrar of Companies etc. require information to be filed with them under law. By examining this accounting information they ensure that concerned companies are following the rules and regulations.

3.5 CLASSIFICATION OF ACCOUNTS

In order to keep a proper record of the two aspect of transaction, accounts may be classified

Personal Accounts

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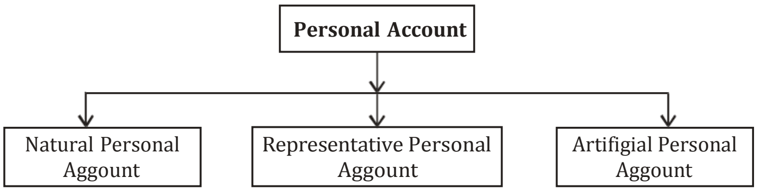
The Account which relates to an individual, firms, companies or an institution are called personal account. The account of the person who receives the benefit of the transaction from the business should be debited, and the account of the person who gives the benefit of the transaction to the business should be credited.

Example: Account of Mr. Jai Gopi, Account of DSSBL Pvt. Ltd., Account of R.K. Institute of Management, Account of Lakshmipathi Balaji, Account of Rabin & Sons Co.,

Types of Personal Account

Personal Account can be classified into following categories:

- Natural Personal Account
- Artificial Personal Account
- Representative Personal Account



Natural Personal Account

Natural Personal Account refers to the accounts of human beings. It includes the accounts like, Subasis, Debasis, Rajkumar, Capital Account, Drawing Account, Debtors and Creditors Account.

Artificial Personal Account

Artificial Person do not have physical constructions as human beings but they works as personal accounts like Companies account, Institutions account, Factory account etc. This accounts also involves accounts of Insurance Company, Hospital Account, Club Account etc.

Representative Personal Account

It is a particular person or a group of person such as outstanding salaries or wages account. In this case, instead of using the name of employees whose salary are outstanding. Here will be credit outstanding salaries account which represents employees, whom salary are payable. Representative personal account like, outstanding expenses account, prepaid expenses account, accrued income account and unearned income account etc.

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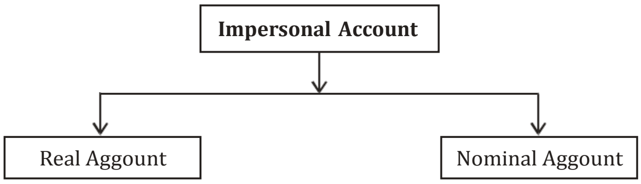
Impersonal Account

Those accounts which are not related with personal account, group of person account, any firm's account, companies account as known as impersonal account. Impersonal accounts are subdivided into–



There are separate rules for recording transactions in respect with real account and nominal account.

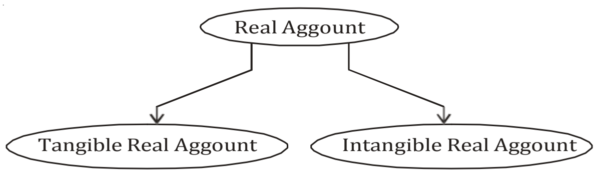
Real Account

Real Account related to all those things which exist and value can be measured in terms of money and which are assets of the business firm. It also known as assets account. *Example:* Cash account, Furniture account, Plant and Machinery account, Goodwill account etc.

Types of Real Account

Real Accounts are classified into two categories:

- Tangible Real Account



Tangible Real Account

These are those account which have physical existence usually that can be seen, felt, measured, touched, purchased, and sold etc. The tangible real account like, Cash account, Furniture account, Building account etc.

Intangible Real Account

These are those account which have no physical existence that cannot be seen, touched, but only felt and measured in the term of money. *Examples* of such account are Goodwill account, Copyright account, Royalty account, Patents account and Trade Mark account etc.

Nominal Account

Nominal account is the records of a business firm's, expenses or losses and income and gains. Therefore, the account of expenses and losses of the business should be debited and the account of an income and gain of business should be credited. It is also known as fictitious account.

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Example: Salary Account, Wages Account, Office Expenses Account, Rent Account, Commission Account, Discount Account, Interest Account etc.

3.6 SUMMARY

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Cost accounting is a branch of management accounting and involves the application of various techniques to monitor and control costs. Its application is more suited to manufacturing concerns.

Governmental Accounting, also known as public accounting or federal accounting, refers to the type of accounting information system used in the public sector. This is a slight deviation from the financial accounting system used in the private sector. The need to have a separate accounting system for the public sector arises because of the different aims and objectives of the state owned and privately owned institutions. Governmental accounting ensures the financial position and performance of the public sector institutions are set in budgetary context since financial constraints are often a major concern of many governments. Separate rules are followed in many jurisdictions to account for the transactions and events of public entities.

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under financial accounting principles to account for the differences with rules prescribed by the tax laws. Information is then used by tax professionals to estimate tax liability of a company and for tax planning purposes.

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Project Accounting refers to the use of accounting system to track the financial progress of a project through frequent financial reports. Project accounting is a vital component of project management. It is a specialized branch of management accounting with a prime focus on ensuring the financial success of company projects such as the launch of a new product. Project accounting can be a source of competitive advantage for project-oriented businesses such as construction firms.

Social Accounting, also known as Corporate Social Responsibility Reporting and Sustainability Accounting, refers to the process of reporting implications of an organization's activities on its ecological and social environment. Social Accounting is primarily reported in the form of Environmental Reports accompanying the annual reports of companies. Social Accounting is still in the early stages of development and is considered to be a response to the growing environmental consciousness amongst the public at large.

3.7 GLOSSARY

a) Financial Accounting: Financial Accounting, or financial reporting, is the process of producing information for external use usually in the form of financial statements.

b) Financial Statements: Financial Statements reflect an entity's past performance and current position based on a set of standards and guidelines known as GAAP (Generally Accepted Accounting Principles). GAAP refers to the standard framework of guideline for financial accounting used in any given jurisdiction.

c) Management Accounting: Management Accounting produces information primarily for internal use by the company's management. The information produced is generally more detailed than that produced for external use to enable effective organization control and the fulfillment of the strategic aims and objectives of the entity.

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d) Cost accounting: Cost accounting is a branch of management accounting and involves the application of various techniques to monitor and control costs. Its application is more suited to manufacturing concerns.

e) Governmental Accounting: Governmental Accounting, also known as public accounting or federal accounting, refers to the type of accounting information system used in the public sector. This is a slight deviation from the financial accounting system used in the private sector.

f) Tax Accounting: Tax Accounting refers to accounting for the tax related matters. It is governed by the tax rules prescribed by the tax laws of a jurisdiction. Often these rules are different from the rules that govern the preparation of financial statements for public use (i.e. GAAP).

g) Project Accounting: Project Accounting refers to the use of accounting system to track the financial progress of a project through frequent financial reports. Project accounting is a vital component of project management.

3.8 CHECK YOUR PROGRESS

Short answer questions

1. What is Financial Accounting?
2. What is Management Accounting?
3. What is Cost Accounting?
4. Give the meaning of Governmental Accounting.
5. What is Tax Accounting?
6. What is Forensic Accounting?
7. What is Project Accounting?
8. Give the meaning of Social Accounting.

Extended answer questions

1. Explain various forms or types of Accounting.
2. Discuss various users of Accounting Information.

True-false

1. Financial Accounting is the process of producing information for external use usually in the form of financial statements.

2. GAAP refers to the standard framework of guideline for financial accounting used in any given jurisdiction.

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3. Management Accounting produces information primarily for internal use by the company's management.

4. Social Accounting is a branch of management accounting and involves the application of various techniques to monitor and control costs.

5. Project Accounting refers to the use of accounting system to track the financial progress of a project through frequent financial reports.

Multiple-choice

1. What is the process of producing information for external use usually in the form of financial statements?

a) Financial Accounting

b) Cost Accounting

c) Management Accounting

d) All the above

2. What refers to the standard framework of guideline for financial accounting used in any given jurisdiction?

a) Accounting

b) Financing

c) GAAP

d) None of the above

3. What is a branch of management accounting and involves the application of various techniques to monitor and control costs?

a) Financial Accounting

b) Cost Accounting

c) Management Accounting

d) Social Accounting

4. What refers to the use of accounting system to track the financial progress of a project through frequent financial reports?

a) Financial Accounting

b) Cost Accounting

c) Management Accounting

d) Project Accounting

Fill-in-the-blanks

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1. Financial Accounting is the process of producing information for external use usually in the form of……………..

2. refers to the standard framework of guideline for financial accounting used in any given jurisdiction.

3. Accounting produces information primarily for internal use by the company's management.

4. Cost accounting is a branch of management accounting and involves the application of various techniques to monitor and control costs.

5. refers to the use of accounting system to track the financial progress of a project through frequent financial reports.

3.9 KEY TO CHECK YOUR ANSWER/ANSWER TO CHECK YOUR PROGRESS

1. True 2. True 3. True 4. True 5. True

1. (a) 2. (c) 3. (d) 4. (d)

1. Financial statements 2. GAAP 3. Management 4. Project Accounting

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3.12 TERMINAL QUESTIONS

1. Why Government departments such as Company law department, Reserve Bank of India, Registrar of Companies etc. maintain separate accounts? Discuss.

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UNIT 4 Double Entry System

STRUCTURE

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4.1 INTRODUCTION

Double entry accounting is a record keeping system under which every transaction is recorded in at least two accounts. There is no limit on the number of accounts that may be used in a transaction, but the minimum is two accounts. There are two columns in each account, with debit entries on the left and credit entries on the right. In double entry accounting, the total of all debit entries must match the total of all credit entries. When this happens, the transaction is said to be "in balance." If the totals do not agree, the transaction is said to be "out of balance," and you will not be able to use the resulting information to create financial statements.

4.2 OBJECTIVES

After reading this unit you will be able to understand:

Accounting Equation

Rules of Recording Business Transactions

4.3 ACCOUNTING EQUATION

Meaning of Accounting Equation

Any transaction of a business firm will affect its assets, liabilities and owner's capital. After a transaction there should be equality between the total assets and the total of liabilities and owner's capital.

The equality between the total assets and total of liabilities and owner's capital is stated in the form of an equation viz.,

Assets = Liabilities + Owner's capital

Such an equation is known as accounting equation. The accounting equation can also be expressed in different ways. They are:

(i) Assets = Liabilities + Owner's capital

(ii) Assets – Capital = Liabilities.

In order to understand properly the accounting equation some examples are given below:

Example: 1

If business borrows ₹ 15,000 from a lender in this case. The assets of business increase by ₹ 15,000 on account of the receipt of cash and the liabilities also increase by ₹ 15,000 because of the borrowing of loan.

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The accounting equation will be–

Assets = Liabilities + Capital

Example: 2

If business purchase goods on credit for ₹ 10,000. In this case the assets of the business increases by ₹ 10,000 an account of receipt of goods and the liabilities also increase by ₹ 10,000 on account of the purchase of goods on credit. For this accounting equation will be:

Assets = Liabilities + Capital

Cash + Stock = Loan + Creditor

15,000 + 10,000 = 15,000 + 10,000

Illustration - 1

From the following transaction show the accounting equation:

(a)	Amio commenced business with	₹ 30,000
(b)	Purchased goods on credit	₹ 10,000
(c)	Withdrew for private use	₹ 1,500
(d)	Purchased goods for cash	₹ 2,000
(e)	Paid Wages	₹ 500
(f)	Paid to Creditors	₹ 1,000
(g)	Sold goods on credit	₹ 2,000
(h)	Sold goods for Cash (Cost Price 1,500)	₹ 2,000
(i)	Outstanding Salary	₹ 500
(j)	Paid rent in advance	₹ 1,000

Solution:

(a) This transaction brings in cash ₹ 30,000 does not result in any liability; results in a capital of ₹ 30,000. So the equation will be -

Assets (`) = Liabilities (`) + Capital (`); 30,000 = 0 + 30,000

(b) This transaction affect the liability and assets not capital. So the equation will be -

Assets = Liabilities + Owner's Capital

Cash + Stock = Creditors; 30,000 + 10,000 = 10,000 + 30,000

(c)This transaction reduce cash and capital. So equation will be -

Assets = Liabilities + Owner's Capital

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(Cash – drawings) + Stock = Creditors

(30,000 – 1,500) + 10,000 = 10,000 + (30,000 – 1,500)

28,500 + 10,000 = 10,000 + 28,500; 38,500 = 38,500

(d) It will reduce the cash by ₹ 2,000 and increase the stock by ₹ 2,000. Equation will be

Assets = Liabilities + Owner's Capital

Cash + Stock of goods = Creditor

(28,500 – 2,000) + (10,000 + 2,000) = 10,000 + 28,500; 38,500 = 38,500

(e) This transaction reduce the cash by ₹ 500 and reduce the capital because it reduces the profit as an expenditure (i.e., reducing capital) Equation will be -

Assets = Liabilities + Owner's Capital

Cash + Stock of goods) = Creditor

(26,500 – 500) + 12,000 = 10,000 + (28,500 – 500)

26,000 + 12,000 = 10,000 + 28,000; 38,000 = 38,000

(f) This transaction will reduce the cash by ₹ 1,000 and reduce the creditor by ₹ 1,000. Equation will be

Assets = Liabilities + Owner's Capital

Cash + Stock of goods Creditor

(26,000 – 1,000) + 12,000 = (10,000 – 1,000) + 28,000

25,000 + 12,000 = 9,000 + 28,000; 37,000 = 37,000

(g) This transaction brings assets (i.e., Debtors) for ₹ 2,000 and reduces Stock of goods. The equation will be -

Assets = Liabilities + Owner's Capital

Cash + Stock of goods + Debtor = Creditors

25,000 + (12,000 – 2,000) + 2,000 = 9,000 + 28,000

37,000 = 37,000

(h) This transaction will reduce the stock and increase capital and cash. Equation will be -

Assets = Liabilities + Owner's Capital

Cash + Stock + Debtor = Creditor

(25,000 + 2,000) + (10,000 – 1,500) + 2,000 = 9,000 + 28,000 + 500

27,000 + 8,500 + 2,000 = 9,000 + 28,500

37,500 = 37,500

(i) This transaction will increase the liability by ₹ 500 and reduces capital because outstanding salary reduce the profit. Equation will be-

Assets = Liabilities + Owner's Capital

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Cash + Stock + Debtor = Creditor

27,000 + 8,500 + 2,000 = 9,000 + 500 + 28,500 – 500

(j) This transaction will reduce the cash ₹ 1,000 and brings a new assets called prepaid rent. Equation will be:

Assets = Liabilities + Owner's Capital

Cash + Stock + Debtor + Prepaid Rent = Creditor

(27,000 – 1,000) + 8,500 + 2,000 + 1,000 = 9,500 + 28,000

Illustration - 2

From the following transaction show the accounting equation:

(a) Rahim commenced business with ₹ 10,000
(b) Purchased a furniture for Cash ₹ 5,000
(c) Depreciation on furniture by ₹ 1,000
(d) Investment ₹ 5,000 in cash.
(e) Purchased a Building for ₹ 10,000 giving ₹ 5,000 in cash and the balance through a loan
(f) Received cash towards commission ₹ 1,000

Solution:

(a) This transaction affects the assets and brings capital. Equation will be-

Assets = Liabilities + Owner's Capital

(Cash) 10,000 = 0 + 10,000

(b) This transaction will bring a new assets (Furniture) and reduce cash. Equation will be

Assets = Liabilities + Owner's Capital

Cash + Furniture = 0 + 10,000

(10,000 – 5,000) + 5,000 = 10,000

(c) This transaction will reduce the asset by ₹ 1,000 and reduce the capital. Equation will be -

Assets = Liabilities + Owner's Capital

Cash + (Furniture – 1,000) = 0 + 10,000 – 1,000

5,000 + (5,000 – 1,000) = 10,000 – 1,000

(d) This transaction brings in cash of ₹ 5,000 and result in a capital of ₹ 5,000. Equation will be -

Assets = Liabilities + Owner's Capital

Cash + Furniture = 0 + 9,000 + 5,000

(5,000 + 5,000) + 4,000 = 9,000 + 5,000

(e) This transaction brings in Building of ₹ 10,000 and reduces the cash by ₹ 5,000 and increase the Liabilities by ₹ 5,000. Equation will be -

Assets = Liabilities + Owner's Capital

Cash + Furniture + Buildings = 5,000 + 14,000

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(10,000 – 5,000) + 4,000 + 10,000 = 19,000

(f) It increase the cash by ₹ 1,000 and capital by ₹ 1,000 because it is an income. Equation will be -

Assets = Liabilities + Owner's Capital

Cash + Furniture + Building = 5,000 + 14,000 + 1,000

(5,000 + 1,000) + 4,000 + 10,000 = 20,000

4.4 BUSINESS TRANSACTION

The main objective of financial accounting is to record the all transactions in the books of accounts and preparing to trading account, Profit and Loss account and balance sheet at the end of the financial year. So we should have some knowledge about the transactions.

The term 'transaction' refers to the happenings events which are measurable in terms of money, which generally, involves exchange of money or money's worth between the business and other parties and which change the financial position of a business concern.

Definitions

According to **Field House**, " Every financial charge which occurs in your business".

According to **Noble and Newcomer**, "Any happenings which brings charge in the pattern of assets or liabilities or proprietorship of a business concern is a financial transaction to it".

Features of Transaction

A financial transaction or business transactions has certain features, they are as follows:

(i) A transaction is an event, happening

(ii) It is measurable in terms of money.

(iii) A transaction involves at least two parties.

(iv) There should be an exchange value.

(v) A transaction will change the financial position of a firm.

(vi) The change in the financial position caused by transaction may be visible or invisible. It is not always visible.

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Types of Transactions

Business Transactions can be classified into four types. They are as follows:

(i)	Cash Transactions	(ii)	Credit Transactions
(iii)	Barter Transactions	(iv)	Paper Transactions

(i) Cash Transactions: A cash transactions refers to any transactions, where the value of a transaction is paid in cash immediately or readily. Some of examples of cash transactions are given below:

(a) Purchase of goods for cash

(b) Purchase of property for cash

(c) Sale of goods for cash

(d) Sale of assets for cash

(e) Sending of money to other party

(f) Cash stolen from office

(g) Cash withdrawn by the proprietor from the business for his/her personal use.

(ii) Credit Transactions: A credit transactions is a transaction, where the value of transaction are not paid immediately in cash. It is payable in future on a date. Examples of credit transaction are as follows:

(a) Purchase of property on credit.

(b) Purchase of goods on credit.

(c) Sale of goods on credit.

(d) Sale of Furniture's on credit.

(e) Any unpaid expenses and outstanding income.

(iii) Barter Transactions: A barter transaction is a business transaction, where there is an exchange of giving some benefit and receiving some benefit of equal value but this exchange is not interm of money. It should be in terms of money's worth. Examples of barter transaction are as follows:

(a) Sale of Furniture in exchange of purchase of type writer.

(b) Giving of goods for Furniture purchased.

(c) Receiving goods for sale of machinery.

(d) Giving of goods to an employee in settlement of his salary.

(iv) Paper Transactions: A paper transaction is a transaction, where there is no question of meeting the value of transaction.Some of examples of cash transactions are given below:

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(a) Depreciation charged on any fixed assets.

(b) Bad debts written off.

(c) Discount allowed to a customer.

(d) Loss of goods by fire.

(e) Loss of assets by fire, or an accident.

Source Documents

Documents on the basis of which entries are recorded in the books of accounts are known as source documents. These documents provide evidence of a business transaction. The objective of accounting requires that each recorded transaction of account should have adequate evidence to support it. Various business documents like, cash memos, invoices, bills, receipts, debit and credit notes, pay-in-slips, cheques, etc., constitute source documents. These documents provide written evidence of transactions that has been taken place. Source documents are also prepared for recording internal events such as depreciation and valuation of stocks. Thus, there must be a source documents for each transaction recorded in the books of accounts.

Meaning of Source Documents

Source documents are documents on the basis of which transactions are recorded in the books of account. These documents include cash memo, invoice, receipt, pay-in slip, cheque, debit note and credit note, etc.

Purposes Served by Source Documents

Source documents serve for some purposes which are explained as follows:

(i) Source documents provide some information about the nature of business transactions and the amounts involved in those transactions.

(ii) These documents provide evidence of a business transaction.

(iii) These documents initiate the accounting process.

(iv) It also serves as legal evidence in case of dispute.

(v) Accounts are debited or credited on the basis of these documents.

(vi) The correctness of transactions recorded in the book of account can be verified with the help of these documents.

Methods of Recording of Business Transactions

The recording of business transaction in the book of accounting consists of the following methods:

(i) Conventional method or Traditional method.

(ii) Modern method or Practical method.

4.5 PRINCIPLES OF DOUBLE ENTRY SYSTEM

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The rules of double entry system of books-keeping is that the account which is receiving some benefits are called as the receiving aspect or income aspect or debit aspect and the giving of some other benefit is called as the giving aspect or outgoing aspect or credit aspect. The rules are related debit or credit benefits. The rules of book-keeping is also known as the golden rule of accounting or fundamental or general rule of the double entry system of accounting.

Principle of double entry-system is a scientific system. There are definite specific rules for passing entries under this system. This system based on the following principles.

(i) ***Two Parties:*** The transaction must involve two parties that means giving of some benefit by one party and on the other hand receiving of equal benefit by the other party. Without two parties no transactions can takes position.

(ii) ***Two Accounts:*** In each and every transaction has involved two accounts. One of them is debited and the other is credited. Certain transactions may involve more than two accounts but the amount involve in these accounts will always be equal i.e. account to be debited and credited will always be equal.

(iii) ***Division of Accounts:*** All the ledger accounts prepared on the basis of this system have two sides. Left hand side is 'Debit' and the right hand side is 'Credit'.

(iv) ***Definite of Rules:*** In system is based upon the accounting truth that every debit has got its corresponding credit. That's why all the business transactions are recorded simultaneously at the debit and credit side.

Rule for Personal Account

Personal Account:

Debit the Receiver

Credit the Giver

In other word, debit that persons account who receives something from the business and credit that person who gives something to business.

Illustration - 1

(i) Cash paid to Mr. Anil Kumar, Rs. 20,000

(ii) Cash received from Mr. Adhir Kumar, Rs. 50,000

Solution:

(i) In this case, two accounts are affected - Anil Kumar account and Cash account. According to the rule of Debit the receiver, Anil Kumar's account will be

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debited as he is the receiver of cash. Similarly, the account of cash will be credited, as cash has gone out from the business. The entry will be:

S.No.	Particulars		LF	Debit	Credit
(i)	Anil Kumar's Account	Dr.		20,000	
	To Cash Account				20,000

(ii) In this case, Cash Account will be debited as cash has been received by the business firm and Adhir Kumar's Account will be credited according to the rule. 'Credit the giver'. The entry will be:

S.No.	Particulars		LF	Debit	Credit
(i)	Cash Account	Dr.		50,000	
	To Adhir Kumar's Account				50,000

Rule for Real Account

Real Account:

Debit What comes in

Credit What goes out.

In the other words, Real account is debit what comes in and credit what goes out where, debit, that particular assets or property account which comes into business and credit that particular assets or property which goes out from the business.

Illustration - 2

(i) Paid cash to Kumar ₹ 5,000

(ii) Sold Machinery ₹ 30,000

(iii) Paid Salary ₹ 7,000

Solution:

(i) In this transactions two accounts are affected - Cash accounts and Kumar's account. According to the rule, 'debit what comes in', Kumar's account will be debited as he is the receiver of cash. Similarly, 'Credit What goes out'. The cash will go from the business. Therefore cash account will be credited. The entry will be:

S.No.	Particulars		LF	Debit	Credit.
(i)	Kumar's Account	Dr.		5,000	
	To Cash Account				5,000

Note: Cash Account is the Real Account.

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(ii) In this case Cash Account and Machinery account is affected by the rule of debit what goes out and credit what comes in. Machinery goes out from the business and cash coming to the business. The Entry will be;

S.No.	Particulars		LF	Debit	Credit
(ii)	Cash Account	Dr.		30,000	
	To Machinery Account				30,000

(iii) In this case two accounts are affected Cash account and Salary account. According to the rules, debit what comes in and Credit What goes on. Here cash account, is the real account because 'Cash goes out' from the business. So the entry will be;

S.No.	Particulars		LF	Debit	Credit.
(iii)	Salary Account	Dr.		7,000	
	To Cash Account				7,000

Rule for Nominal Account

Nominal Account:

Debit all Expenses or Losses

Credit all Income or Gains

In the other word, Nominal Account is debit all expenses and losses and credit all income and gain of a business.

Illustration - 3

(i) Wages Paid	₹ 5,000
(ii) Commission received	₹ 150
(iii) Interest received	₹ 2,000

Solution:

(i) In this transaction two accounts are affected, Wages account and Cash account. Wages account represent expenses then according to rule 'debit the expenses or losses, So wages account should be debited and cash account should be credited according to rule of Real account "Credit What goes out". The entry will be;

S.No.	***Particulars***		***LF***	***Debit***	***Credit***
(i)	Wages Account	Dr.		₹ 5,000	
	To Cash Account				₹ 5,000

(ii) In this transactions two account affected, Commission account and Cash account. Commission received by business is an income. So, commission account

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should be debited according to the rule of nominal account, Credit all income or gains. On the other hand cash account should be debited as per rule of real account, debits what's come in. The entry will be;

S.No.	Particulars	LF	Debit	Credit
	Cash Account Dr.		₹ 150	
	To Commission Account			₹ 150

(iii) In this transaction, two accounts are affected, Cash Account and Interest Account. Interest Account is a Nominal Account and it represent the income so it will be credited according to the rule of nominal account. 'Credit all income or gains and Cash Account is real account according to the real account rule 'debit what comes in'. So cash account should be debited. The entry will be;

S.No.	Particulars	LF	Debit	Credit
	Cash Account Dr.		₹ 2,000	
	To Interest Account			₹ 2,000

Golden Rule of Accounting:

Personal Account

Debit the Receiver

Credit the Giver

Real Account

Debit What Comes in

Credit What Goes out

Nominal Account

Debit all Expenses or Losses

Credit all Incomes or Gains

Differences between Personal Accounts and Real Accounts

The main differences between Personal Accounts and Real Accounts are explained as follows:

(i) Real Accounts relate to all those things which exists and whose value can be measured in terms of money and which are the assets of the business. On the other hand, personal account which relates to an individual, firms, companies or an institution are called personal account.

(ii) Under Personal Account a separate account is opened for each person or firm etc. Wherein transactions relating to that person or firm are recorded. Whereas, under the real account a separate account is opened or each type of asset, where all transactions relating to that asset are recorded.

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(iii) Personal accounts show both debit balances or credit balances, whereas real accounts show only debit balances.

Differences Between Nominal Account and Real Account

The main difference between Nominal Account and Real Account are as follows:

(i) Nominal accounts record a trader's expenses and gain or incomes. On the other hand, Real accounts are accounts of properties assets of a business.

(ii) Nominal accounts reveal whether we have gained or lost on a particular account, where as Real account a separate account is opened for each type of asset, where all transactions relating to that assets are recorded.

(iii) Nominal accounts are used for preparing trading and profit & loss account whereas, Real account are used for preparing of balance sheet only.

(iv) All the trader's expenses or income like Salary Account, Wages Account, Rent Account, Office Expenses account etc., are the example of nominal Account, whereas, The Cash Account, Furniture Account, Land and Building Account etc. are the example of Real Account.

(v) With the help of Nominal account, it is possible to know the amount spent on different account of expenditure in a particular period, where as, Real account speak about the value of various assets as properties owned by the firm in terms of money and indicate the financial position of the business.

4.6 SUMMARY

The double entry system of accounting or bookkeeping means that every business transaction will involve two accounts (or more). For example, when a company borrows money from its bank, the company's Cash account will increase and its liability account Loans Payable will increase. If a company pays Rs. 2000 for an advertisement, its Cash account will decrease and its account Advertising Expense will increase.

Double entry also allows for the accounting equation (assets = liabilities + owner's equity) to always be in balance. In our example involving Advertising Expense, the accounting equation remained in balance because expenses cause owner's equity to decrease.

A third aspect of double entry is that the amounts entered into the general ledger accounts as debits must be equal to the amounts entered as credits.

Recording business transactions is a multi-step process. The first step in recording business transactions is to examine the transaction and decide what accounts will be affected. The second step in recording business transactions is to

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decide what account will be debited and what account will be credited. The third step in recording business transactions is to actually document the transaction in a journal.

The accounting involves the record keeping of the business transactions and every business transaction is recorded with the principle of double entry bookkeeping, meaning every debit in the transaction will have equal amount of corresponding credit thus making the match of all total debits with all total credits. This, in effect, is called the matching of Trial balance.

The different accounting software available in the market has made the record keeping convenient, fast, and easy to access. As you know there are five categories of accounts namely, Assets, Liabilities, Owners (Equity), Revenues, and Expenses. When a business transaction is recorded with the help of a particular module in any of these accounting softwares, the double entry accounting is automatically generated in that accounting software. However, it is important to understand when and which of these five categories of accounts need to be debited or credited while recording the accounting entries.

2.7 GLOSSARY

a) Double entry system: The double entry system of accounting or bookkeeping means that every business transaction will involve two accounts (or more).

b) Recording business transaction: Recording business transactions is a multi-step process. The first step in recording business transactions is to examine the transaction and decide what accounts will be affected. The second step in recording business transactions is to decide what account will be debited and what account will be credited. The third step in recording business transactions is to actually document the transaction in a journal.

c) Double-entry accounting: Double-entry accounting states that for every one transaction that occurs, there will be at least two accounts affected. One account will be debited, and one account will be credited. A debit is an entry made on the left side of an account. A credit is an entry made on the right side of an account. These dual effects of a single transaction will either increase or decrease an account balance.

d) Business Transaction: The term ‘transaction refers to the happenings events which are measurable in terms of money, which generally, involves exchange of money or money’s worth between the business and other parties and which change the financial position of a business concern.

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e) Goods: Goods refers commodities or things which are for resale. In other words, articles purchased for sales at profit or processing by the business or for the use in the manufacture of certain other goods as raw material are known as goods. If any firm dealing with machinery then it will be goods but the firm dealing other goods, machinery will be assets.

f) Net Worth: Net Worth is the difference between the total assets of an entity and its external liabilities. It represents what is owes to its owners. The terms worth, owner's investment or capital all has the same meaning in accounting.

2.8 CHECK YOUR PROGRESS

Short answer questions

1. What do you mean by double entry system?
2. Give the meaning of accounting equation.
3. Define accounting terminology.
4. Show the accounting equations if there are no liabilities.
5. Give an equation to calculate owner's equity.
6. What is Net Worth?

Extended answer questions

1. Give an equation for calculating external equity.
2. State a transaction in which there is increase in one liability and decrease in another.
3. Enumerate the heads of traditional classification of account.
4. How will you compute accounting equation? What is the effect of transaction on accounting equation? Explain with examples.
5. Explain different types of book-keeping system.
6. State the procedure for developing an accounting equation.

True-false

1. The double entry system of accounting means that every business transaction will involve two accounts (or more).

2. Single entry allows for the accounting equation (assets = liabilities + owner's equity) to always be in balance.

3. The term 'transaction refers to the happenings events which are measurable in terms of money, which generally, involves exchange of money or money's worth between the business and other parties.

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4. Goods refer commodities or things which are for resale.

5. Net Worth is the difference between the total assets of an entity and its external liabilities.

Multiple-choice questions

1. What means that every business transaction will involve two accounts (or more)?

a) Single Entry System

b) The Double Entry System

c) Ledger

d) Journal

2. What allows for the accounting equation (assets = liabilities + owner's equity) to always be in balance?

a) Single Entry System

b) The Double Entry System

c) Ledger

d) Journal

Fill-in-the-blanks

1. of accounting means that every business transaction will involve two accounts (or more).

2. Double entry allows for the accounting equation (assets = liabilities + owner's equity) to always be in…………….

3. The term …………….refers to the happenings events which are measurable in terms of money, which generally, involves exchange of money or money's worth between the business and other parties.

4. refer commodities or things which are for resale.

5. is the difference between the total assets of an entity and its external liabilities.

4.9 KEY TO CHECK YOUR ANSWER/ANSWER TO CHECK YOUR PROGRESS

1. True 2. False 3. True 4. True 5. True

1. (b) 2. (b)

1. The double entry system 2. Balance 3. Transaction 4. Goods 5. Net Worth

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4.12 TERMINAL QUESTIONS

1. Why is closing and balancing of Account necessary? What is the procedure of closing and balancing the personal, Real and Nominal Accounts?

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2. "Business transaction involves exchange of money or money's worth between the business and other parties". Discuss.

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UNIT 5 JOURNALIZING AND POSTING

STRUCTURE

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5.1 INTRODUCTION

Journalizing is the process of recording a business transaction in the accounting records. This activity only applies to the double-entry bookkeeping system. Journalizing can result in entries to the general ledger or to subsidiary ledgers. An entry is made to a subsidiary ledger when it involves a high-volume transaction that management has decided to summarize separately from the general ledger.

5.2 OBJECTIVES

After reading this unit you will be able to understand:

Preparation of Journal

Classification of Journals

Preparation of Ledger

Classification of Ledger

5.3 JOURNAL

The term 'Journal' comes from a French word 'Jour' which means a day. It is a day book. A Journal is a chronological record of transactions entered into by a business. A journal entry is recorded for each transaction. Journalizing is the process of recording entries in a journal. Each journal entry contains a date with columns for the amounts debited and credited. Accounts credited are intented to distinguish them from accounts debited. Transactions are normally recorded in a general journal. Specialized journal may be used to record some specialization transactions.Special journals accomplish the same purpose as a general journal, but they save time in recording similar transactions. Documents on the basis of which entries or transactions are recorded in the books of accounts are known as source documents. These documents provide information about the nature of the transaction and the amount involved in it. The verifiable objective principle of accounting requires that each recorded transaction of account should have adequate evidence to support it. Various business documents such as cash memos, invoices, bills, receipts, debit and credit notes, pay-in-slips, cheques, etc., constitute source documents. Thus, the journal provides a chronological record of all the transactions with details of the accounts debited, and the amount of each transactions. The frequency of posting differs among companies, partly based on the degree to which their accounting system is automated. For example, in some computerized systems, amounts are posted to the ledger accounts at the time an entry is recorded in the journal.

Meaning of Journal

A journal is a chronological record of transactions entered into by a business. It is the book in which transactions are recorded first of all according to double entry system. A journal may be defined as a book containing a day-to-day record of transactions. It is also called the book of original entry. Ajournal entry is recorded for each transaction of accounting book. Thus, the book in which all the business transactions are entered systematically for the first time is called journal.

Definitions of Journal

According to **Carter**, "The Journal as originally used, is a book of prime entry in which transactions are copied in order of date from a memorandum or waste book. The entries as they are copied are classified into debits and credits, so as to facilitates their correctly posted afterwards in the ledger".

"The book in which all the business transactions are entered systematically for the time is known as journal". - **John Mathew.**

Importance or Uses of Journal

(i) The journal is a chronological records (daily basis) of all business transactions.

(ii) The use of journal simplifies ledger.

(iii) In the journal both the debit and credit aspect of a transaction recorded so it ensure observance of double entry system.

(iv) Journal helps to understand the principle of double entry system.

(v) Journal helps in solving misunderstanding and disputes in the business.

(vi) Journal helps to understand the purpose and the nature of the entries with the help of providing narration i.e., a brief explanation after journalizing each entry.

(vii) Journal makes the rectifying of errors easily because the entries in the journal are made date wise.

Features of Journal

The main features of a journal are as follows:

(i) It is a book of prime, first or original entry.

(ii) It contains a day-to-day record of transactions.

(iii) It shows dual aspects of each and every transaction.

(iv) It is very useful for small business concern only.

(v) It is a subsidiary book i.e. used for simplifying the ledger.

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(vi) The transaction is recorded in a chronological order.

(vii) It helps to identify nature of accounts i.e., which account is to be debited and which account is to be credited for every transaction.

Advantages of Journal

The following advantages derived by the business if a journal is maintained;

(i) It provides a day wise record of all business transactions chronologically.

(ii) Journal is a daily records, as it record each days transaction of same day.

(iii) Journal is a book of prime entry or original entry or first entry, as all business transactions are first in the journal.

(iv) Journal reduce the possibilities of errors and its easier to post them to the ledger.

(v) Journal simplifies ledger, as the business transactions are not required to be noted down in the ledger.

Limitations of Journal

Journal suffers from certain limitations. They are:

(i) Journal is only a subsidiary book. It is not a book of final entry.

(ii) The writing of work in the journal is very difficulty and laborious.

(iii) Journal become very bulky because all business transactions are recorded in journal.

(iv) Journal is useful for small business concern only.

(v) Journal cannot provide information about any balance of each day.

5.4 STEPS OF JOURNALISING

The process of recording a transaction in the journal is called journalising. The different steps to be followed in journalising business transactions are-

Step-1 To find out the name of accounts which are involved in the transaction.

Step-2 To find out nature of accounts (real, nominal, personal) involved and ascertain which accounting rule is applicable for both the accounts.

Step-3 To apply the golden rule and decide to debit and credit, which account is to be debited and which account is to be credited.

Step-4 To write (which one debited) the name of the account to be debited close to the left hand side in the particular column and along with the abbreviation 'Dr.'on the same line and write the name of account (which are credited) to be credited in the next line started by the word 'To' at a little gap from (debited account) first line of particular column.

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Step-5 To write 'narration' (i.e. a brief description of the transaction) with the brackets in the down of main transaction in the same column.

Structure of Journal:

The Specimen ruling of journal is given below:

Date ***(Rs.)***	***Particulars***	***LF***	***Debit***	***Credit (Rs.)***

The five columns of Journal are explained as follows:

(i) ***Date:*** Under this column, the date is recorded on which the transactions are entered. To keep the year on top and below the year, month and day of the transactions has to be written.

(ii) ***Particulars:*** It is the second column, which contains two names of accounts one is to be debited and another one is to be credited. The debit entry shows the name of the account to be debited with the amount in the debit column.

(iii) ***L.F. (Ledger Folio):*** The transaction entire into journal entry and posted to the ledger, the page number or folio number of the ledger account where the posting of has been made from journal is recorded in the L.F. Column.

(iv) ***Amount Dr. (Debit):*** In this column amount to be debited is recorded against the debit column.

(v) ***Amount Cr. (Credit):*** In this column amount to be credited in recorded against the credit column.

Casting and Carry Forward

At the end of each page, both the Dr. and Cr. columns are totaled up just below the last entry is passed. These totals must be equal because the amount debited in each entry must be equal to the amount credited. These totals are carried forward to the next page progressively up to the end of the accounting period, for this purpose, the words 'carried forward' or 'Total c/f' are written in particulars columns at the end of each page and the words, 'brought forward' or 'Total b/f' are written at the start of each page.

NOTES

5.5 EXAMPLES OF JOURNAL ENTRIES

Illustration - 1

Introduction of cash into the business by the proprietor will be the capital of the business. Generally a businessman starts business with cash, but sometimes he may starts business with cash as well as other assets or liabilities or only with borrowed money. In such a case instead of opening a proprietors personal accounts by his name open a capital account.

a) Amit Roy started business with cash ₹ 90,000.

b) Narugopal commenced business with ₹ 80,000.

c) Mustafizur introduced into business with ₹ 60,000.

d) Ganesha invested in the business ₹ 30,000.

e) Manjunath started business with personal saving ₹ 58,000.

f) Cash brought in by Paru as capital ₹ 1,20,000.

g) Received from Reddy Kumar, the proprietor ₹ 50,000

Pass the Journal Entry.

Solution:

Journal Entries

S.No.	*Particulars*	*LF*	*Debit*	*Credit*
a)	Cash Account	Dr	90,000	
	To Amit Roy's Capital Account			90,000
	(Being the started business by the proprietor as capital)			
b)	Cash Account	Dr.	80,000	
	To Narugopal's Capital Account			80,000
	(Beingthecommencedbusinessbytheproprietorwithcash)			
c)	Cash Account	Dr.	60,000	
	To Mustafizur's Capital Account			60,000
	(Being the proprietor introduced cash into the business)			
d)	Cash Account	Dr.	30,000	
	To Ganesha's Capital Account			30,000
	(Being cash invested in business by the proprietor as capital)			
e)	Cash Account	Dr.	58,000	
	To Capital Account			58,000
	(Being the proprietor using personal saving capital for started business)			
f)	Cash Account	Dr.	1,20,000	

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	To Capital Account (Being the Cash brought into the business by the proprietor for as capital)			1,20,000
g)	Cash Account	Dr.	50,000	
	To Capital Account (Being the proprietor introduced cash into the business as capital).			50,000

Note: From the above transaction clearly understand, the proprietor bring into cash for the business as capital. Here two accounts involving in each of the transactions: i) Cash account and ii) Capital account. Cash account is a real account, so, it should be debited because cash comes into the business. On the other hand, capital account is the personal account and credit the giver, so, Capital account should be credited.

Illustration - 2

Journalise the following transactions:

2015 July	1	Ajay started business with ₹50,000
	2	Paid into Bank ₹ 40,000
	4	Bought goods ₹ 5,000 for cash
	12	Sold goods for cash ₹ 15,000
	17	Purchased goods from Uday ₹ 7,000
	18	Sold goods to Vikash ₹ 10,000
	25	Withdraw from the Bank for personal use ₹ 5,000
	30	Paid salaries to staff ₹ 8,000

Solution:

Journal Entries

Date	*Particulars*	*LF*	*Debit*	*Credit*
2015				
July 1	Cash Account	Dr.	50,000	
	To Ajay's Capital Account			50,000
	(Being Ajay started business with cash)			
2	Bank Account	Dr.	40,000	
	To Cash Account			40,000
	(Being paid amount to Bank)			
4	Purchases Account	Dr.	5,000	
	To Cash Account			5,000
	(Being Purchased goods for cash)			
12	Cash Account	Dr.	15,000	
	To Sales Account			15,000

NOTES

	(Being sold goods for cash)			
17	Purchases Account	Dr.	7,000	
	To Uday's Account			7,000
	(Being Purchased goods from Uday on credit)			
18	Vikash's Account	Dr.	10,000	
	To Sales Account			10,000
	(Being sold goods to Vikash on credit)			
25	Drawing's Account	Dr.	5,000	
	To Bank Account			5,000
	(Being withdrew from Bank for Personal use)			
30	Salary Account	Dr.	8,000	
	To Cash Account			8,000
	(Being paid salary by cash)			

Illustration - 3

Enter the following transactions in the Journal of Mr. Harry.

March 1 Harry started business with cash ₹ 1,50,000"

3 Goods purchased for cash ₹ 50,000

" 4 Sold goods for cash ₹ 30,000

" 5 Goods purchased from Anush ₹ 20,000

" 7 Sold goods to Ramesh ₹ 15,000

" 8 Purchased furniture for cash ₹ 5,000

" 10 Paid cash to Anush ₹ 15,000

" 11 Bought goods from Raj for cash ₹ 27,000

" 13 Sold goods to Ashok on credit ₹ 12,000

" 16 Paid wages to Chandra ₹ 800

" 18 Interest received ₹ 250

" 22 Paid Rent ₹ 5,000

" 27 Received cash from Rajesh ₹ 13,000"

29 Sold goods to Rajib for cash ₹ 6,00. "

31 Paid salary to Mohanthy ₹ 2,300

Solution:

In the books of Harry

Journal Entries

Date	*Particulars*	*LF*	*Debit*	*Credit*

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Mar.1 2004	Cash Account	Dr. 1,50,000	
	To Capital Account		1,50,000
	(Being Mr. Harry commenced business)		
3	Purchases Account	Dr. 50,000	
	To Cash Account		50,000
	(Being purchased goods for cash)		
4	Cash Account	Dr. 30,000	
	To Sales Account		30,000
	(Being sold goods for cash)		
5	Purchases Account	Dr. 20,000	
	To Anush's Account		20,000
	(Being purchased goods from Anush on credit)		
7	Ramesh's Account	Dr. 15,000	
	To Sales Account		15,000
	(Being sold goods on credit to Ramesh)		
8	Furniture Account	Dr. 5,000	
	To Cash Account		5,000
	(Being bought furniture for cash)		
10	Anush's Account	Dr. 15,000	
	To Cash Account		15,000
	(Being cash paid)		
11	Purchases Account	Dr. 27,000	
	To Cash Account		27,000
	(Being goods purchased from Raj for cash)		
13	Ashok's Account	Dr. 12,000	
	To Sales Account		12,000
	(Being goods sold on credit)		
16	Wages Account	Dr. 800	
	To Cash Account		800
	(Being wages paid		
18	Cash Account	Dr. 250	
	To Interest Account		250
	(Being received interest)		
22	Rent Account	Dr. 5,000	
	To Cash Account		5,000

NOTES

	(Being rent paid)			
27	Cash Account	Dr.	13,000	
	To Rajesh's Account			13,000
	(Being cash received from Rajesh)			
29	Cash Account	Dr.	6,000	
	To Sales Account			6,000
	(Being sales for cash)			
31	Salary Account	Dr.	2,300	
	To Cash Account			2,300
	(Being salary paid to Mohanthy)			
			3,51,350	**3,51,350**

5.6 LEDGER

When the transactions of a business for a given period have been recorded in the Journal, the next step is to classify journal entries into account. This classification of journal entries is done in another book called the 'Ledger'. It must be clear by now that every transaction, after first being recorded in a book of original entry, finds its subsequent destination in the Ledger.It is in this book which is properly arranged, classified and condensed form of all the necessary information regarding the working of our business. After a certain period, if we want to know whether a particular account is showing a debit or credit it becomes very difficult. So, the ledger is designed to accommodate the various accounts maintained by a trader. It contains the final and permanent record of all the transactions in a duly classified form. A ledger book contains various accounts to which entries are made in the journal. The entries in the journal are posted or transferred to the appropriate accounts in the ledger periodically, say, weekly, fortnightly, monthly or quarterly depending upon the convenience and the requirements of the business, to know the exact position of each account on any particular date.

Meaning of Ledger

The term 'Ledger' is derived from the Dutch word 'Legger' which means to 'lie' Ledger, therefore, means a book where the various accounts by (i.e., are 'kept'). A Ledger is a book in which all the accounts of a trader whether personal, or nominal are kept for record. In Ledger, one separate account is opened for each and every particular type of transaction. For every journal entry, one ledger account is to be debited and another ledger account is to be credited. Every Ledger account is divided into two sides. The left-side is known as the debit side and the right-side as the credit side. If the debit side of any account in the ledger is heavier

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than its credit side, the account is said to have a debit balance to the extent of such difference. If the credit side of any account is heavier than its debits, the difference is called a credit balance. Thus, Ledger is that book which can give a properly arranged and classified form of all the necessary information regarding the working of our business.

Definition of Ledger

According to **J.R.Batliboi**, "The Ledger is the chief book of accounts, and it is in this book that all the business transactions would ultimately find their place under their accounts in a duly classified form".

According to **L.C. Croper**", The book which contains a classified and permanent record of all the transactions of a business is called a ledger'.

According to **O.P.Gupta**, "Ledger is that principal book of accounts in which all the business transactions find their ultimate place in the shape of accounts in a classified form. This book supplies all the information regarding the working of a business".

A ledger contains accounts for all the persons with whom the business deals, accounts for all the assets or things held by the business and accounts for all the expenses incurred and all the incomes earned by the business. It may be in the form of a bound register or cards or punched sheets in a loose leaf binder. In the ledger, each account is opened generally on a separate page or card or sheet.

5.7 FEATURES OF LEDGER

The main features of a ledger are as follows:

(i) The ledger contains all the accounts like personal account, real account and nominal account.

(ii) It is a permanent record of business transactions.

(iii) It is a book of final entry. All business transactions are, first, recorded in the journal, and are, finally, entered in the ledger.

(iv) It is an analytical record of transactions.

(v) It is a secondary record, as the entries in the ledger are derived from the entries in the journal.

5.8 IMPORTANCE OF LEDGER

Ledger is very important book of accounts because it helps us in achieving the objectives of accounting. In the journal, transactions of the same nature may be found on different pages. As transactions of the same nature are found on

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different pages of the journal, one cannot know easily from the journal the cumulative or net effect of transactions of the same nature on any particular date. But in Ledger all these transactions of the same nature will be recorded on one page or sheet. After journalising the accounting transactions and their posting into ledger, it becomes necessary to balance the accounts in the ledger.

The balance is done at periodic intervals, generally at the close of the financial year. To know easily the cumulative or net effect of transactions of the same nature; i.e, the exact position or balance of each account on any particular date, it becomes necessary to maintain the ledger, where transactions of the same nature can be brought together in one place. Hence, the ledger is called the 'Principal Book' and it is necessary for all the traders to prepare a Ledger.

5.9 ADVANTAGES OF LEDGER

Some advantages of ledger are as follows:

(i) It is only the book which gives a properly arranged, classified and condensed form of all the necessary information regarding the working of our business.

(ii) It is a permanent record of all the transactions of a business.

(iii) It helps to find out the main items of revenue expenses.

(iv) It provides a means of easy reference of same nature.

(v) In the ledger all the transactions of same nature will be recorded on one page only.

(vi) It helps to prepare a final account.

5.10 STRUCTURE OF A LEDGER

Each ledger account is divided into two equal parts. The left hand side is known as the debit side and the right hand side as the credit side. This statement is prepared in 'T' shape, therefore, sometimes it is called a ' T ' account. The structure of the ledger account is given below:

Ledger Account

Dr. **Cr.**

Date	Particulars	JF	Amount	Date	Particulars	JF	Amount

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As shown above, each side of the account has four columns to record the necessary details of each transactions which has been explained as follows:

(i) ***Date:*** Under this column, the date is recorded on which the transactions are entered. To keep the year on top and below the year, month and day of the transactions has to be written.

(ii) ***Particulars:*** It is the second column, which contains two names of accounts one is to be debited and another one is to be credited. The debit entry shows the name of the account to be debited with the amount in the debit column.

(iii) ***Journal Folio or J.F:*** Page number of Journal or Subsidiary books is referred in the folio column.

(iv) ***Amount Dr. (Debit):*** In this column amount to be debited is recorded against the debit column.

(v) ***Amount Cr. (Credit):*** In this column amount to be credited is recorded against the credit column.

5.11 PROBLEMS ON LEDGER

Illustration - 1

Enter the following transactions in the journal and Post them in Ledger.

January

2011	2	Furniture purchased for cash ₹ 20,000
	5	Parmesha owed ₹ 1,500. He sent a cheque which was paid into bank the same day for ₹ 1,450 in full settlement.
	9	Goods purchased for ₹ 16,000
	15	Sold goods for ₹ 25,000

Solution:

Journal Entries

Date	*Particulars*		*LF*	*Debit*	*Credit*
2011					
Jan.2	Furniture Account	Dr.		20,000	
	To Cash Account				20,000
	(Being purchased furniture for cash)				
5	Bank Account	Dr.		1,450	
	Discount Account	Dr.		50	

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Date	Particulars		LF	Dr. Amount	Cr. Amount
	To Parmesha's Account (Being amount received in full settlement from Parmesha)				1,500
9	Purchases Account To Cash Account (Being purchased goods for cash)	Dr.		16,000	16,000
15	Cash Account To Sales Account (Being sold goods for cash)	Dr.		25,000	25,000
				62,500	**62,500**

Ledger Accounts:

Cash Account

Dr. **Cr.**

Date	Particulars	JF	Amount	Date	Particulars	JF	Amount
2011							
Jan.15	To Sales A/c		25,000	Jan.2	By Furniture A/c		20,000
31	To Balance c/d		11,000	9	By Purchases A/c		16,000
			36,000				**36,000**
				Feb.1	By Balance b/d		11,000

Furniture Account

Date	Particulars	JF	Amount	Date	Particulars	JF	Amount
Jan.2	To Cash A/c		20,000	Jan. 31	By Balance c/d		20,000
			20,000				**20,000**
Feb.1	To Balance b/d		20,000				

Bank Account

Date	Particulars	JF	Amount	Date	Particulars	JF	Amount
Jan 5	To Parmesha's A/c		1,450	Jan. 31	By Balance c/d		1,450
			1,450				**1,450**
Feb-1	To Balance b/d		1,450				

Discount Account

Date	Particulars	JF	Amount	Date	Particulars	JF	Amount
Jan 5	To Parmesha's A/c		50	Jan.			

				31	By Balance c/d		50
			50				**50**
Feb-1	To Balance b/d		50				

Purchases Account

Date	*Particulars*	*JF*	*Amount*	*Date*	*Particulars*	*JF*	*Amount*
9	To Cash A/c		16,000	Jan.			
				31	By Balance c/d		16,000
			16,000				**16,000**
Feb-1	To Balance b/d		16,000				

Sales Account

Date	*Particulars*	*JF*	*Amount*	*Date*	*Particulars*	*JF*	*Amount*
Jan.				31	By Cash A/c		25,000
31	To Balance c/d		25,000				
			25,000				**25,000**
				Feb.1	By Balance b/d		25,000

Illustration - 2

Prepare Capital Account for the following transactions:

(i) Rajesh commenced business with machinery Rs. 20,000, furniture Rs. 15,000, and cash Rs. 8,000

(ii) During the year he introduced Rs. 12,000

Solution:

Capital Account

Dr. **Cr.**

Sl.No.	*Particulars*	*JF*	*Amount*	*Sl.No.*	*Particulars*	*JF*	*Amount*
				(i)	By Machinery A/c		20,000
				(i)	By Furniture A/c		15,000
				(i)	By Cash Account		8,000
	To Balance c/d		55,000	(ii)	By Cash Account		12,000
			55,000				**55,000**

NOTES

Illustration - 3

From the following transactions prepare in the Personal Account of Mr. Anand and balance the amount at the end of each month.

2010 April

1	Sold goods to Mr. Anand ₹ 30,000
3	Received from Mr. Anand ₹ 24,550 and discount allowed him ₹ 50.
12	Mr. Anand bought goods ₹ 7,000
16	Received cash from Mr. Anand ₹ 5,400
May -1	Balance from last month ₹ 6,000
2	Sold goods to Mr. Anand ₹ 7,000
20	Received cash from Mr. Anand ₹ 5,540 and discount allowed ₹ 60
30	Received Cash 12,950 in full settlement of account ₹ 13,000

Solution:

Mr. Anand's Account

Date	*Particulars*	*JF*	*Amount*	*Date*	*Particulars*	*JF*	*Amount*
2010				2010			
Apr.1	To Sales A/c		30,000	Apr.3	By Cash Account		24,550
12	To Sales A/c		7,000	3	By Discount A/c		50
				16	By Cash Account		5,400
				31	By Balance c/d		7,000
			37,000				**37,000**
May.1	To Balance b/d		7,000	May.20	By Cash Account		5,540
2	To Sales Account		7,000	20	By Discount A/c		60
30	To Balance c/d		4,600	30	By Cash Account		12,950
				30	By Discount A/c		50
			18,600				**18,600**

Illustration - 4

Is the following account correctly prepared? If not prepare it correctly.

Cash Account

Particulars	*Amount*	*Particulars*	*Amount*
To Furniture(Cash purchased)	2,500	By Balance b/d	15,700
To Drawings	3,500	By Shyam Sundar	
To Cash Sales	13,700	(Sale of goods on credit)	300
To Depreciation	2,000	By Salaries	10,200
To Commission (receive)	1,000	By Interest (receive)	4,000
To Credit Sales	10,000	By Payment of commission	3,100
To Balance c/d	6,400	By Discount allowed	200
		By Bad Dedts	200
		By Stationery	400

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		By	Bank (amount withdrawn from bank for office use)	5,000
	39,100			**39,100**

Solution:

Cash Account

	Particulars	Amount		Particulars	Amount
To	Balance b/d	15,700	By	Drawings	3,500
To	Cash Sales	13,700	By	Furniture(Cash urchased)	2,500
To	Commission (receive)	1,000	By	Salaries	10,200
To	Interest (receive)	4,000	By	Payment of commission	3,100
To	Bank(amount withdrawn		By	Stationery	400
	from bank for office use)	5,000	By	Balance c/d	19,700
		39,400			**39,400**
To	Balance b/d	19,700			

Illustration - 5

Prepare a personal account of Mr. Ganesh from the following transactions.

2011 March

1 Debit balance of Ganesh Account Rs. 8,100
3 Bought goods from Ganesh Rs. 1,400
5 Goods worth Rs. 2,300 sold to him.
9 Paid to him Rs. 1,300
12 Returned goods to him Rs.130
15 Ganesh bought goods from us Rs. 1,500
18 He returned goods Rs.600
22 Received a bearer cheque from Ganesh for Rs. 1,000.
25 Goods worth Rs. 250 sent back to him
30 Ganesh sold goods to us worth Rs. 1,800

Solution:

Ganesh's Account

Dr. **Cr.**

Date	Particulars	JF	Amount	Date	Particulars	JF	Amount
2011				2011			
Mar.1	To Balance b/d		8,100	3	By Purchases Account		1,400
5	To Sales Account		2,300	18	By Sales return Account		600
9	To Cash Account		1,300	30	By Purchases Account		1,800
12	To Purchase returns A/c		130				

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15	To Sales Account		1,500				
22	To Bank Account		1,000				
25	To Sales Account		250	31	By Balance c/d		10,780
			14,580				**14,580**
Apr.1	To balance b/d		10,780				

Illustration - 6

Prepare a personal account of Varun from the following transactions in the book of Ganesh.

2011 March

1 Debit balance of Varun ₹ 10,050

5 Bought from varun ₹ 1,500

7 Cheque issued to Varun ₹ 1,800

9 Sold to Varun ₹ 3,500

12 Ganesh sold goods to Varun ₹ 1600

14 Varun sold goods to Ganesh ₹ 900

20 Received cheque from Varun ₹ 1,800

24 Varun claimed an allowance of ₹ 300 for damaged goods.

28 Varun received goods returned by Ganesh ₹ 450

Solution:

Varun's Account

Dr. **Cr.**

Date	*Particulars*	*JF*	*Amount*	*Date*	*Particulars*	*JF*	*Amount*
2011				2011			
Mar.1	To Balance b/d		10,050	5	By Purchases A/c		1,500
7	To Bank Account		1,800	14	By Purchases A/c		900
9	To Sales Account		3,500	20	By Cash Account		1,800
12	To Sales Account		1,600	24	By Sales return A/c		300
28	To Purchase returns A/c		450	31	By Balance c/d		12,900
			17,400				**17,400**
Apr.1	To Balance b/d		12,900				

Illustration - 7

Prepare the Personal A/c of Mr. Balaji from the following transactions in the books of Ganesh.

2002 Mar. 1st Debit balance of Balaji's A/c ₹ 8200

4th Bought goods from Balaji ₹ 1500

7th Cheque of ₹ 2,000 issued to Balaji

10th Goods sold to Balaji ₹ 1,200

13th Balaji sold goods to Ganesh ₹ 800

16th Received an account payee cheque from Balaji ₹ 1200

20th Goods worth ₹ 230 returned to him

24th Balaji bought goods from Ganesh ₹ 1400

26th Balaji claimed an allowance of ₹ 300 for damaged goods.

NOTES

28th A bearer cheque received from Balaji for ₹ 800 29th Balaji received goods returned by Ganesh ₹ 270

31st Received ₹ 8500 in settlement of ₹ 8,700 from Balaji.

Solution:

Dr. **Mr. Balaji's Account** **Cr.**

Date	*Particulars*	*JF*	*Amount*	*Date*	*Particulars*	*JF*	*Amount*
2002				2002			
Mar.1	To Balance b/d		8,200	Mar.4	By Purchases A/c		1,500
7	To Bank A/c		2,000	13	By Purchases A/c		800
10	To Sales A/c		1,200	16	By Cash A/c		1,200
20	To Purchases return A/c		230	26	By Sales returns A/c		300
24	To Sales A/c		1,400	28	By Cash A/c		800
29	To Purchases return A/c		270	31	By Cash A/c		8,500
				31	By Discount A/c		200
			13,300				**13,300**

5.12 SUMMARY

A journal is a chronological record of transactions entered into by a business. It is the book in which transactions are recorded first of all according to double entry system. A journal may be defined as a book containing a day-to-day record of transactions. It is also called the book of original entry. Ajournal entry is recorded for each transaction of accounting book. Thus, the book in which all the business transactions are entered systematically for the first time is called journal.

Transactions are normally recorded in a general journal. Specialized journal may be used to record receive transactions. Special journals accomplish the same purpose as a general journal, but they save time in recording similar transactions. Documents on the basis of which entries or transactions are recorded in the books of accounts are known as source documents.

The term 'Ledger' is derived from the Dutch word 'Legger' which means to 'lie' Ledger, therefore, means a book where the various accounts by (i.e., are 'kept'). A Ledger is a book in which all the accounts of a trader whether personal, or nominal are kept for record. In Ledger, one separate account is opened for each and every particular type of transaction.

Ledger is very important book of accounts because it helps us in achieving the objectives of accounting. In the journal, transactions of the same nature may be found on different pages. As transactions of the same nature are found on different pages of the journal, one cannot know easily from the journal the cumulative or net effect of transactions of the same nature on any particular date. But in

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Ledger all these transactions of the same nature will be recorded on one page or sheet. After journalising the accounting transactions and their posting into ledger, it becomes necessary to balance the accounts in the ledger.

5.13 GLOSSARY

a) Journal: A journal is a chronological record of transactions entered into by a business. It is the book in which transactions are recorded first of all according to double entry system. A journal may be defined as a book containing a day-to-day record of transactions.

b) Journal Entry: A journal entry is recorded for each transaction of accounting book. Thus, the book in which all the business transactions are entered systematically for the first time is called journal.

c) Transactions: Transactions are normally recorded in a general journal. Specialized journal may be used to record receive transactions.

d) Ledger: A Ledger is a book in which all the accounts of a trader whether personal, or nominal are kept for record. In Ledger, one separate account is opened for each and every particular type of transaction.

5.14 CHECK YOUR PROGRESS

Short answer questions

1. What is a Journal?
2. What do you mean by Journalising?
3. What is meant by term credit?
4. What is meant by term debit?
5. What is simple journal entry?
6. What is Narration?
7. What do you mean by trade discount?
8. Give the meaning of cash discount.
9. What is a Ledger?

Extended answer questions

1. Explain importance of Journal.
2. Enumerate the steps in Journalising.
3. How is an opening entry recorded in a Journal?

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4. Explain the need and importance of ledger.

5. Explain the procedure for balancing a Ledger Account.

True-false

1. Ledger is a chronological record of transactions entered into by a business.
2. Transactions are normally recorded in a general journal.
3. A Ledger is a book in which all the accounts of a trader whether personal, or nominal are kept for record.
4. In Ledger, one separate account is opened for each and every particular type of transaction.

Multiple-choice

1. What may be defined as a book containing a day-to-day record of transactions?

a) A journal b) Ledger

c) Trial Balance d) Balance sheet

2. What is recorded for each transaction of accounting book?

a) Ledger b) A journal entry

c) Balance Sheet d) All the above

3. What is a book in which all the accounts of a trader whether personal, or nominal are kept for record?

a) A journal b) Ledger

c) Trial Balance d) Balance sheet

Fill-in-the-blanks

1. A journal is a chronological record of transactions entered into by a…………..

2. Transactions are normally recorded in a general……………...

3.is a book in which all the accounts of a trader whether personal, or nominal are kept for record.

4. In Ledger, one separate account is opened for each and every particular type of…………...

5.15 KEY TO CHECK YOUR ANSWER/ANSWER TO CHECK YOUR PROGRESS

1. False 2. True 3. True 4. True

1. (a) 2. (b) 3. (b)

1. Business 2. Journal 3. A Ledger 4. Transaction

NOTES

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5.18 TERMINAL QUESTIONS

1. Why is closing and balancing of Account necessary? What is the procedure of closing and balancing the Personal, Real and Nominal Accounts?

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UNIT 6 Trial Balance

STRUCTURE

NOTES

6.1 INTRODUCTION

A trial balance is a list of all the general ledger accounts (both revenue and capital) contained in the ledger of a business. This list will contain the name of each nominal ledger account and the value of that nominal ledger balance. Each nominal ledger account will hold either a debit balance or a credit balance. The debit balance values will be listed in the debit column of the trial balance and the credit value balance will be listed in the credit column.

6.2 OBJECTIVES

After reading this unit you will be able to understand:

- Trial Balance
- Preparation of Trial Balance

6.3 MEANING OF TRIAL BALANCE

When all Journal entries have been posted into Ledger, the every transactions have been entered twice in the Ledger. This statement is called the Trial Balance. If the accounts are properly maintained, then no error is committed in totalling. Thus, Trial balance may be the total balance of a list of debit and credit of all the Ledger Accounts which prepared on any particular period.

Definition of Trial Balance

According to **J.R.Batliboi**, "Trial Balance is a statement, prepared with the debit and credit balance of ledger account to test the arithmetical accuracy of the books".

According to **M.S. Gosave**, "Trial Balance is a statement containing the balances of all the ledger accounts as at any given date, arranged in the form, of debit and credit columns, placed side by side and prepared with the object of checking the arithmetical accuracy of ledger posting".

Accourding to **Spicer and Pegler**, "A Trial balance is a list of all balances standing of the ledger accounts and cash book of a concern at any given date".

Importance of Trial Balance

The Trial balance is prepared based on the fundamental principle of double entry book keeping i.e. for every debit in one account, there is corresponding credit in some other Accounts. The transaction have been recorded as per the principle of double entry when the Trial balance tallies. When it does not tally it reveals the presence of errors.

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Trial balance takes all balances whether of Real, Nominal or Personal accounts. Tallying the Trial balance can not give guarantee that double entry book-keeping is absolutely correct, though some reliance can be put on it. It does not include stock in hand at the end of the period. All adjustments is necessary to be done at the period are given outside the trial balances. Thus, it is a schedule of list of balances, both debit and credit, extracted from the accounts in the ledger including the cash and bank balances from the cash book.

Objectives of Trial Balance

The preparation of Trial balance is to achieve the following objectives:

(i) To check the arithmetical accuracy of ledger.

(ii) To have a proof that the double entry of each transactions has been properly recorded.

(iii) To give the balance of all accounts in the ledger in one place.

(iv) To prepare the Profit & Loss Account and Balance Sheet of the business.

(v) To serve as on aid to management.

6.4 ADVANTAGES & LIMITATIONS OF TRIAL BALANCE

Advantages:

The advantages of Trial Balance follows are as:

a) Trial balance is a connecting link between ledger accounts and final accounts.

b) It helps the reduction of errors which took place while posting the subsidiary journals to ledger.

c) Trial balance proves that all the entries in the journal have been correctly posted into the ledger.

d) It is used as a base for the preparation of financial statement or final account.

e) It helps to rectifiy the errors before preparation of final account.

f) It is a check of accuracy of the book of account.

Limitations:

The limitations of Trial Balance are as follows:

a) Trial balance can be prepared only by those who are maintaining double entry accounting book system.

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b) This system can not be adopted by small business concern because it is very costly.

c) If trial balance is not made correctly then the final account prepared will not reflect the true and correct view of business concern.

d) Trial balance is not as conclusive proof of the accuracy of the books of account.

6.5 PROCEDURE OF PREPARING TRIAL BALANCE

A Trial balance is a list of debit and credit totals, or a list of debit and credit balances, of all the ledger accounts prepared on any particular date to verify whether the entries in books of account are arithmetically correct.

Procedure's of preparing Trial Balance:

· ***Equal balance of debit total and credit total:*** In this step the trial balance is prepared with the help of debit total and credit total in ledger account.

· ***Debit balance and credit balance:*** In this step the debit balances of the various ledger accounts are entered in the debit column of the trial balance, and the credit balances of the various ledger accounts are entered in the credit column of the trial balance.

· ***Combined procedure:*** In this step, the trial balance is prepared with the help of the debit totals and credit totals as well as the debit balances and credit balances of the various ledger accounts.

· ***The balance of debit total and credit total but exceeding closed accounts:*** In this step, the trial balance is prepared like the first method with the help of the total debits and total credits. But the total debits and total credits of only those ledger accounts which are not closed and which show balances are entered in the trial balance.

Structure of Trial Balance

Item No.	*Particulars*	*LF*	*Debit (Rs.)*	*Credit (Rs.)*

Errors Disclosed by Trial Balances

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- Posting of wrong amount to a ledger account
- Wrong totalling of subsidiary books.
- Items omitted to be posted from a subsidiary book into ledger.
- Omission of balance of an account in the Trial balance.
- Posting on the wrong side of the ledger account.
- Balance of same account wrongly entered an written on the wrong side of a Trial balance.

Errors Not Disclosed by Trial Balance

- Posting an item on the correct side but in the wrong account
- Writing the wrong amount in the subsidiary books.
- Omission of an entry altogether in a subsidiary book.
- Errors of principle.
- Compensating errors.

Illustration - 1

Prepare a Trial balance form the following:

Sundry Debtors	8,000
Sundry Creditors	6,000
Capital	50,000
Cash in hand	4,000
Cash at Bank	35,000
Motor Van	20,000
Furniture & Fixture	2,500
Purchase	5,000
Sales Returns	250
Wages	150
Stock on hand	12,200
Sales	35,000
Purchase Returns	150
Discount	150
Commission	300
Gas & Water	600
Salaries	2,000
Bills Receivable	1,000

Solution:

NOTES

Trial Balance

Name of Account	*LF*	*Debit*	*Credit*
Sundry Debtors		8,000	
Sundry Creditors			6,000
Capital			50,000
Cash in hand		4,000	
Cash at Bank		35,000	
Motor Van		20,000	
Furniture & Fixture		2,500	
Purchase		5,000	
Sales Return		250	
Wages		150	
Stock on hand		12,200	
Sales			35,000
Purchase return			150
Discount (Dr.)		150	
Commission		300	
Gas & Water		600	
Salaries		2,000	
Bills Receivable		1,000	
		91,150	**91,150**

Illustration - 2

Re-write the following Trial balances to correct the same Trial balance on 31st March 2010.

Particulars	₹	*Particulars*	₹
Wages	2,680	Capital	10,000
Purchase	12,490	Sales	31,080
Salaries	520	Rent paid	500
Carriage	50	Discount received	120
Buildings	12,010	Light charges	160
Bank overdraft	470	Suppliers	800
Cash in hand	60	Opening stock	9,260
Customers	1,490	Furniture	3,250
	29,770		**55,170**

Solution:

Trial Balance

Ledger Accounts	*LF*	*Debit*	*Credit*
Wages		2,680	
Purchases		12,490	
Salaries		520	

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Carriage	50	
Building	12,010	
Cash in hnd	60	
Bank overdraft		470
Customers	1,490	
Capital		10,000
Sales		31,080
Rent paid	500	
Discount received		120
Light charges	160	
Suppliers		800
Stock	9,260	
Furniture	3,250	
	42,470	**42,470**

Illustration - 3

The following balance have been extracted from the books of M/s DSSBL Pvt. Ltd. Kolkata, on March 2011. You are to draw out a Trial balance.

Particulars	***₹***	***Particulars***	***₹***
Capital	11,60,000	Purchase	2,25,000
Cash balance	1,20,000	M/s DTTC	3,00,000
M/s CLTS (Cr.)	1,00,000	General expenses	75,000
Furniture	80,000	Land & Building	1,30,000
Goods	45,000	Return inwards	25,000
Drawings	75,000	Advertisement	60,000
Sundry debtors	1,45,000	Salaries	35,000
Commission received	3,000	Discount (Credit)	2,000

Solution:

Trial Balance

Ledger Accounts	***LF***	***Debit***	***Credit***
Capital			11,60,000
Cash balance		1,20,000	
M/s CTLS (credit)			1,00,000
Furniture		80,000	
Goods		45,000	
Drawing		75,000	
Sundry debtors		1,45,000	
Salaries		35,000	
Commission received			3,000
Discount (credit)			2,000

NOTES

Purchase	2,25,000	
M/s DTTC (Dr)	3,00,000	
General expenses	75,000	
Land & Building	1,30,000	
Return inwards		25,000
Advertisement	60,000	
	12,90,000	**12,90,000**

Illustration -4

From the following ledger balances, prepare Trial balance as on 31st December 2010.

Particulars	***Amount***
Cash in hand	1,700
Capital	23,000
Furniture	13,000
Telephone Charge	1,800
Sales	15,500
Advertisement	6,800
Purchases	10,000
Office Equipment	1,500
Creditors	34,600
Drawing	1,450
Discount	100
Salaries	1,200
Rent	3,600
Discount Allowed	50
Commission earned	300
Sundry Debtors	33,400
Interest on Investment	1,000

Solution:

Trial Balance as on 31st December 2010

Ledger Accounts	***LF***	***Debit***	***Credit***
Cash in hand		1,700	–
Capital		–	23,000
Furniture		13,000	–
Telephone Charge		1,800	–
Sales		–	15,500
Advertisement		6,800	–
Purchases		10,000	–

NOTES

Office Equipment	1,500	
Creditors	–	34,600
Drawing	1,450	–
Discount	–	100
Salaries	1,200	–
Rent	3,600	–
Discount Allowed	50	–
Commission earned	–	300
Sundry Debtors	33,400	–
Interest on Investment	–	1,000
	74,500	**74,500**

Illustration - 5

From the following ledger balances, prepare a Trial balance as on 31st January 2011.

Particulers	**₹**
Capital	51,000
Commission received	800
Furniture	4,000
Manufacturing expenses	600
Machinery	12,000
Purchases	26,000
Sales	1,72,000
Buildings	1,20,000
Opening Stocks	14,000
Wages	10,000
Factory Rent	3,000
Advertisement	50,000
Salaries	10,000
Carriage inwards	800
Carriage outwards	1,400
Discount allowed	800
Discount received	400
Bad and doubtful debts reserve	800
Sundry debtors	45,000
Sundry creditors	91,200
Cash at Bank	12,000
Cash in hand	1,600

Solution:

NOTES

Trial Balance as on 31st Jan. 2011

Details	*LF*	*Amount Dr.*	*Cr.*
Capital			51,000
Commission received			800
Furniture		4,000	
Manufacturing expenses		600	
Machinery		12,000	
Purchases		26,000	
Sales			1,72,000
Buildings		1,20,000	
Opening stocks		14,000	
Wages		10,000	
Factory Rent		8,000	
Advertisement		50,000	
Salaries		10,000	
Carriage inwards		800	
Carriage outwards		1,400	
Discount allowed		800	
Discount received			400
Bad debt and doubtful debt reserve			800
Sundry Debtors		45,000	
Sundry Creditors			91,200
Cash at Bank		12,000	
Cash in hand		1,600	
		3,16,200	**3,16,200**

Illustration - 6

From the following balances, prepare a Trial Balance.

Particulars	₹	*Particulars*	₹
Drawings	2,000	Sales	68,000
General expenses	4,740	Purchases	40,000
Buildings	20,000	Bank Overdraft	10,000
Stock	16,540	Capital	?
Wages	8,515		
Debtors	6,280		
Creditors	2,500		
Bad Debts	550		

Loan to Ravi	7,880

NOTES

Solution:

Trial Balance

Heads of Accounts	*LF*	*Debit* (₹)	*Credit* (₹)
Drawings		2,000	–
General Expenses		4,740	–
Buildings		20,000	–
Stock		16,540	–
Wages		8,515	–
Debtors		6,280	–
Creditors		–	2,500
Bad debts		550	–
Loan to Ravi		7,880	–
Sales		–	68,000
Purchases		40,000	–
Bank overdraft		–	10,000
Capital (balancing figure)		–	26,005
		1,06,505	**1,06,505**

Illustration - 7

Prepare Trial Balance from the following ledger balances: Motor vehicle ₹ 10,000, Cash 5,600, Drawings 6,200, Bank overdraft ₹ 7,500, Purchase Return 700, Debtors 13,200, Bad Debts 1,200, Stock 6,400, Creditors 7,700, Capital 32,800, Sales 14,400, Goodwill 12,000, Purchases 8,800, Rent from tenant 3,500, Stationary 1,500, Depreciation 1,700.

Solution:

Trial Balance

Ledger Accounts	*LF*	*Debit*	*Credit*
Motor vehicles		10,000	–
Cash		5,600	–
Drawings		6,200	–
Bank Overdraft		–	7,500
Purchase returns		–	700
Debtors		13,200	–
Bad debts		1,200	–
Stock		6,400	–
Creditors		–	7,700
Capital		–	32,800
Sales		–	14,400

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Goodwill		12,000	–
Purchases		8,800	–
Rent from tenants		–	3,500
Statement		1,500	–
Depreciation		1,700	–
		66,600	**66,600**

Illustration - 8

From the following information prepare a Trial balance as on 31st March 2011.

Particulars	₹	*Particulars*	₹
Capital Account	12,500	Bank (Cr. Balance)	2,850
Sales	15,450	Purchase Returns	125
Funiture & Fittings	640	Commission (Cr.)	375
Motor Car	6250	Sales Return	200
Buildings	7,500	Advertisement	250
Total Debtors	3,800	Interest Account (Dr.)	118
Total Creditors	2,500	Cash Balance	650
Bad Debts	125	Insurance & Tax	1,250
Stock on 1-4-2010	3,460	Salaries	4,082
Purchases	5,475		

Solution:

Trial Balance

Details	*LF*	*Debit*	*Credit*
Capital Account			12,500
Sales			15,450
Furniture & Fittings		640	
Motor Car		6,250	
Buildings		7,500	
Total Debtors		3,800	
Total Creditors			2,500
Bad Debts		125	
Stock on 1-4-2010		3,460	
Purchases		5,475	
Bank (Cr. Balance)			2,850
Purchase Returns			125
Commission (Cr.)			375
Sales Return		200	
Advertisement		250	
Interest Account (Dr.)		118	
Cash Balance		650	

Insurance & Tax	1,250	
Salaries	4,082	
Total	**33,800**	**33,800**

Illustration - 9

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

Details	***LF***	***(Amt.)Dr.***	***(Amt.)Cr.***
Capital		88,000	
Machinery			80,000
Stock			40,000
Debtors		32,000	
Creditors			48,000
Sales			1,76,000
Interest on investment			4,000
Purchases		1,12,000	
Bank overdraft		56,000	
Manufacturing expenses			56,000
Loan from Babu		56,000	
Carriage inward		4,000	
Carriage outward			8,000
Purchases return		16,000	
Wages		32,000	
Establishment expenses		48,000	
Sales return		–	32,000
Discount received		4,800	
Commission earned		3,200	
Cash in hand		–	8,000
		4,52,000	**4,52,000**

Solution:

Trial Balance

Details	***LF***	***Debit***	***Credit***
Capital		–	88,000
Machinery		80,000	–
Stock		40,000	–
Debtors		32,000	–
Creditors		–	48,000
Sales		–	1,76,000
Interest on investment		–	4,000
Purchases		1,12,000	–

NOTES

Bank overdraft	–	56,000
Manufacturing expenses	56,000	–
Loan from Babu	–	56,000
Carriage inward	4,000	–
Carriage outward	8,000	–
Purchases Return	–	16,000
Wages	32,000	–
Establishment expenses	48,000	–
Sales Return	32,000	–
Discount Received		4,800
Commission earned		3,200
Cash in hand	8,000	–
	4,52,000	**4,52,000**

Illustration - 10

RS Bank a client of yours asks you to trial balance for the year ending 31st March 2010. On which the closing stock was valued at ₹ 5,740.You are requested to prepare the trial balance correctly.

Trial Balance of RS Bank as on 31st March 2010.

Details	*LF*	*Debit*	*Credit*
RS Bank's capital			15,560
RS Bank's drawing		5,640	
Lease hold premises		7,410	
Sales			27,560
Due from customers			5,300
Purchase		12,680	
Purchase returns		2,640	
Loan from Bank			2,500
Creditors		5,280	
Trade &Office expenses		7,840	
Cash at Bank		1,420	
Bills payable		1,000	
Salaries		5,980	
Stock (1st April 2009)			2,640
Rent		4,650	
Sales Returns			980
		54,540	**54,540**

Solution:

Amended Trial Balance

NOTES

Details	*LF*	*Debit*	*Credit*
RS Bank's capital			15,560
RS Bank's drawings		5,640	
Sales			27,560
Due from customers		5,300	
Purchase		12,680	
Purchase returns			2,640
Loan from bank			2,500
Creditors			5,280
Trade & office expense		7,840	
Cash at bank		1,420	
Bills payable			1,000
Salaries		5,980	
Stock (1st April)		2,640	
Rent		4,650	
Sales returns		980	
Lease hold premises		7,410	
		54,540	**54,540**

6.6 SUMMARY

Trial balance is the statement of balance of all accounts in the ledger prepared to identify arithmetical accuracy of the books of account. After all the transactions of a particular period are recorded either in the single journal or in various subsidiary books and posted their respective accounts in the ledger. It is a method of ascertaining that the all entries in the books of accounts are correctly made. In this sense trial balance is a list of debit and credit balance where all ledger accounts prepared on a particular period. A Trial balance has been defined as "Tri-all balance of ledger account to verify their arithmetical accuracy.

The Trial balance is prepared based on the fundamental principle of double entry book keeping i.e. for every debit in one account; there is corresponding credit in some other Accounts. The transaction has been recorded as per the principle of double entry when the Trial balances tallies. When it does not tally it reveals the present of errors.

Trial balance takes all balances whether of Real, Nominal or Personal accounts. Tallying the Trial balance cannot give guarantee that double entry book-keeping is absolutely correct, though some reliance can be put on it. It does not include stock in hand at the end of the period. All adjustments is necessary to be done at the period are given outside the trial balances. Thus, it is a schedule of list of balances,

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both debit and credit, extracted from the accounts in the ledger including the cash and bank balances from the cash book.

A Trial balance is a list of debit and credit totals, or a list of debit and credit balances, of all the ledger accounts prepared on any particular date to verify whether the entries in books of account are arithmetically correct.

6.7 GLOSSARY

a) Trial balance: Trial balance is the statement of balance of all accounts in the ledger prepared to identify arithmetical accuracy of the books of account. After all the transactions of a particular period are recorded either in the single journal or in various subsidiary books, and posted their respective accounts in the ledger.

b) Error of Omission: An error of omission is when a transaction is completely omitted from the accounting records. As the debits and credits for the transaction would balance, omitting it would still leave the totals balanced.

c) Error of reversal: An error of reversal is when entries are made to the correct amount, but with debits instead of credits, and vice versa.

d) Error of commission: An error of commission is when the entries are made at the correct amount, and the appropriate side (debit or credit), but one or more entries are made to the wrong account of the correct type.

e) Error of principle: An error of principle is when the entries are made to the correct amount, and the appropriate side (debit or credit), as with an error of commission, but the wrong type of account is used.

f) Compensating errors: Compensating errors are multiple unrelated errors that would individually lead to an imbalance, but together cancel each other out.

6.8 CHECK YOUR PROGRESS

Short answer questions

1. What do you mean by trial balance?
2. What is Error of Omission?
3. What is Error of reversal?
4. What is Error of commission?
5. What is Error of principle?

Extended answer questions

NOTES

1. Explain the Procedures of preparing trial balance.

2. Explain the errors which are disclosed by the trial balance.

3. What are the advantages and disadvantages of trial balance?

True-false

1. Trial balance is the statement of balance of all accounts in the ledger prepared to identify arithmetical accuracy of the books of account.

2. An error of Commission is when a transaction is completely omitted from the accounting records.

3. An error of reversal is when entries are made to the correct amount, but with debits instead of credits, and vice versa.

4. An error of commission is when the entries are made at the correct amount, and the appropriate side (debit or credit), but one or more entries are made to the wrong account of the correct type.

5. An error of principle is when the entries are made to the correct amount, and the appropriate side (debit or credit), as with an error of commission, but the wrong type of account is used.

Multiple-choice

1. What is the statement of balance of all accounts in the ledger prepared to identify arithmetical accuracy of the books of account?

a) Ledger

b) Trial balance

c) Journal

d) All the above

2. When a transaction is completely omitted from the accounting records, it is called as…….

a) An error of omission

b) An error of reversal

c) An error of commission

d) An error of principle

3. When entries are made to the correct amount, but with debits instead of credits, and vice versa, it is called as………

a) An error of omission

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b) An error of reversal

c) An error of commission

d) An error of principle

4. When the entries are made at the correct amount, and the appropriate side (debit or credit), but one or more entries are made to the wrong account of the correct type, it is called as…………..

a) An error of omission

b) An error of reversal

c) An error of commission

d) An error of principle

Fill-in-the-blanks

1. is the statement of balance of all accounts in the ledger prepared to identify arithmetical accuracy of the books of account.

2. An error of omission is when a transaction is completely omitted from the………….

3. is when entries are made to the correct amount, but with debits instead of credits, and vice versa.

4. is when the entries are made to the correct amount, and the appropriate side (debit or credit), as with an error of commission, but the wrong type of account is used.

6.9 KEY TO CHECK YOUR ANSWER/ANSWER TO CHECK YOUR PROGRESS

1. True 2. False 3. True 4. True 5. True

1. (b) 2. (a) 3. (b) 4. (c)

1. Trial balance 2. Accounting records 3. An error of reversal 4. An error of principle

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6.12 TERMINAL QUESTIONS

Conceptual Questions

1. What do you mean by trial balance?
2. State the three objectives of trial balance.
3. Name the five errors, which are not disclosed by trial balance.
4. How is trial balance prepared?
5. State the various method of preparing trial balance.

Analytical Questions

1. Explain the Procedure of preparing trial balance.

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2. Explain the errors which are disclosed by the trial balance.
3. What are the advantages and disadvantages of trial balance?

Essay Type Questions

1. Define Trial balance. Discuss importance, limitations and methods of preparing a trial balance.
2. Explain the errors which are disclosed and not disclosed by the trial balance?

PRACTICAL QUESTIONS

Q-1. Re-write the following Trial balances correctly for 31st March 2011.

Particulars	₹	*Particulars*	₹
Wages	10,720	Capital	4,000
Salaries	2,080	Sales	1,24,320
Carriage	200	Discount received	480
Building	48,040	Rent Paid	2,000
Bank Overdraft	1,880	Light Charges	640
Cash in hand	240	Suppliers	32,000
Customers	5,960	Opening stock	37,040
		Furniture	13,000

Q-2. Habib Bank a client of yours with whom Book -keeping is not a strong point, asked you to Audit the account for the year ending 31st December 2010 on which date the closing stock was valued at ₹ 28,700 on the basis of your audit. The Bank furnishes you the following statement.

Trial Balance as on 31st December 2010

Details	*LF*	*Debit*	*Credit*
Habib Bank's Capital			44,800
Habib Bank's drawings		28,200	
Lease hold premises		37,050	
Sales			1,37,800
Due from customer			26,500
Purchase		63,400	
Purchase return		13,200	
Cash from Bank			33,000
Creditors			12,500
Trade and office expenses		26,400	
Cash at bank		39,200	
Bill payable		7,100	

Salaries	5,000	
Stock (1st January)	29,900	
Rent		13,200
Returns	23,250	4,900
	2,72,700	**2,72,700**

If you don't approve this statement amend it.

Q-3. From the following Balance prepare Trial Balance of Mr. Sawpon as on 31st March 2010.

Particulars	**₹**	***Particulars***	**₹**
Salaries	4,106	Purchase	33,189
Mr. Sawpon Capital	1,50,000	Land and Buildings	55,000
Plant and Machinery	85,000	Furniture and Fixtures	2,500
Motor Vans	15,750	Bills Receivable	4,000
Factory wages	5,000	General expenses	12,200
Salaries to staff	4,500	Rent and Taxes	1,700
Lighting and Power	900	Coal and Fuel	600
Trade expenses	575	Commission	2,700
Duty and Clearing charges	1,260	Stock on 1st April 2004	50,450
Purchases	96,000	Sales	1,65,000
Returns inwards	1,800	Returns outwards	2,100
Bank charges	125	Travelling expenses	3,750
Advertising	2,115	Repairs to Plant	1,070
Loan from Jai Gopi	25,000	Interest on loan	960
Cash at Bank	6,400	Cash on hand	300
Petty cash balance	75	Mr. Sawpon's Drawings	6,000
Sundry Debtors	85,420	Sundry Creditors	88,650

Q-4. From the following list of balances extracted from the books of Ravila, prepare a Trial balance as on 31st March, 2010.

Particulars	**₹**	***Particulars***	**₹**
Capital	28,810	Bills Receivable	10,000
Drawings	3,000	Salaries	4,000
Free hold premises	11,600	Bank Loan	4,800
Purchases	63,000	Sales	85,00
Sundry Debtors	13,500	Stock (1st April 2004)	20,000
Sundry Creditors	8,500	Bills payable	6,850
Furniture and Fittings	5,000	Carriage on purchases	300
General expenses	3,250	Wages	1,570
Returns inward	900	Bank Charges	300
Postage and Stationery	250	Carriage on sales	350

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Discount allowed	840	Discount received	280
Cash at Bank	2,400	Cash in hand	480

Q-5. From the following balances prepare a Trial balances of Robin as on 31st March 2010.

Particulars	₹	*Particulars*	₹
Furniture	20,000	Stationery	500
Wages	1,500	Interest on loan	200
Opening stock	25,000	Drawings	1,32,600
Salaries	7,000	Capital	3,00,000
Purchase	2,00,000	Machinery	1,20,000
Sales	2,40,000	Postage	300
Sundry Debtors	10,000	Power and Fuel	1,200
Sundry Creditors	15,000	Trade Expenses	500
Bills Receivable	41,000	Bad debts	200
Reserve for doubtful debts	2,000	Bills Payable	3,000

Q-6. From the following prepare a Trial balance as on 31st March 2011.

Particulars	₹	*Particulars*	₹
Capital	80,00,000	Discount allowed	4,000
Debtors	47,85,000	Sales return	45,000
Drawings	32,60,000	Sales	50,69,000
Bad debts	1,00,000	Machinery	36,00,000
Bills Payable	2,10,000	Trade Expenses	30,000
Creditors	20,25,000	Bank overdraft	1,57,000
Purchase	30,87,000	Purchase Return	35,000
Stock	2,45,000	Rent	36,000
Cash	1,21,000	Salary	85,000
Outstanding Expense	1,27,000	Stationery	4,58,000
Reserve for bad debts	2,25,000		

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UNIT 7 FINAL ACCOUNTS

STRUCTURE

NOTES

7.1 INTRODUCTION

The final accounts are primarily prepared for ascertaining the operational result and the financial position of the business. These are prepared with the help of Trial Balance. The Profit and Loss Account is prepared for ascertaining whether the business earned profit or incurred loss during a particular period of time called accounting period. Having ascertained the operational results, i.e., profit or loss by preparing the Profit & Loss Account, one final account still remains to be prepared is the Balance Sheet. The Balance Sheet is primarily prepared to know the financial position of the business.

7.2 OBJECTIVES

After reading this unit you will be able to understand:

- Preparation of Profit and Loss Account
- Preparation of Balance Sheet with Adjustment Entries

7.3 TRADING ACCOUNT

Trading account is the outcome of Trial Balance. The debit balances of Trial Balance would represent either **Assets** or **Losses**, and the credit balances either Liabilities or Gains. Trading account is prepared to know the trading results, how much Gross Profit or Gross Loss derived in business concern for a given particular period.

According to **J.R. Batliboi,** "The trading account shows the results of buying and selling of goods. In preparing this account, the general establishment charges are ignored and only the transactions in goods are included".

Trading account includes only such transactions which are related with goods, such as opening stock, closing stock, purchase of goods, sales of goods, purchase returns, sales returns, manufacturing expenses, and other direct expenses. Finally trading account is merely the result of trading i.e, involve purchasing and selling of goods.

Objectives of Trading Account

The main objectives of trading accounts are as follows:

(i) To know the gross results arising from the buying and selling of goods.

(ii) To identify the weak spots of the firm by comparing purchases, sales and stock of one period with similar items of the preceding period.

(iii) To know information about ratio of gross profit to the turnover, in order

NOTES

to get result how far have been achieved.

(iv) To know information on the direct expenses of which percentage bear to gross profit.

Preparation of The Trading Account

Trading account is prepared by only those transactions which depends on the goods. The items which are directly involved in the trading account are-

(i) Opening Account

(ii) Purchase and Purchase Returns

(iii) Sales and Sales Returns

(iv) Direct Expenses

(v) Closing Stock

Structure of Trading Account

Trading account of XYZ Company for the year ending on ...

Dr. **Cr.**

Particulars		***Amount***	***Particulars***		***Amount***
To Opening stock		xxx	By Sales	xx	
To Purchase	xx		Less: Returns	xx	xxx
Less: Returns	xx	xxx	By Closing stock		xxx
To Direct expenses:			By Gross Loss		xxx
Wages	xx		[Transfer to P & L A/c]		
Factory Expenses	xx				
Carriage inwards	xx				
Cartage	xx				
Freight	xx				
Factory rent	xx				
Belting	xx				
Motive Power	xx				
Tallow & Oil, Coal & Coke, Gas & Water	xx				
Excise duty	xx				
Dock charges	xx				
Octroi charges	xx				
Royalties	xx				
		xxx			
To Gross Profit [Transfer to P&L A/c]		xxx			
		xxx			xxx

NOTES

Explanation of items which written on the debit side of the trading account:

Opening Stock: Generally the closing stock of the previous year is known as the opening stock for the current year. In the case of the newly started business there will be no opening stock. Opening stock consists of raw materials, work-in-progress and finished goods.

***Purchases*:** Purchase includes cash and credit purchases of all goods brought for resale during the trading period. The gross purchase will appear in the inner column of trading account. Purchase returns or return outwards deducted from purchases and the net amount will be shown on outer column of trading account.

Note: *When goods withdraw by the trader for his personal use and given goods as free samples that goods worth should be deducted from the purchases on the debit side of the trading account.*

***Direct Expenses*:** Direct expenses include expenses incurred in purchasing the goods, bringing goods to godown and manufacturing of goods and making the goods for sale. Direct expenses always shown on the debit side of the trading account. Direct expenses include the following:

***(i) Wages*:** Wages are paid to workers who are involved in production of goods and as such are debited to trading account. The wages and salaries usually given to the workers and shown on the trading account but salary always should be considered in direct expenses and shown on the profit and loss account.

***(ii) Carriage and Cartage*:** Carriage and Cartage inwards paid on the purchase of plant, fixtures, office furniture or any other asset not for -sale should be debited to such asset account, and not to carriage or cartage account.

Carriage inwards appears in the trading account and carriage outwards in the profit and loss account. In working out exercises, when the item carriage appears in the trial balance, and it is not specifically may be debited to trading account.

***(iii) Freight*:** Freight inwards, i.e., freight paid on goods bought is included in the trading account; freight outwards i.e., paid on goods sold is shown in the profit and loss account.

Freight paid on the purchase of plant, machinery, furniture or any other fixed assets should be charged to such assets account as it would add to the purchase price of the assets in question.

(iv) Motive power, Gas, Coal, Water, Heating and Lighting etc: These are the direct expenses used for running machinery in the production process. Therefore, these all items shown on the debit side of the trading account.

***Note*:** If the above items are used for office purpose such expenses should be shown on the profit and loss account.

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(v) Excise Duty: Excise duty is paid to the government on goods manufactured. It also increases the cost of goods manufactured. So, it has to be entered on the debit side of the trading account.

(vi) Octroi: Octroi is levied by the municipal communities or corporation when the goods enter the city and hence detailed to trading account.

***(vii) Royalty*:** This is the amount paid to the owner of patentee, author and landlord for using their right respectively patent, copyright and land. It is generally paid on the basis of production and is charged on the debit of trading account. But if it is based upon sales then it will be debited to the profit and loss account.

(viii) Consumable stores: These refers to cotton waste, lubricating oil, greases etc., which are required for the upkeep of machines, therefore, they are charged to the trading account.

Explanation of items, which are written on the credit side of the trading account:

Sales or Sales Return: In trading account sales comprises of both cash and credit sales. The gross sales should appear in the inner column and the net figure after deduction of return inwards or returns in the outer column on the credit side of the trading account. It is incorrect to show return inwards or sales return on the debit side of the trading account. Sales of an asset should not be shown in trading account. When any assets is sold, cash account is to be debited and particular asset account is to be credited.

Note: *When goods are sold by traders as a consignee or goods sold on hire purchase on installment systems would need to be specifically treated.*

Closing Stock: The items of closing stock do not include in the books and is therefore not in the trial balance. In order, however, to ascertain the true results of trading at the end of any financial period, the trader has to take stock of goods unsold and bring it into account after valuing properly. The entry for so doing is to debit stock in trade account and credit the trading account. It should be clearly understood that only the goods remaining unsold at the end of the financial period and which are the property of the trader should be treated as closing stock. Thus goods received by trader to be sold on consignment or on sales or return do not be included in the closing stock.

Closing Entries Relating to Trading Account

The preparation of trading account requires that the balances of all such accounts which are due to appear in trading account are transferred. The entries which are passed for closing these accounts are known as closing entries. The accounts which have debit balances shall be credited and the account which they have to be transferred shall be debited and vice-versa.

NOTES **(i) Closing entry for those accounts which are to be transferred to the debit side of the trading account -**

Paritculars	*LF*	*Debit*	*Credit*
Trading Account Dr.		xxx	xxx
To Opening Stock Account			xxx
To Purchase Account			xxx
To Sales Return Account			xxx
To Wages Account			xxx
To Carriage Account			xxx
To Dock Charges Account			xxx
To Motive Power Account			xxx
To Manufacturing Expenses Account			xxx
To Royalty Account.			xxx
(Being the transfer of above accounts to the debit of the Trading account)		xxx	

(ii) Closing entry for those accounts which are to be transferred to the credit of Trading Account.

Paritculars	*LF*	*Debit*	*Credit*
Sales Account Dr.		xxx	
Purchases Return Account Dr.		xxx	
Closing Stock Account Dr.		xxx	
To Trading Account			xxx
(Being the transfer of above account to the credit of the Trading account)			

(iii) If the debit side of the trading account exceeds the credit side, the difference will be gross profit. The gross profit will be transferred to the credit of profit and loss account by passing the following entry.

Paritculars	*LF*	*Debit*	*Credit*
Trading Account Dr.		xxx	
To Profit and Loss Account			xxx
(Being transfer of gross profit to profit and loss account)			

(iv) If the credit side of the trading account exceeds the debit side, the difference will be gross loss. The gross loss will be transferred to debit of the profit and loss account by passing the following entry.

Paritculars	*LF*	*Debit*	*Credit*
Profit and Loss Account Dr.		xxx	
To Trading Account			xxx
(Being transfer of gross loss to Profit and Loss Account).			

Illustration - 1

NOTES

Prepare a Trading Account of Mr. Prashanth for the year ending 31st March 2007 from the following particulars:

Particulars	***Rs.***
Stock of goods on 1-4-2006	3,50,000
Stock of goods on 31-03-2007	4,00,000
Purchases	4,50,000
Sales	6,00,000
Purchases Return	70,000
Sales Return	90,000
Carriage inward	10,000
Wages	5,000

Solution:

Trading Account of Mr. Prashanth for the year ended

Dr. **31st March 2007** **Cr.**

Particulars		***Amount***	***Particulars***		***Amount***
To Opening Stock		3,50,000	By Sales	6,00,000	
To Purchases	4,50,000		*Less:* Returns	90,000	5,10,000
Less: Returns	70,000	3,80,000	By Closing Stock		4,00,000
To Carriage inward		10,000			
To Wages		5,000			
To Gross Profit		1,65,000			
(Transfer to Profit & Loss A/c)					
		9,10,000			**9,10,00**

Illustration - 2

Prepare a Trading Account of Mr. Murali for the year ending 31st March 2011 from the following particulars.

Particulars	***Rs.***
Purchases of Materials	2,50,000
Carriage on Purchases	6,000
Wages	70,000
Stock of goods on 1-04-2010	3,60,000
Stock of goods on 31-03-2011	3,80,000
Sales	6,50,000
Sales return	80,000
Purchases return	30,000
Duty and Clearing charges	70,000
Factory Rent and Lighting expenses	30,000
Factory Salaries	20,000

NOTES

Solution:

Trading Account of Mr. Murali for the year ended 31st March 2010

Dr. **Cr.**

Particulars		*Amount*	*Particulars*		*Amount*
To Opening Stock		3,60,000	By Sales	6,50,000	
To Purchases	2,50,000		*Less:* Sales return	80,000	5,70,000
Less: Returns	30,000	2,20,000	By Closing Stock		3,80,000
To Carriage Inward		6,000			
To Wages		70,000			
To Duty and Clearing charges		70,000			
To Factory Salaries		20,000			
To Factory Rent and Lighting expenses		30,000			
To Gross Profit (Transfer to Profit & Loss A/c)		1,74,000			
		9,50,000			**9,50,000**

7. 4 PROFIT AND LOSS ACCOUNT

Profit and loss account is the outcome of both trial balance and trading account. Profit and loss account is prepared to know the business results, how much net profit or net loss derived in the business concern for a given financial year.

After ascertaining gross profit or gross loss from trading account it would be transferred to the profit and loss account on the credit side and debit side respectively. Profit and loss account includes only such transactions which are miscellaneous incomes like; interest, commission, dividend, discount, profit on exchange, rent received etc., on the credit side of profit and loss account also includes all the expenses incidental to the carrying on the business such as office rent, salaries, insurance, stationary and printing, telephone expenses, audit fees, advertising, carriage outwards, sales tax, repairs and renewals, entertainment expenses, legal charges, … etc. on the debit side.

According to Prof. **Carter**, “A Profit and Loss account is an account into which all gains and losses are collected in order to ascertain, the excess of gains over the loses or vice-versa.”

Objectives of Profit and Loss Account

(i) To ascertain the net profit or net loss in certain period of time in business entity.

(ii) To compare the profit and loss of the current year with the previous year.

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(iii) To know information on the indirect expenses of which percentage bear to gross profit.

(iv) To know the net profit ratio to asset turnover, in order to getting results how far have been achieved.

Preparation of The Profit and Loss Account.

Profit and loss account is a nominal account and as such all the indirect expenses and losses are shown on its debit side and all the incomes and gains are shown on its credit side as per nominal account rules, "Debit all expenses and losses, Credit all incomes and gains".

STRUCTURE OF PROFIT AND LOSS ACCOUNT

Profit & Loss Account for the year ending on...

Dr. **Cr.**

Particulars		*Amount*	*Particulars*	*Amount*
To Gross Loss		xxx	**By Gross Profit** (transferred	xxx
(transferred from trading account)			from trading account)	
To Administration expenses:			By Cash discounts earned	xxx
Salaries	xx		**By Income from investment**	
Wages	xx		Dividend on shares	xxx
Rent & Taxes	xx		Miscellaneous	xxx
Office Lighting	xx		Interest on money deposit	
Printing & Stationery	xx		By Bad debts recovered	xxx
Telephone charges	xx		By Commission received	xxx
Fees & Expenses	xx		By Income from other sources	xxx
Postage & Telegrams	xx		By Profit earned on sales of assets	xxx
Audit fees	xx		**By Net Loss**	xxx
Office car keeping	xx		(Transferred to Balance sheet)	
Office general expenses	xx	xxx		
To Selling and distribution exp:				
Ware house and Store rent	xx			
Packing expenses	xx			
Freight and Carriage				
outwards	xx			
Sampling expenses	xx			
Cost of catalogues	xx			
Bad debts	xx			
Commission	xx			
Advertisement	xx			

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Export expenses	xx			
Insurance premium	xx			
Brokerage	xx			
Noting charges	xx			
Entertainment exp.	xx	xxx		
To Financial expenses:				
Discount allowed	xx			
Interest on capital	xx			
Loss in exchange	xx			
Discounting bill	xx			
Discount on issue of debentures	xx			
Preliminary expenses written off	xx	xxx		
To Depreciation & Maintenance:				
Repairs and Renewals	xx			
Loss by fire or theft	xx			
Depreciation of asset	xx	xxx		
To Net Profit		xxx		
(Transfer to Balance sheet)				
		xxx		**xxx**

Explanation of items which written on the left side Debit of Profit and Loss Account:

Gross Loss: Gross loss is transferred from trading account to profit and loss account and this happens to be the first item on the debit side.

Administration expenses: Administration expenses includes all the expenses which are incurred for the maintenance and supervision of the business. These expenses plays a vital role for organizing the business firm. This head includes items like salaries, wages, rent, rates and taxes, office lighting, printing and stationary, telephone charges, fees, expenses, postage, telegrams, audit fees, and other office expenses.

Salaries: Salaries includes remuneration paid to clerks and managerial staff. It is an usual expense of general nature. But, if salary is directly connected with the production of goods, then it should be debited to trading account.

Wages: If wages are paid to indirect workers (i.e, workers not connected to manufacturing), this will be debited to profit and loss account.

Rent and Taxes: These expenses are paid for office buildings. Rent and

NOTES

Taxes refers to rent paid for office building and taxes paid to municipal or corporations. These are also usual and general business expenses and as such they are also debited to profit and loss account. But, incase the rent or taxes are directly connected with factory or production, then they should be debited to trading account.

Office lighting: Office lighting refers to lighting charges incurred for providing light in the office. This is one of the usual office expenses, so it has to be debited to the profit and loss account.

Printing and Stationary: Printing and stationary expenses are usually exists in every office. So this expenses has to be debited to profit and loss account.

Telephone, Postage and Telegrams: These are general expenses for office. So these expenses should be debited to profit and loss account.

Selling and Distribution expenses: These expenses are also called post production expenses. These expenses will help to promote the products in the markets. These expenses include wear house and storage rent, packing expenses; freight and carriage, outwards, bad debts, commission, advertisement, export expenses, insurance premiums, brokage … etc.

Carriage outwards or freight outwards: Carriage outwards or freight outwards refers to the transport charges incurred in taking the goods to the market for sale. It is one of the major expenses in selling and distribution expenses. So it has to be entered on the debit side of the profit and loss account.

Bad debts: Bad debts normally exists in every business. Bad debts refers, the debts which are turned into bad. Some of the debtors do not pay their debts, such debts are unrecoverable in nature.

Advertisement: The amount spent on advertisement is also a business expense, it has to be debited to profit and loss account. But high expenditure on advertisement will be considered as deferred revenue expenditure and part of it will be debited to profit and loss account and the remaining will be shown as asset in balance sheet until written off.

Insurance: Insurance refers to insurance premium paid for insuring the buildings, machinery, stock. etc. against fire and other risks. This item should be debited to profit and loss account.

Financial expenses: Financial expenses refers to expenses incurred while sourcing finance for running the business. The following expenses arise while sourcing the finance. They are, cash discount allowed, interest paid on borrowed money, interest on capital, trade finance expenses … etc.

Cash Discount: Whenever any buyer made payment on or before the

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specified period the business concern allow cash discount for prompt payment. It is one of the financial expense to the firm. So it has to be debited to profit and loss account.

Interest on Capital: It refers to interest allowed to the proprietor on his capital. The trader invests in business his own capital as well as loan taken from the outsiders. So the interest paid to outsiders as well as on his own capital is the financial expenses to the firm. So it has to be debited to profit and loss account.

Trade Finance expenses: Whenever any business concern get finance facility from the bank, the bank will charge some percentage on the financing amount. So these kind of expenses will appear on the debit side of profit and loss account.

Depreciation and Maintenance: These expenses are incurred for the maintainance of the fixed assets of the business. Repairs and renewal loss by fire or theft, depreciation of assets are the examples for this head.

Repairs and Renewals: These expenses are usual expenses incurred on repairs and renewals on furniture, building, machinery, motor vehicles. etc. is debited to profit and loss account.

Depreciation: When the value of some asset goes down due to wear and tear, this loss on asset is called depreciation. The amount lost each year can be taken away from the business profits. So this expenses has to be debited to profit and loss account.

Loss by fire and theft: This is the loss by an even events in the business. So this can be treated as business expense/loss. So it has to be debited to profit and loss account.

Explanation of items which written on the credit side of the Profit and Loss Account:

Credit side of the profit and loss account represents the incomes of the firm other than sale proceeds. These items include normal and abnormal incomes arising in the business activities. These incomes are also called non business incomes, because these incomes are not arising from the genuine sale proceeds. Examples for this kind of incomes are cash discount earned, investment income, recovery of bad debts, commission received, income from other sources, profits earned on sale of assets ….etc.

Gross profit: Gross profit is transferred from trading account to profit and loss account. It is shown to be the first item on the credit side of the profit and loss account.

Income from investment: When can amount invested in shares, by their every financial year end, the business firm may get dividend (income). This is treated as income so it has to be credited to profit and loss account.

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Investing on money deposits also fetch interest on deposits, and any type of investment too fetch the interest so this incomes should be credited to profit and loss account.

Recovery of bad debts: Some debts will recover which were treated as bad in the past. In this case the recovered bad debt portion is to be treated as an income for the present financial year, hence it has to be shown on credit side of the profit and loss account.

Commission received: This type of income also occur in the normal course of business. Since it is one type of income, it will appear on credit side of profit and loss account.

Profit earned on sale of assets: This income refers to the excess amount received by sale of asset to its salvage value if the sale of asset is generating income. Then it will appear on credit side of the profit and loss account.

Illustration - 3

Prepare Profit and Loss Account from the following particulars relating to the year ending 29th Feb. 2011

Particulars	₹
Gross Profit	1,40,000
Salaries	28,000
Administration expenses	10,000
Selling expenses	20,000
Maintenance expenses	5,000
Commission received	7,000
Sundry Office expenses	10,000

Solution:

Profit and Loss Account for the year ended of 29th Feb. 2011

Dr. **Cr.**

Particulars	*Amount*	*Particulars*	*Amount*
To Salaries	28,000	By Gross Profit	1,40,000
To Administration expenses	10,000	By Commission received	7,000
To Selling expenses	20,000		
To Maintenance expenses	5,000		
To Sundry office expenses	10,000		
To Net Profit	74,000		
(Transfers to capital A/c)			
	1,47,000		**1,47,000**

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Illustration - 4

Prepare the Profit and Loss Account from the following particulars relating to the year ending 30th April 2011

Particulars	₹
Office Salaries	40,000
Postage and Telegrams	20,000
Office Rent	7,000
Sundry Office expenses	10,000
Selling expenses	8,000
Gross Profit	2,00,000
Advertisement	12,000
Commission paid	9,000
Commission received	8,000
Prepaid Rent	1,000
Outstanding Salaries	15,000

Solution:

Profit and Loss Account for the year ended 30th April 2011

Dr. **Cr.**

Particulars	*Amount*	*Particulars*	*Amount*
To Office Salaries	40,000	By Gross Profit	2,00,000
To Postage and Telegrams	20,000	By Commission received	8,000
To Sundry Office Expenses	10,000		
To Selling Expenses	8,000		
To Advertisement	12,000		
To Commission Paid	9,000		
To Office Rent	7,000		
To Net Profit (Transfer to Capital A/c)	1,02,000		
	2,08,000		**2,08,000**

Note: Prepaid Rent & outstanding salary is as treated assets or liability respectively. So they are not entered into profit & loss account.

Illustration - 5

Prepare Trading and Profit and Loss Account for the year ended 31 March 2011 and a Balance Sheet as on that date:

	₹		₹
Capital	40,000	Depreciation	4,600
Bad debt	1,000	Bad debt provision	3,000
Salaries	8,000	Outstanding Salaries	1,000
Insurance	1,300	Debtors	50,000

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Prepaid Insurance	300	Creditors	40,000
Purchases (Less Closing Stock)	1,50,000	Closing Stock	22,400
Furniture	5,400	Sales	2,10,000
Machinery	36,000	Opening Stock	15,000

Solution:

Trading and Profit & Loss Account for the ended 31st March 2011

Particulars		**₹**	***Particulars***	**₹**
To Opening Stock		15,000	By Sales	2,10,000
To Purchase	1,50,000		By Closing Stock	22,400
Add: Closing Stock	22,400	1,72,400		
To Gross profit c/d		45,000		
		2,32,400		**2,32,400**
To Salaries		8,000	By Gross Profit b/d	45,000
To Insurance		1,300		
To Depreciation		4,600		
To Bad debts		1,000		
To Net profit		30,100		
		45,000		**45,000**

Balance Sheet as on 31 March 2000

Liabilities		**₹**	***Assets***	**₹**
Outstanding salaries		1,000	Prepaid Insurance	300
Bad debts provision		3,000	Closing Stock	22,400
Creditors		40,000	Machinery	36,000
Capital	40,000		Furniture	5,400
Add: Net profit	30,100	70,100	Debtors	50,000
		1,14,100		**1,14,100**

Illustration - 6

From the following Trial Balance of S. Saha prepare Trading and Profit & Loss Account for the year ending 31st March 2010 and the Balance Sheet as on that date:

Particulars	***Debit***	***Credit***
Purchase	21,750	
Discount allowed	1,300	
Wages	6,500	
Salaries	2,000	
Sales		35,000
Travelling expenses	400	
Commission	425	
Carriage inward	275	

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Administration expenses	105	
Trade expenses	600	
Interest	250	
Buildings	5,000	
Furniture	200	
Debtors	4,250	
Capital		13,000
Creditors		2,100
Cash	7,045	
Total	**50,100**	**50,100**

Stock on 31st March, 2010 was ₹ 6,000, Depreciate Buildings by 20%, create a provision for bad debts 10% on debtors, outstanding wages ₹ 475.

Solution:

Trading and Profit & Loss Account of S. Saha for the year ended 31st March 2010

Particulars		**₹**	***Particulars***	**₹**
To Purchase		21,750	By Sales	35,000
To Wages	6,500		By Closing Stock	6,000
Add: Outstanding	475	6,975		
To Carriage inward		275		
To Gross Profit c/d		12,000		
		41,000		**41,000**
To Salaries		2,000	By Gross Profit b/d	12,000
To Discount		1,300		
To Travelling expenses		400		
To Commission		425		
To Admin. expenses		105		
To Trade expenses		600		
To Interest		250		
To Depreciation on buildings		1,000		
To Provision for bad Debts		425		
To Net Profit		5,495		
(Transfer to capital account)				
		12,000		**12,000**

Balance Sheet of S. Saha for the ended March 31st 2010

Liabilities		**₹**	***Assets***		**₹**
Creditors		2,100	Cash in hand		7,045
Outstanding wages		475	Debtors	4,250	
Capital	13,000		*Less:* Provision		
Add: Net Profit	5,495	18,495	for bad debts	425	3,825
			Closing Stock		6,000

		Furniture		200
		Building	5,000	
		Less: Depreciation	1,000	4,000
	21,070			**21,070**

Notes: Wages outstanding is an expenses of the current year, so it will be added to wages at the debit side of trading account. The amount is still payable, so it will also the posted at the liabilities side.

7.5 BALANCE SHEET

Balance Sheet is a statement which reflects the true position of assets and liabilities on a particular period. It is also known as financial statement.

In view of the fact that the assets and liabilities changes from day to day as a result of business transactions, the trader must necessarily feel anxious to find out what his true financial position is at the end of each trading period. In the first place, he would like to know whether the net profit as is disclosed by the profit and loss account is correctly arrived at, for, if so, his capital at the end of the period must necessarily increase by that amount. He is equally anxious to see for himself as to how such capital is made up, i.e., what the component assets and Liabilities of the business are. In order, therefore, to obtain this information at the end of the trading period, he has to set out his several assets and liabilities as at that date in the shape of a statement and this statement is called the Balance Sheet.

Balance sheet is prepared from the Trial balance, after all the balances on nominal account are transferred to the trading and profit and loss account and corresponding account in the ledger are closed. The balances now left in the trial balance and remaining one in the ledger represent either personal or real account. All assets and liabilities are setout in the balance sheet in a systematic manner. In the right side are shown the assets and on the left-hand side are shown the various liabilities.

Finally, Balance Sheet shows the true financial position of the business on a specific date i.e., at the end of an accounting period the total assets and total liabilities must be equal.

Definitions

According to **T.R. Batliboi,** "A Balance Sheet is a statement prepared with a view to measure the exact financial position of a business on a certain fixed date".

In the words of '**Free man**,' A Balance sheet is an itemwise lists of assets, liabilities and proprietorship of a business at a certain data.

According to **Palmer**, "The Balance sheet is a statement at a particular date

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showing on one side the trader's property and possessions and on the other side the liabilities.

Objectives of Balance Sheet

(i) To find out the financial position of the business firm for a particular financial period.

(ii) To know the sources and applications of the fund.

(iii) To act as a effective communication tools for stake holder. (creditors, government, income tax authority's and general public) etc.

(iv) To assists in decision making for future course of action.

(v) To obtain the information about assets (economic resource control by the entity that are expected to provide further benefits) and liabilities .

Preparation of a Balance sheet

While preparing a balance sheet the following steps must be considered. Balance sheet is known as liabilities on the **left** hand side, assets on the **right** hand side, instead there is no debit side or no credit side in the balance sheet.

In the balance sheet the debit balances of trial balances of personal and real accounts are to be shown on the assets side and the credit balances of personal accounts are to be shown on the liabilities side. It is prepared on a specific data i.e. at the end of accounting period. So use the word as on .... or as at. in the heading of Balance sheet instead of "For the year ended. ". Finally, thus the word 'To' and 'By' are not shown in the balance sheet.

Structure of a Balance Sheet as on…

Liabilities		*Amount*	*Assets*	*Amount*
Current Liabilities:			**Current Assets:**	
Bank Overdraft		xxx	Cash in hand	xxx
Bills Payable		xxx	Cash at Bank	xxx
Outstanding expenses		xxx	Bills Receivable	xxx
Income received in advance		xxx	Prepaid expenses	xxx
Sundry Creditors		xxx	Accrued Income	xxx
Short term loans		xxx	Investment	xxx
Fixed Liabilities:			Sundry Debtors	xxx
Long term loan		xxx	Stock (closing)	xxx
Reserves		xxx	Loose Tools	xxx
Capital	xxx		**Fixed Assets:**	xxx
Add: Net profit	xxx		Goodwill	xxx
Add: Interest on Capital	xxx		Furniture & Fixture	xxx
	xxx		Plant & Machinery	xxx
Less: Drawings	xxx		Long term Investment	xxx

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Less: Interest on Drawings	xxx	xxx	
		xxx	**xxx**

Alternative Structure of a Balance Sheet as on ...

Liabilities		*Amount*	*Assets*	*Amount*
Capital	xxx		**Fixed Assets:**	xxx
Add: Net profit	xxx		Goodwill	xxx
Add: Interest on capital	xxx		Furniture & Fixture	xxx
	xxx		Plant & Machinery	xxx
Less: Drawing	xxx		Long term Investment	xxx
Less: Interest on Drawings	xxx	xxx	**Current Assets:**	
Fixed Liabilities:			Cash in hand	xxx
Long term loan		xxx	Cash at Bank	xxx
Reserves		xxx	Bills Receivable	xxx
Current Liabilities:			Prepaid expenses	xxx
Bank Overdraft		xxx	Accrued Income	xxx
Bills payable		xxx	Investment	xxx
Outstanding expenses		xxx	Sundry Debtors	xxx
Income received in advance		xxx	Stock (closing)	xxx
Sundry Creditors		xxx	Loose Tools	xxx
Loan		xxx		
		xxxx		**xxxx**

Assets are classified in different types and they are as follows

(i) Liquid assets/quick assets
(ii) Fixed assets
(iii) Current assets/Floating assets
(iv) Fictious assets/Nominal assets
(v) Wasting assets
(vi) Tangible assets
(vii) Intangible assets

(i) Liquid/Quick Assets: Liquid assets are those assets, that is either cash or any other asset that can be easily turned in to cash, such as cash in hand, cash at bank, money owed by customers, shares that can be easily sold, bills receivables, short term investments, debtors, accrued income… etc. In other words, within a short span of time the business concern can get cash from its liquid/quick assets.

(ii) Fixed Assets: Fixed assets are those assets which are tangible and relatively long-lived; that is used in order to produce goods, used in operation of business and not intended for sale. *Examples* of fixed assets are land and building, plant and machinery, motor vehicles, furniture … etc. These assets increases profit earning capacity of the business and are valued at cost less depreciation method.

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(iii) Current or Floating Assets: Current assets are those assets which are convertible into cash through the normal course of business within a short span of time, say within one year. Current assets includes liquids assets, prepaid expenses and stock.

(iv) Fictitious assets/Nominal assets: Fictitious assets are those which have no real value. *Examples* of fictitious assets are preliminary expenses, debit balance of profit and loss account, deferred revenue expenditure … etc.

(v) Wasting assets: Wasting assets falls under fixed assets category, but only the difference is wasting assets are depleted or exhausted gradually in the process of use. *Examples* are mines, oil wells, quarries, patents, properties taken on lease …etc.

(vi) Tangible Assets: Tangible assets are those assets which can be see, and touch. *Examples* of such assets are building, plant and machinery, furniture etc. Tangible assets are physically visible and can be easily valued.

(vii) Intangible Assets: Intangible assets are exactly opposite to the tangible assets, where business concern has and can make money from it, but these assets are not something physical and so cannot easily be valued, *for example* technical knowledge, name of the product (Brand name), good will, copyright, patents, trademark etc.

Classification of Liabilities

Liabilities are obligations to outside parties arising from events that have already happened. In simple, liabilities are claims against the entities assets. Liabilities are broadly classified into three major categories. They are:

(i) Long term Liabilities

(ii) Short term Liabilities

(iii) Contingent Liabilities

(i) ***Long term liabilities:*** Long term liabilities are those obligations which are going to meet after one year or more. *Examples* are term loans from banks and financial institutions, debentures, mortgage loans, ….etc.

(ii) ***Short term liabilities:*** Obligations which are going to meet in a short span of time (with in one year of the date of balance sheet), are called short term liabilities. *Examples* of such liabilities are Bank overdrafts, bills payable, unearned revenues, outstanding expenses.

(iii) ***Contingent liabilities:*** A contingency is an occurrence that might arise in the future. These liabilities will become repayable only on the happening of some event, otherwise not. Since these liabilities are uncertain, will not appear in balance sheet, however they are shown as a foot note below the balance sheet. *Examples* are

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(i) **Liability against a suit pending in a court of law:** This will become a liability when the firm losses the case in the court of law.

(ii) **Liability in respect of a guarantee given:** In case the person or firm for whom guarantee is given by the firm fails to meet its obligations the firm would become liable for such guarantee.

(iii) **Liability for bill discounts:** In case the acceptor dishonors a bill discounted on the due date the firm will become liable to the bank.

Points to be considered while preparing Balance Sheet:

Capital refers to the amount invested in a business by the proprietor or partner (in case of a partnership business). It is the excess of assets over external liabilities. Capital is increased by profit or introduce additional capital and is decreased by losses and withdraw by proprietor. It also known as proprietor's net assets or net equity.

Drawings: Drawings refer to the amount of cash or goods withdrawn by the proprietor for his personal or domestic use. Example withdraw cash for purchasing two-wheeler for his son, goods taken by the owner for his domestic use, cash withdraw for paying premium of life insurance.

Bills Payable: A bill of exchange is an order drawn by a creditor on a debtor, it will be a bill receivable to the drawer and a bill payable to the acceptor. Bills payable is an obligation to pay the amount to the supplier of goods, before the agreed period (normally 45 days to 90 days) by the trader.

***Overdraft*:** A banker, on being satisfied as to the financial standing of his customer or after receiving proper securities, will allow the customer to over draw his current account, in which case, the over draft would be a sort of temporary advance by the banker and it is to be shown under short term liabilities.

Outstanding liabilities: There are several items, such as rent, salaries, wages, advertisement,….etc. that belongs to the past and have accrued due, but have not been paid; since it is yet to be payable it will appear under short term liabilities.

Current assets: Current assets are such assets as are acquired either for the purpose of resale or held temporarily in course of a business for their subsequent conversion in to money, such as stock-in-trade, bad debts, bills value, Bills receivable… etc. Current assets are held for resale with a view to make profit or for immediate conversion in to cash, and are therefore, valued at the cost or the current market price whichever is lower at the date of balance sheet.

Stock-in-trade: This item should be very carefully valued and any overvaluation should be guarded. The basis accepted while valuation of stock-in-trade is cost or market price whichever is lower at the date of balance sheet.

Bills Receivables: This item will represent bills receivable not matured at the date of the balance sheet.

Goodwill: It is the value of an establishment business over and above the value represented by the tangible or concrete assets, such as land, buildings, ma-

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chinery, furniture, stock, book debts … etc. It is an intangible assets it cannot be seen and touched. It can be realised only at the time of the dissolution of the concern along with other assets, but not independently.

The term goodwill can hardly be said to have any precise significance. It is generally used to denote the benefit arising from connection and reputation, and its value is what can be get for the chance of being able to keep that connection and improve it.

Fixed assets: Fixed assets are those which are acquired and intended to be retained permanently for the purpose of carrying on a business, such as land, building plant and machinery … etc.

As fixed assets are acquired not for resale but by way of permanent equipment to serve as a medium to enable the business being carried on they should not be valued on the basis of price they would realize if sold (fair market value).

Working Capital: Working capital means the capital available for the working of a business after its fixed assets have been acquired.

Capital Expenditure: When an amount has been expended and the expenditure results in the acquisation of an assets or in addition to the value of any existing assets, such an expenditure is styled capital expenditure and will take its place in the Balance Sheet.

Revenue Expenditure: All ordinary expenses incurred in the course of running a business, such as salaries, wages, printing and stationary, advertisement, rent, postage, telegrams, etc., as well as any expenses incurred in keeping the existing assets in proper repairs and maintaining them in their orginal state efficiency, and which do not result in an addition to the value of exsisting assets, would be classed as revenue expenditure and would find their place in the revenue account , i.e.., the profit and loss account.

Deferred Revenue Expenditure: Any expenditure which is the primarily of a revenue nature, but the benefits derived from which are not exhausted during the current period, would be carried forward and treated as an assets to the extent of the unexpired benefits. Such carrying forward is no doubt, permissible. provided it is not continued for such a length of time as to affect the profits of the years which it cannot be considered to have benefited. The most frequently occurring examples of deferred revenue expenditure are preliminary expenses, alternations to machinery or plant, special repairs and advertising.

Balance Sheet and Profit & Loss Account are Inter-depended - As the balance of profit & loss account is transferred to the capital account and as the closing balance on the capital account is shown in the balance sheet, it is clear that the balance sheet shows the position inclusive of the profit or loss made during the trading period.

Illustration - 7

From the following particulars prepare a Balance Sheet for the year ended 3rd May, 2011.

Particulars	₹
Land and Building	80,000
Capital	1,90,000
Plant and Machinery	1,20,000
Net Profit	20,000
Sundry Creditors	48,000
Cash at Bank	10,000
Bills Payable	9,000
Sundry Debtors	20,000
Bills Receivable	7,000
Cash in hand	30,000

Solution:

Balance Sheet for the year ended 31st May, 2011

Liabilities		*Amount*	*Assets*	*Amount*
Capital	1,90,000		Land & Building	80,000
Add: Net Profit	20,000	2,10,000	Plant & Machinery	1,20,000
Sundry Creditors		48,000	Bills Receivable	7,000
Bills Payable		9,000	Cash at Bank	10,000
			Cash in hand	30,000
			Sundry Debtors	20,000
		2,67,000		**2,67,000**

Illustration - 8

From the following Trial Balance of Supriya, Prepare the Balance Sheet for the year ended 31st December, 2010.

Paritculars	*Dr.(₹)*	*Cr.(₹)*
Supriya's Capital		29,000
Supriya's Drawing		760
Purchase and Sales	8,900	15,000
Sales & Purchases Returns	280	450
Wages	800	
Stock (01-01-2010)	1,200	
Land & Building	22,000	
Carriage Inwards	200	
Advertisement	240	
Net Profit		2,750
Trade expenses	200	
Interest		350

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Insurance	130	
Cash in hand	190	
Salaries	800	
Debtors and Creditors	6,500	1,200
Bills Receivable & Bills Payable	1,500	700
Cash at Bank	1,200	

Stock on 31st December, 2010 was valued ₹ 1,500

Solution:

Balance Sheet as on 31st December, 2010

Liabilities		***Amount***	***Assets***	***Amount***
Creditors		1,200	Cash in hand	190
Bills Payable		700	Cash at Bank	1,200
Capital	29,000		Bills Receivable	1,500
Add: Net Profit	2,750		Debtors	6,500
	31,750		Closing Stock	1,500
Less: Drawings	760	30,990	Land & Building	22,000
		32,890		**32,890**

Adjustments

The journal entries necessary to adjust the various accounts for the purpose of making provision for depreciation, reserve for doubtful debts, prepaid expenses, outstanding expenses or liabilities into an account etc, is known as adjusting entries. Adjustment entries are adjustment for such incomes and expenditures must be made in the current year itself, to reach at the accurate profit and loss account.

Generally, those items which have not been included in the trial balance of final account but bringing into record certain income and expenses of the current period are called adjustments. The certain expenses of current period which are incurred but not yet paid, and certain incomes of the current period which are earned but not yet received, appointment of the expenses paid during the current year and income received during the current year, between the current year and the next year and bringing into account. Income but not cash like interest of drawings, appreciation of fixed assets, etc. Expenses but not cash like depreciation of fixed assets, interest on capital, anticipated income like reserve for discount on creditor, etc. Anticipated losses like reserve for bad debts, reserve for discount on debtors.

Objectives of Adjustments

The necessity and objective of making adjustments, including all expenses, losses, and income, gains related to the accounting period in the final account. The following main objectives are:

(i) To bring out all prepaid and outstanding expenses.

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(ii) To provide for other reserve and provision, depreciation, interest on capital, doubtful debts, discount on debtor etc.

(iii) To make adjustment of such income and expenses which have been paid in advance.

(iv) To make a record of such income and expenditures which are due but have not been received.

(v) To ascertain the free financial statement of a business firm.

7.6 COMMON ADJUSTMENTS IN FINAL ACCOUNT

The following adjustments are usually used in the preparation of final account:

- Closing stock
- Prepaid expenses / expenses paid in advance.
- Outstanding expenses / unpaid expenses
- Accrued income / outstanding income.
- Unearned income / income received in advance.
- Bad debts
- Depreciation
- Interest on capital
- Interest on drawing
- Provision for bad and doubtful debts
- Provision or reserve for discount on debtors/creditors
- Capital expenditure treated as revenue expenditure
- Good distribute as free sample
- Loss by fire / accident
- Contingent liabilities.

Closing Stock

Closing stock are those goods which remained unsold at the end of the trading period. Adjusting entry for closing stock:

Closing Stock Account Dr.

To Trading Account

Explanation: Closing stock account is debited because it is an asset.

Trading Account is credited because the trading account is a nominal account.

Treatment of Closing Stock in Final Accounts:

First, it should be entered on the credit side of the trading account and secondly entered on the assets side of the Balance Sheet.

Outstanding Expenses

The expenses (example. salary, wages, rent) which have been incurred

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during a particulars trading period, but not paid by the closing date of that period are called “Outstanding expenses”. Adjustment entry for outstanding expenses :-

Various expenses Account Dr.

To Outstanding liabilities for expenses Account.

Explanation: The various expenses account is debited because all expenses and losses are nominal account. The outstanding expenses is liabilities so all liabilities should be credited.

Example - 1

How to treat outstanding expenses in final account?

From the following prepare a Trading Account, Profit & Loss Account and Balance Sheet.

Salary	₹ 5,000
Wages	₹ 2,000
Rent	₹ 3,000

Adjustment: Outstanding Salary ₹ 1,000 Outstanding Wages ₹ 500 Outstanding Rent ₹ 1,500

Solution:

Trading Account

Dr. **Cr.**

Particulars		*Amount*	*Particulars*	*Amount*
To Wages	2,000			
Add: Outstanding	500	2,500		

Dr. **Profit & Loss Account** **Cr.**

Particulars		*Amount*	*Particulars*	*Amount*
To Salary	5,000			
Add: Outstanding	1,000	6,000		
To Rent	3,000			
Add: Outstanding	1,500	4,500		

Balance Sheet

Liabilities	*Rs.*	*Assets*	*Rs.*
Outstanding Wages	500		
Outstanding Salary	1,000		
Outstanding Rent	1,500		

Prepaid Expenses

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Prepaid expenses are those expenses which are paid in current period but relates to the next period are known as prepaid expenses. Adjusting entry for prepaid expenses:

Prepaid Expenses Account Dr.
To Various Expenses Account

Outstanding Income

Incomes earned during a particular period but not received during that period are called "Outstanding incomes". Adjustment entry for outstanding income:

Outstanding income Account Dr.
To Various income Account.

First, the outstanding income should be added to the respective incomes on the credit side of the profit & loss account. Secondly, total outstanding income should be entered on the assets side of the balance sheet.

Income Received in Advance or Unearnd Incomes

Sometimes, certain income might have been received during the trading period even though they have not been earned. Adjusting entry for this is as follows:

Various incomes Account Dr.
To Income received in advance account

First, the income received in advance amount should be deducted from the respective income on the credit side of profit & Loss Account. Secondly total Advance income received should be entered on the liabilities side of balance sheet.

Bad Debts

The amount due to us from our debtors are called 'debts'. Debts which are definitely proved to be irrecoverable are called 'bad debts'. Bad debts may be causes of insolvency of the debtors or willful non payment by the debtors, etc. Adjustment entry for Bad Debt is as follows:

Bad debts Accounts Dr.
To Sundry debtors Account.

Bad debts is a nominal account and it is a loss, Debtors is an assets account. Loss always should be debited and assets is reducing so it has been credited.

The bad debts are given in Trial balance, it will be entered only one time on the debit side of the profit & loss account, if the bad debts is given in adjustment then it will be entered on the debit side of profit & loss account and on the assets side it should be deducted from the debtors.

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Provision for Doubtful Debts or Reserve for Doubtful Debts

In addition to the Bad debts. There may be some debts, the recovery of which is doubtful, such debts are called doubtful debts. Bad debts are definitely losses but doubtful debts are only expected loss. A provision should be made out of current year's profits for meeting the losses that may arise, this provision is called a reserve for doubtful debts. Adjusting entry for provision for doubtful debts:

Profit & Loss Account Dr.

To Provision for doubtful debts Account.

Reserve for Discount on Debtors

If a customer pays his dues promptly, the business concern allows cash discount to the debtors. This is loss to the business concern. The business concern can not know how much cash discount it will have to allow to its debtors at the end of the current trading period. For this the business concern has to make some provision to meet the loss arising on account of the discount that will have to be allowed to the debtors is known as Reserve for discount on debtors. Adjusting Entry for Reserve for discount on debtors.

Profit and Loss Account Dr.

To Reserve for discount on Debtors Account.

For creating the provision for discount on debtors, the profit and loss account should be debited because the provision made for discount is charged against profit.

Provision for Discount on Creditors

A trader can expect to get some cash discount from the creditors. But he does not know how much discount he will get so for the purpose of recording the expected discount from the creditors. The trader creates a "Reserve for discount on creditors". Adjusting Entry for reserve for discount on creditors:

Reserve for discount on creditors Account Dr.

To Profit and Loss Account.

Accounting Treatment

If the discount received from creditors during the year and the Reserve for discount on creditors required at the end of that year (i.e., New reserve for discount received) is greater than the reserve for discount on creditor already existing (i.e, old reserve for discount on creditors), then, the difference will appear on the credit side of the Profit and Loss Account.

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Depreciation

Depreciation means the decreasing value of an assets. Depreciation is a loss, it should be taken into account, while preparing the final accounts of a concern.

The depreciation is usually charged at a certain percentage on the book value of the assets for the period for which the asset is used. Entry for charging depreciation

Depreciation Account Dr.
To Concerned Assets Account

The Depreciation Account is a nominal account, it is a loss, so it should be debited.

Whenever depreciation is charged on an asset the value of that assets goes down in order to reduce the balance of the assets account, which has a debit balance, the asset should be credited.

Interest on Capital

Capital is invested by the proprietor in the business is in the nature of a loan granted by him to the business.

Therefore it is desirable to allow a reasonable rate of interest on the proprietor capital before ascertaining the real Net Profit or Net Loss of the business. Adjusting Entry for interest on Capital:

Interest on capital Account Dr.
To Capital Account

Interest on Drawings

The interest on drawings is not actually received from the proprietor. It is due from the proprietor in order to record the amount due from the proprietor, the proprietors capital account or drawings account is debited.

The interest on drawings is a gain to the business therefore the interest on drawings account is credited.

Interest on drawing is an income to the business, it should be entered on the credit side of profit and loss Account, and again it should be deducted from the liabilities side of balance sheet.

Goods distributed by a concern as free samples

Goods distributed by a concern as free samples, not already recorded in the books must be recorded at the time of preparation of final accounts by means of an adjusting entry. The entry will be:

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Advertisement Account Dr.

To Purchase Account

First the goods distributed as free samples must be deducted from purchase on the debit side of the trading account. Secondly the advertisement, they must be entered on the debit side of the profit and loss account. (They must not appear in the Balance Sheet)

Goods destroyed by Fire, Accident, Floods etc.

(a) If the goods are destroyed and the loss is not recoverable, first an entry has to be passed, for recording the destroyed value:

Stock destroyed Account Dr.

To Trading Account

Secondly, as the loss is not recoverable, it has to be transferred to the Profit and Loss Account. The entry will be -

Profit and Loss Account Dr.

To Stock destroyed Account.

First the value of goods destroyed must be entered on the credit side of the trading account as by stock destroyed.

Secondly the entire Loss must be entered on debit side of the Profit and Loss Account as "To loss on goods destroyed".

(b) If the goods are destroyed and the loss is fully recoverable from the insurer (i.e., insurance company): First the entry for recording the value of goods destroyed will be-

Stock, destroyed Account Dr.

To Trading Account.

Secondly - The entry for recording the amount recoverable from the insurer will be:

Insurer Account Dr.

To Stock Destroyed Account.

The value of goods destroyed must be entered on the credit side of the trading account as by stock destroyed.

The amount recoverable from the insurer must be entered on the assets side of the Balance Sheet as "Amount due from insurer".

(c) If the goods are destroyed and the loss is partially recoverable from the insurer, the entry for recording the value of goods destroyed will be:

Stock destroyed Account Dr.

To Trading Account

Secondly, the entry will be for the recoverable Amount:

Insurance Account Dr.

(With the Amount of loss recoverable)

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Profit and Loss Account Dr.
(With the Balance of loss not recoverable)
To Stock destroyed Account
(With the total value of goods destroyed).

The treatment for goods destroyed in final account is - First the full value of goods destroyed must be entered on the credit side of trading account as "By Stock destroyed".

Secondly, the amount of loss not recoverable must be entered on the debit side of the Profit and Loss Account as "To loss on stock destroyed".

Thirdly, the amount of loss recoverable from the insurer must be entered on the assets side of the Balance Sheet as "Amount due from insurance Company".

Contingent Liabilities

A contingency is an occurrence that might arise in the future. These liabilities will become repayable only on the happening of some event, otherwise not. Since these liabilities are uncertain, will not appear in balance sheet, however they are shown as a foot note below the balance sheet. Examples are

(i) **Liability against a suit pending in a court of law:** This will become a liability when the firm losses the case in the court of law.

(ii) **Liability in respect of a guarantee given:** In case the person or firm for whom guarantee is given by the firm fails to meet its obligations the firm would become liable for such guarantee.

(iii) **Liability for bill discounts:** In case the acceptor dishonors a bill discounted on the due date the firm will become liable to the bank.

The Usual Closing Entries are as follows:

For transferring Opening Stock, Purchases, Wages, Carriage Inwards, etc., to Trading Account:

Trading Account Dr.
To Stock Account
To Purchases Account
To Wages Account
To Carriage Inwards Account.

(The effect of this entry will be to close Stock, Purchases, Wages and such other Accounts as are transferred to Trading Account).

For transferring Sales to the Trading Account:

Sales Account Dr.
To Trading Account

(This entry will close the Sales Account)

For transferring all the Expenses or Losses to the Profit and Loss Account:

Profit and Loss Account Dr.

NOTES

To each of the various Nominal Accounts
which represent expenses or losses.
(This entry closes all the expenses accounts).

For transferring all the items of Gain to the Profit and Loss Account:

Various Nominal Account Dr.
(representing difference sources of gain)
To Profit and Loss Account
(This entry closes all the remaining Nominal Accounts)

For transferring Net Gain to the Capital Account:

Profit and Loss Account Dr.
To Capital Account
(This entry closes the Profit and Loss Account)

For transferring Net Loss (if any) to the Capital Account:

Capital Account Dr.
To Profit and Loss Account

For transferring the Proprietor's Drawings to his capital Account:

Capital Account Dr.
To Drawings Account
(This entry closes the Drawings Account)

7.7 PRACTICAL PROBLEMS ON FINAL ACCOUNT

Illustration - 1

From the following Trial Balance, show the journal entries and Amount of Profit and Loss Account, Balance sheet as on 31st Dec. 2010

Paritculars	*Debit*	*Credit*
Capital Account		2,03,000
Drawings Account	15,000	
Freehold Land and Premises	90,000	
Plant and Machinery	40,000	
Loose Tools	3,000	
Bills Receivable	3,000	
Stock	40,000	
Materials Purchased	51,000	
Wages	20,000	
Carriage Inwards	1,000	
Carriage Outwards	500	
Coal and Coke	5,000	
Salaries	5,000	

Rent, Rates and Taxes	2,800	
Discounts and Allowances	1,500	
Bills Payable		3,800
National Bank	25,000	
Cash in hand	400	
Sundry Debtors	45,000	
Sundry Creditors		40,000
Repairs and Replacements	1,800	
Purchases Returns		2,650
Works Extensions Account	7,500	
Bad Debts	1,200	
Advertisements	500	
Goods Sold		1,15,00
Sales Returns	2,000	
Gas and Water	200	
Oil, Grease,and Waste	600	
Furniture and Fixtures	1,200	
General Expenses	800	
Printing and Stationery	450	
	3,64,450	**3,64,450**

Write depreciation of Plant and Machinery at 5%, Loose Tools at 15% and Furniture at 5%. The Stock on hand on 31st December, 2010 amounted to ₹ 60,000. Provide for 5% discount on sundry debtors and 5% for doubtful debts. ₹ 1,500 were due for wages and Rs. 450 for salaries for the month of December 2010. The last bill of ₹ 400 for taxes was for the half-year ending 31st March 2011.

Solution:

Journal Entries

Paritculars	***LF***	***Debit***	***Credit***
Depreciation Account Dr.		2,510	
To Plant & Machinery			2,000
To Furniture and Fixtures			60
To Loose Tools			450
(Being 5 per cent Depreciation on Plant, Machinery, Furniture and Fixtures and 15 per cent on Loose Tools written off)			
Profit and Loss Account Dr.		2,250	
To Reserve for Doubtful Debts			2,250
(Being 5 per cent provision or Doubtful Debts on Sundry Debtors)			
Discounts and Allowances Dr.		2,137	
To Reserve for Discounts			2,137
(Being 5 per cent provision for Discounts on Debtors).			

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Wages Account	Dr.	1,500	
Salaries Account	Dr.	450	
To Outstanding Creditors			1,950
(Being the outstanding liability in respect of Wages and Salaries brought into account)			
Expenses Prepaid	Dr.	200	
To Taxes			200
(Being the amount of Prepaid Taxes carried forward)			
Trading Account	Dr.	1,21,300	
To Stock in Trade			40,000
To Materials Purchased			51,000
To Returns Inwards			2,000
To Wages			21,500
To Coal and Coke			5,000
To Carriage Inwards			1,000
To Oil, Grease and Waste			600
To Gas and Water			200
(Being the transfer of the above items to Trading Account).			
Sales Account	Dr.	1,15,000	
Returns Outwards	Dr.	2,650	
To Trading Account			1,17,650
(Being the transfer of the above items to Trading Account)			
Stock-in-Trade	Dr.	60,000	
To Trading Account			60,000
(Being the incorporation of Closing Stock)			
Profit and Loss Account	Dr.	18,947	
To Salaries			5,450
To Rent, Rates and Taxes			2,600
To Repairs and Replacements			1,800
To General Expenses			800
To Carriage Outwards			500
To Advertisements			500
To Printing and Stationery			450
To Discounts and Allowances			3,137
To Bad Debts			1,200
To Depreciation			2,510
(Being the transfer of the above items to Profit and Loss Account)			
Profit and Loss Account	Dr.	22,653	
To Capital Account			22,653
(Being the transfer of Net Profit)			

Trading and Profit & Loss Account for the year ended 31st December, 2010 NOTES

Particulars		*Amount*	*Particulars*		*Amount*
To Opening Stock		40,000	By Sales	1,15,000	
To Purchases	51,000		*Less:* Returns	2,000	1,13,000
Less: Returns	2,650	48,350	By Closing Stock		60,000
To wages	20,000				
Add: Outstanding wages	1,500	21,500			
To Coal and Coke		5,000			
To Carriage Inwards		1,000			
To Oil, Grease and Waste		600			
To Gas and Water		200			
To Gross Profit c/d		56,350			
		1,73,000			**1,73,000**
To Salaries		5,450	By Gross Profit b/d		56,350
To Rent, Rate and Taxes		2,600			
To Repairs and Replacements		1,800			
To General Expenses		800			
To Carriage Outwards		500			
To Advertisements		500			
To Printing & Allowances		450			
To Discounts and Allowances		1,500			
To Bad Debts		1,200			
To Reserve for Doubtful Debts		2,250			
To Depreciation :					
Plant & Machinery 5%		2,000			
Discount on debtors		2,137			
Furniture & Fixtures 5%		60			
Loose Tools 15%		450			
To Net Profit		34,653			
		56,350			**56,350**

Balance Sheet for the year ended 31st Dec. 2010

Liabilities		₹	*Assets*		₹
Capital	2,03,000		Freehold land & premisses		90,000
Add: Net profit	34,653		Plant & machinery	40,000	
	2,37,653		*Less:* Depreciation	2,000	38,000
Less: Drawings	15,000	2,22,653	Loose Tools	3,000	
Outstanding expenses:			*Less:* Depreciation	450	2,550
Salary	450		Furniture & Fixtures	1,200	
Wages	1,500	1,950	*Less:* Depreciation	60	1,140
Bills payable		3,800	Closing stock		60,000
Sundry creditors		40,000	Work extension		7,500

NOTES

		National Bank		25,000
		Bills receivable		3,000
		Cash in hand		400
		Sundry debtors	45,000	
		Less: Reserve forbad debts	2,250	
			42,750	
		Less: Discount	2137	4,0613
		Advance Tax paid		200
	2,68,403			**2,68,403**

Illustration - 2

From the following Trial Balance of M/s Medicament as at 31st December, 2003. Prepare the Final Accounts after considering the necessary adjustment.

Trial Balance

Particulars	*Debit*	*Credit*
Capital Account		30,000
Drawings Account	2,600	
Plant and Machinery	12,000	
Stock on 1st Jan 2003	5,000	
Creditors		6,000
Purchases	35,000	
Sales		50,000
Return inwards	2,000	
Return outwards		1,000
Sundry Debtors	8,000	
Carriage inwards	500	
Carriage outwards	500	
Wages	3,000	
Salaries	2,000	
Factory Rent	200	
Office Rent	500	
Insurance	500	
Discount received		600
Discount allowed	300	
Furniture	2,000	
Bad debts	400	
Commission	300	
Building	8,000	
Bills Payable		2,000
Cash in hand	200	

Cash at Bank	600	
Bills Receivable	6,000	
	89,600	**89,600**

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Adjustments:

a) Closing stock ₹ 20,000

b) Prepaid Insurance ₹ 200

c) Interest on Capital at 5%

d) Office Rent Outstanding ₹ 400

e) Depreciation is to be provided at 10% on Furniture and Plant & Machinery.

Solution:

Trading and Profit & Loss Account of M/s Medicament as on 31st December, 2003.

Particulars		*Amount*	*Particulars*		*Amount*
To Opening Stock		5,000	By Sales	50,000	
To Purchases	35,000		*Less:* Returns	2,000	48,000
Less: Returns	1,000	34,000	By Closing Stock		20,000
To Carriage Inwards		500			
To Wages		3,000			
To Factory Rent		200			
To Gross Profit c/d		25,300			
		68,000			**68,000**
To Salaries		2,000	By Gross Profit c/d		25,300
To Carriage Outwards		500	By Discount		600
To Office Rent	500				
Add: Outstanding	400	900			
To Insurance	500				
Less: Prepaid	200	300			
To Discount		300			
To Bad Debts		400			
To Commission		300			
To Interest on Capital		1,500			
To Depreciation on:					
Furniture	200				
Plant & Machinery	1,200	1,400			
To Net Profit		18,300			
		25,900			**25,900**

NOTES

Balance Sheet for the year ended 31st Dec. 2003

Liabilities		₹	*Assets*		₹
Bills Payable		2,000	Cash in hand		200
Outstanding Rent		400	Insurance prepaid		200
Creditors		6,000	Bank balance		600
Capital	30,000		Bills Receivable		6,000
Add: Interest	1,500		Debtors		8,000
Add: Net Profit	18,300		Furniture	2,000	
	49,800		*Less:* Depriciation	200	1,800
Less: Drawing	2,600	47,200	Buildings		8,000
			Plant & Machinery	12,000	
			Less: Depriciation	1,200	10,800
			Stock (on 31 dec.03)		20,000
		55,600			**55,600**

Illustration - 3

From the following Trial Balance of Sri. Manoj, prepare Trading and Profit & Loss Account for the year ended 31-12-2005 and Balance Sheet as on that date

Trial Balance

Particulars	*Debit*	*Credit*
Capital	—	20,000
Drawings	5,000	—
Machinery	20,000	—
Furniture	5,000	—
Debtors	16,000	—
Creditors	—	35,000
Insurance	3,000	—
Salaries	5,000	—
Land and Buildings	15,000	—
Stock on 1-1-2005	7,000	—
Purchases	30,000	—
Sales	—	50,000
Discount Received	—	1,000
Rent	2,000	—
Bills Payable		5,000
Cash in hand	5,000	—
Bank Overdraft	—	2,000
Total	**1,13,000**	**1,13,000**

Adjustments:

a) Closing Stock- Rs. 8,000

NOTES

b) Insurance Prepaid - Rs. 500
c) Rent Outstanding - Rs. 1,000
d) Reserve for doubtful debts at 5% on debtors
e) Depreciate Land and Building at 10%

Solution:

Trading and Profit & Loss Account of M/s Manoj as on 31-12-2005

Dr. **Cr.**

Particulars		***Amount***	***Particulars***	***Amount***
To Opening Stock		7,000	By Sales	50,000
To Purchases		30,000	By Closing Stock	8,000
To Gross Profit c/d		21,000		
(Transferred to Profit & Loss A/c)				
		58,000		**58,000**
To Salaries		5,000	By Gross Profit b/d	21,000
To Reserve for doubt full debts		800		
To Insurance	3,000		By Discount Received	1,000
Less: Prepaid Insurance	500	2,500		
To Rent	2,000			
Add: Outstanding rent	1,000	3,000		
To Depreciation on Land & Building		1,500		
To Net Profit		9,200		
(Transferred to Balance Sheet)				
		22,000		**22,000**

Balance Sheet as on 31-12-2005

Liabilities		**₹**	***Assets***		**₹**
Capital	20,000		Land & Building	15,000	
Add: Net Profit	9,200		*Less:* Depreciation	1,500	13,500
	29,200		Machinery		20,000
Less: Drawings	5,000	24,200	Furnitures		5,000
Creditors		35,000	Debtors	16,000	
			Less: RDD	800	15,200
Bills Payable		5,000	Prepaid Insurance		500
Outstanding Rent		1,000	Closing Stock		8,000
Bank Overdraft		2,000	Cash in hand		5,000
		67,200			**67,200**

NOTES

Illustration - 4

From the following information of Chandrashekar, prepare Final Accounts for the year 31st March 2006.

Particulars	₹	*Particulars*	₹
Drawings	4,500	Trade expenses	300
Purchases	20,000	Printing	150
Returns Inwards	1,500	Furniture	2,000
Stock (1-4-2005)	8,000	Machinery	5,000
Salaries	4,200	Bad debts	400
Wages	1,200	Discounts	700
Rent	350	Sundry Debtors	14,000
Cash in hand	260	Insurance	400
Cash at Bank	5,940	Sales	30,500
Capital	24,000	Discounts	1,900
Sundry Creditors	10,000	Bills payable	2,500

Adjustment:

a) Closing stock ₹ 7,000

b) Insurance prepaid ₹ 60

c) Outstanding liabilities: salaries ₹ 200, wages ₹ 200

d) Make provision for doubtful debts at 5% on debtors

e) Calculate interest on capital at 5% p.a.

f) Depreciate Machinery at 5% and Furniture at 10%

g) Reserve for discount on creditors at 1%.

Solution:

Trading and Profit & Loss Account of Chandrashekar
for the year ended 31st Mar. 2006

Particulars		₹	*Particulars*		₹
To Opening Stock		8,000	By Sales	30,500	
To Purchases		20,000	*Less:* RIW	1,500	29,000
To Wages	1,200		By Closing stock		7,000
Add: O/s wages	200	1,400			
To Gross profit c/d		6,600			
		36,000			36,000
To Salaries	4,200		By Gross profit b/d		6,600
Add: O/s salaries	200	4,400	By Discount		1,900
To Rent		350	By Reserve for Dist. on creditors		100
To Insurance	400		By Net loss (transferred to capital)		390
Less: Prepaid	60	340			
To Trade expenses		300			
To Printing		150			
To Discount		700			
To Interest on capital		1,200			

To Depreciation on				
a) Machinery		250		
b) Furniture		200		
To Bad debts	400			
Add: Provision for DD	700	1,100		
		8,990		**8,990**

Chandrashekar's Balance Sheet as on 31st March 2006

Liabilities		₹	***Assets***		₹
Sundry creditors	10,000		Land & Building		260
Less Reserve for Dist.	100	9,900	Cash at bank		5,940
Bills payable		2,500	Sundry debtors	14,000	
O/s expenses:			*Less:* Provision for DD	700	13,300
Salary	200				
Wages	200	400	Closing stock		7,000
Capital	24,000		Prepaid insurance		60
Add: Int. on capital	1,200		Machinery	5,000	
	25,200		*Less:* Dept.	250	
Less: Net loss	390				4750
	24,810		Furniture	2,000	
Less: Drawings	4,500	20,310	*Less:* Dept.	200	1,800
		33,110			**33,110**

Illustration - 5

Prepare final accounts from the following. Trial Balance and other adjustments.

Particulars	***Dr.***	***Cr.***
Machinery	78,000	
Furniture	2,000	
Capital	-	1,00,000
Purchases and Sales	60,000	1,27,000
Return	1,000	750
Stock	30,000	-
Discount	425	800
Debtors and Creditors	45,000	25,000
Salaries	7,550	
Wages	10,000	
Carriage outwards	1,200	
Provision for bad debts	-	525
Rent	10,000	

NOTES

Advertisement	2,000	
Cash	6,900	
	2,54,075	**2,54,075**

Adjustments:

1) Closing stock ₹ 34,220
2) Provision for bad debts is to be kept at ₹ 500
3) Allow interest on capital at 10% p.a.
4) Depreciate machinery by 10% and furniture by 5%
5) Outstanding salary ₹ 550

Solution:

Trading and P & L A/c for year ended.....

Particulars		₹	*Particulars*		₹
To Opening Stock		30,000	By Sales	1,27,000	
To Purchases	60,000		*Less:* Return	1,000	1,26,000
Less: Returns	750	59,250	By Closing stock		34,220
To Wages		10,000			
To Gross profit c/d		60,970			
		1,60,220			**1,60,220**
To Salaries	7,550		By Gross profit		60,970
Add: Outstanding	550	8,100	By Discount		800
To Discount		425	By Excess provision for		
To Carriage		1,200	doubtful debt		25
To Rent		10,000			
To Advertisement		2,000			
To Int. on capital		10,000			
To Depn. on machinery		7,800			
To Depn. on furniture		100			
To Net profit					
		61,795			**61,795**

Balance Sheet.....

Liabilities		*Amount*	*Assets*	*Amount*
Creditors		25,000	Machinery (78,000-7,800)	70,200
Capital	1,00,000		Furniture (2,000-100)	1,900
*Add:*Int on cap.	10,000		Debtors (45,000-500)	44,500
*Add:*Net profit	22,170	1,32,170	Cash	6,900
Outstanding Salary		550	Closing stock	34,220
		1,57,720		**1,57,720**

Illustration – 6

NOTES

From the following Trial balance of Ramesh as on 31-12-2007 prepare Final accounts as on the above date:

Particulars	*Dr.(Rs.)*	*Cr.(Rs.)*
Capital Account		1,20,000
Drawings	15,000	
Bills Receivable	22,000	
Machinery	20,000	
Debtors and Creditors	60,000	58,000
Wages	39,000	
Purchase and Sales	2,52,000	3,55,000
Commission		5,500
Rent and Taxs	6,000	
Stock on 1-1-2007	90,000	
Salaries	10,500	
Travelling Expenses	2,000	
Insurance	600	
Repairs	3,400	
Bad debts	3,500	
Furniture	9,000	
Returns	5,000	2,000
Cash in hand and Bank	2,500	
	5,40,500	**5,40,500**

Adjustments:

1) Stock on hand 31-12-2007 was ₹ 1,00,000
2) Create 5% provision on debtors for doubtful debts.
3) Prepaid insurance amounted to ₹ 100
4) Wages outstanding was ₹ 1,000
5) Depreciate Machinery by 5% and Furniture by 10% p.a.

Solution:

Trading and Profit & Loss Account of Mr. Ramesh as on 31-12-2007

Dr. **Cr.**

Particulars		₹	*Particulars*		₹
To Opening Stock		90,000	By Sales	3,55,000	
To Purchase	2,52,000		*Less:* Returns	5,000	3,50,000
Less: Returns	2,000	2,50,000	By Closing Stock		1,00,000
To Wages	39,000				
Add: Outstanding	1,000	40,000			
To Gross Profit		70,000			
		4,50,000			**4,50,000**
To Salaries		10,500	By Gross Profit		70,000

To Travelling expenses		2,000	By Commission	5,500
To Repairs		3,400		
To Rent & Taxes		6,000		
To Insurance	600			
Less: Prepaid	100	500		
To Depreciation:				
Machinery	1,000			
Furniture	900	1,900		
To Bad debts	3,500			
Add: New bad debts	3,000	6,500		
To Net Profit		44,700		
		75,500		**75,500**

Balance Sheet for the year ended 31st Dec. 2007

Liabilities		*Amount*	*Assets*		*Amount*
Outstanding wages		1,000	Cash in hand & Bank		2,500
Creditors		58,000	Bills Receivable		22,000
Capital	1,20,000		Prepaid Insurance		100
Add: Net profit	44,700		Debtors	60,000	
	1,64,700		*Less:* Bad debts	3,000	57,000
Less: Drawings	15,000	1,49,700	Closing Stock		1,00,000
			Furniture	9,000	
			Less: Depreciation	900	8,100
			Machinery	20,000	
			Less: Depriciation	1,000	19,000
		2,08,700			**2,08,700**

Illustration - 7

From the following Trial Balance and other adjustment, prepare Final accounts as on 31-12-08

Particulars	*Dr.*	*Cr.*
Drawings and Capital	6,000	75,000
Purchases and Sales	2,25,000	4,20,750
Stock	45,000	—
Plant and Machinery	75,000	—
Trade expenses	10,000	—
Carriage inwards	2,500	—
Carriage outwards	1,500	—
Discount	350	—
Factory Rent	1,500	—
Insurance	700	—
Debtors and Creditors	60,000	15,000

NOTES

Office rent	3,000	—
Bad debts provision	—	200
Stationery	600	—
General expenses	2,800	—
Advertising	15,000	—
Bills Receivables and Bills Payable	3,000	2,000
Salaries	18,000	—
Wages	20,000	—
Furniture	7,500	—
Coal & Gas	1,000	—
Cash	14,500	
	5,12,950	**5,12,950**

Adjustments:

(i) Closing Stock amounted to ₹ 35000

(ii) Plant and Machinery depreciated by 10% & Furniture at 5%

(iii) Bad debts reserve to be raised to 2.5% on debtors

(iv) Outstanding Factory Rent ₹ 300 and Office Rent ₹ 600

(v) Insurance included Rs. 100 in respect of 2008.

Solution:

Trading and Profit & Loss Account for the year ended 31-12-2008

Particulars		***Amount***	***Particulars***	***Amount***
To Opening stock		45,000	By Sales	4,20,750
To Purchases		2,25,000	By Closing stock	35,000
To Carriage inwards		2,500		
To Factory Rent	1,500			
Add: Outstanding	300	1,800		
To Wages		20,000		
To Coal & Gas		1,000		
To Gross Profit c/d		1,60,450		
		4,55,750		**4,55,750**
To Salaries		18,000	By Gross Profit b/d	1,60,450
To Trade expenses		10,000		
To Carriage outwards		1500		
To Discount		350		
To Insurance	700			
Less : Prepaid	100	600		
To Office rent		3600		
To R.B.D	1,500			
Less : Old reserve	200	1,300		
To Stationery		600		

NOTES

To General expenses		2,800		
To Advertising		15,000		
To Depreciation:				
Plant & Machinery	7,500			
Furniture	375	7875		
To Net Profit		98,825		
		1,60,450		**1,60,450**

Balance Sheet for the year ended 31-12-08

Liabilities		₹	*Assets*		₹
Creditors		15,000	Cash		14,500
Bills Payable		2,000	Bills Receivable		3,000
Outstanding Rent		900	Debtors	60,000	
Capital	75,000		*Less:* R.B.D	1,500	58,500
Add: Net Profit	98,825		Prepaid insurance		100
	1,73,825		Closing Stock		35,000
Less : Drawings	6000	1,67,825	Furniture	7,500	
			Less: Depreciation	375	7,125
			Plant & Machinery	75,000	
			Less: Depreciation	7,500	67,500
		1,85,725			**1,85,725**

Illustration - 8

From the following Balances, prepare final accounts of Rajeev, on 31st Dec 2009 after considering the adjustments given below:

Particulars	*Amount*	*Particulars*	*Amount*
Capital	35,000	Taxes & Insurance	2,000
Drawings	6,000	General expenses	4,000
Furniture	2,600	Salaries	12,000
Bank loan	4,200	Commission(Dr.)	1,600
Creditors	13,800	Carriage outwards	2,000
Buildings	24,000	Discount(Dr.)	2,000
Stock on(1-1-2009)	20,000	Discount(Cr.)	2,000
Debtors	15,000	Bad debts	800
Rent received	1,000	Sales Returns	2,000
Purchases	1,12,000	Sales	1,50,000

Adjustments:

a) Stock on hand on 31-12-2009 ₹ 20,000

b) Write off depreciation: Buildings ₹ 1,000, Furniture ₹ 600

c) Make Reserve of 5% on Debtors for Bad debts.

d) Carry forward ₹ 200 for unexpired insurance.

Solution:

NOTES

Trading and Profit & Loss Account of Rajeev

Dr. as on 31st Dec, 2009 Cr.

Particulars		*Amount*	*Particulars*		*Amount*
To Opening stock		20,000	By Sales	1,50,000	
To Purchases		1,12,000	*Less:* Returns	2,000	1,48,000
To Gross Profit c/d		36,000	By Closing stock		20,000
		1,68,000			**1,68,000**
To Salaries		12,000	By Gross Profit b/d		36,000
To Commission		1,600	By Discount (Cr.)		2,000
To Taxes & Insurance	2,000		By Rent received		1,000
Less: Prepaid	200	1,800			
To General Exps		4,000			
To Carriage outwards		2,000			
To Discount(Dr.)		2,000			
To Bad debts	800				
Add: New reserve	750	1,550			
To Depreciation					
Building	1,000				
Furniture	600	1,600			
To Net Profit		12,450			
		39,000			**39,000**

Balance Sheet for the year ended 31-12-2009

Liabilities		₹	*Assets*		₹
Capital	35,000		Furniture	2,600	
Add: Net Profit	12,450		*Less:* Depreciation	600	2,000
	47,450		Buildings	24,000	
Less: Drawings	6,000	41,450	*Less:* Depreciation	1,000	23,000
Bank loan		4,200	Debtors	15,000	
Creditors		13,800	*Less:* Reserve	750	14,250
			Stock		20,000
			Prepaid Insurance		200
		59,450			**59,450**

NOTES

7.8 SUMMARY

Trading account is the outcome of Trial Balance. The debit balances of Trial Balance would represent either Assets or Losses, and the credit balances either Liabilities or Gains. Trading account is prepared to know the trading results, how much Gross Profit or Gross Loss derived in business concern for a given particular period. Opening stock consists of raw materials, work-in-progress and finished goods.

Purchase includes cash and credit purchases of all goods brought for resale during the trading period. The gross purchase will appear in the inner column of trading account. Purchase returns or return outwards deducted from purchases and the net amount will be shown on outer column of trading account.

Direct expenses include expenses incurred in purchasing the goods, bringing goods to godown and manufacturing of goods and making the goods for sale. Profit and loss account is the outcome of both trial balance and trading account.

7.9 GLOSSARY

a) Trading account: Trading account is the outcome of Trial Balance. The debit balances of Trial Balance would represent either Assets or Losses, and the credit balances either Liabilities or Gains. Trading account is prepared to know the trading results, how much Gross Profit or Gross Loss derived in business concern for a given particular period.

b) Opening Stock: Generally the closing stock of the previous year is known as the opening stock for the current year. In the cost of the newly started business there will be no opening stock. Opening stock consists of raw materials, work-in-progress and finished goods.

c) Purchases: Purchase includes cash and credit purchases of all goods brought for resale during the trading period. The gross purchase will appear in the inner column of trading account. Purchase returns or return outwards deducted from purchases and the net amount will be shown on outer column of trading account.

d) Direct Expenses: Direct expenses include expenses incurred in purchasing the goods, bringing goods to godown and manufacturing of goods and making the goods for sale.

e) Profit and loss account: Profit and loss account is the outcome of both trial balance and trading account. Profit and loss account is prepared to know the business results, how much net profit or net loss derived in the business concern for a given financial year.

NOTES

f) Balance Sheet: Balance Sheet is a statement which reflects the true position of assets and liabilities on a particular period. It is also known as financial statement.

7.10 CHECK YOUR PROGRESS

Short answer questions

1. What do you mean by final account?
2. Give the meaning of trading account.
3. What do you mean by profit and loss account?
4. What do you mean by adjustment?
5. Give the meaning of closing entry.
6. What is balance sheet?
7. What do you mean by depreciation?
8. Give the meaning of intangible assets.
9. Define Goodwill.
10. Explain outstanding expenses.
11. What is depreciation?
12. What do you mean by fictitious of assets?
13. What do you mean by prepaid expenses?

Extended answer questions

1. How are the assets and liabilities set out in balance sheets?
2. Distinguish between trading account and profit and loss account.
3. How does profit and loss account differ from a balance sheet?
4. Distinguish between capital expenditure and revenue expenditure.
5. Why is it necessary to make a provision for bad debts?
6. What are the points to be considered while preparing balance sheet?
7. State the objectives of trading account and profit & loss account.

True-false

1. Trading account is the outcome of Trial Balance.
2. Closing stock consists of raw materials, work-in-progress and finished goods.

NOTES

3. Direct expenses include expenses incurred in purchasing the goods, bringing goods to godown and manufacturing of goods and making the goods for sale.

4. Profit and loss account is the outcome of both trial balance and trading account.

5. Balance Sheet is a statement which reflects the true position of assets and liabilities on a particular period. It is also known as financial statement.

Multiple-choice

1. Trading account is the outcome of……………..

a) Journal b) Ledger

c) Trial Balance d) All the above

2. Opening stock consists of …………..

a) Raw materials b) work-in-progress

c) Finished goods d) All the above

Fill-in-the-blanks

1. Trading account is the outcome of……………...

2.consists of raw materials, work-in-progress and finished goods.

3.include expenses incurred in purchasing the goods, bringing goods to godown and manufacturing of goods and making the goods for sale.

4. Profit and loss account is the outcome of both trial balance and……………..

7.11 KEY TO CHECK YOUR ANSWER/ANSWER TO CHECK YOUR PROGRESS

1. True 2. False 3 True 4. True 5. True

1. (c) 2. (d)

1. Trial Balance 2. Opening stock 3. Direct expenses 4. Trading account

7.12 BIBLIOGRAPHY

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7.13 SUGGESTED READINGS

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2. Chandra, Prasanna, "Financial Management: Theory and Practices", Tata Mc Graw Hill, New Delhi.

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7.14 TERMINAL QUESTIONS

1. Prepare proforma of trading account, profit and loss account and balance sheet.

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2. Explain the usual adjustments in final account.

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Practical Questions

Q-1. On December 31, 2010 the following information was available from the books of Sri Mukul Rao.

Stock (01-01-2010)	1,20,000	
Purchase made during the year	2,50,000	
Sales	3,00,000	
Carriage inwards		10,000
Return inwards		20,000
Return outwards		30,000
Wages		8,000
Import duty		12,000
Stock (31-12-2010)		1,70,000
Motive power		3,000

Prepare the Trading account for the year 2005.

Q-2. From the following Trial balance of M/s Ranga & Sons co., Prepare Trading and Profit & Loss account for the year ended 31st March 2011.

Particulars	***Debit***	***Credit***
Ranga & Sons capital		62,000
Stock (01-04-2010)	23,000	
Purchases & Sales	32,000	53,700
Sales and Purchase Returns	2,000	1,500
Wages	1,800	
Land & Building	52,000	
Freight & Carriage	2,700	
Trade expenses	1,300	
Advertisement	1,500	
Interest		800
Debtors and Creditors	28,000	32,000

NOTES

Cash in hand	1,200	
Salaries	2,500	
Office expenses	2,000	
	1,50,000	**1,50,000**

Adjustments:

Stock on 31st March 2011 was valued at ₹ 30,000

Q-3. From the following particulars, prepare a Balance Sheet on 31st December 2010.

Particulars	*Amount*	*Particulars*	*Amount*
Capital	1,25,000	Closing Stock	43,000
Drawing	20,000	Net Profit	75,000
Long term loan (cr.)	2,00,000	Sundry Creditors	80,000
Machinery	75,000	Bills Receivable	15,000
Land & Building	1,56,000	Bank Overdraft	35,000
Sundry Debtor	55,000	Cash in hand	21,000
Bills Payable	10,000	Cash in Bank	50,000
Investment	90,000		

Q-4. From the following balances of Mr. Sajal Kumar prepare Trading Account, Profit & Loss Account for the year ending 31st December 2010 and Balance Sheets as on that date.

Particulars	*Amount*	*Particulars*	*Amount*
Purchases	14,000	Commission received	1,000
Sales	28,800	Debtors	5,000
Opening Stock	3,000	Salaries	4,800
Machinery	8,000	Insurance	1,200
Cash	2,000	Buildings	15,000
Creditors	1,500	Bills Payable	2,000
Wages	3,000	Furniture	500
Printing & Stationery	1,700	Interest received	800
Capital	25,000	Patents	4,000
Factory Rent	300	Bank Overdraft	3,400

Adjustments:

(i) Closing Stock ₹ 5,500

(ii) Outstanding Printing charges ₹ 300

(iii) Insurance paid in advance ₹ 200

(iv) Unpaid Wages ₹ 500

(v) Commission received in advance ₹ 100

(vi) Interest accrued but not received ₹ 200

NOTES **Q-5.** From the following Trial balance of M/s Sheema Enterprises prepare the Final Account for the year ended 31st March 2010. and the Balance Sheet as at the date.

Particulars	*Debit*	*Credit*
Land & Buildings	50,000	
Purchase	1,10,000	
Stock	40,000	
Returns	1,500	2,500
Wages	10,000	
Salaries	9,000	
Office expenses	2,400	
Carriage Inwards	1,200	
Carriage Outwards	2,000	
Discounts	750	1,200
Bad Debts	1,200	
Sales		2,05,000
Capital Account		1,30,000
Insurance	1,500	
Commission		1,500
Plant & Machinery	50,000	
Furniture & Fixtures	10,000	
Bills Receivable	20,000	
Sundry Debtors	40,000	
Sundry Creditors		25,000
Cash in hand	1,500	
Cash at bank	4,500	
Office Equipment	12,000	
Bills Payable		2,350

The following adjustments are required:

(i) Closing Stock amounted to ₹ 60,000

(ii) Outstanding Liabilities: Wages ₹ 2,000 Rent ₹ 3,000

(iii) Depreciate Land & Buildings at 5% , Plant & Machinery at 10%, Office Equipments and Furniture and Fixtures at 10%.

(iv) Raise a Bad and doubtful Debts reserve at 5% on sundry Debtor.

(v) Insurance premiums prepaid ₹ 200.

(vi) Provide Interest on Capital at 5%.

Q-6. The following is the Trial balance of Mr. Gobinda as at 30th June 2006. You are asked to pass the necessary Adjusting and Closing Entries and to prepare the Trading and Profit & Loss Account and Balance Sheet as at that date.

Particulars	*Dr.(₹)*	*Cr.(₹)*
Mr. Gobinda s Capital Account		1,08,090
Stock on 1st July 2005	46,800	
Sales and Sales Returns	8,600	2,89,600
Purchases and Purchases Returns	2,43,100	5,800
Frieght and Carriage	18,600	
Rent and Taxes	5,700	
Salaries and Wages	9,300	
Sundry Debtors	24,000	
Creditors		14,800
Bank loan at 6 %		20,000
Bank Interest	900	
Printing and Advertising	14,600	
Income from Investments		250
Cash at Bank	8,200	
Discounts Receivable		3,690
Investments	5,000	
Furniture and Fittings	1,800	
Discounts Payable	7,340	
General Expenses	3,160	
Audit Fees	500	
Insurance	800	
Travelling Expenses	2,130	
Postage and Telegrams	870	
Cash in hand	830	
Deposit with Mr. Amio at 5 %	30,000	
Drawings Account	10,000	
	4,42,230	**4,42,230**

Stock on 30th June 2006 was ₹ 78,600. 50% of Printing and Advertising is to be carried forward as a charge in the following year. Depreciate Furniture and Fittings by 10%. Create 5 % Reserve on Debtors. Reserve 2% for Discount on Debtors and Creditors. Insurance prepaid amounts to ₹ 200, Salaries outstanding ₹ 500 and Carriage outstanding ₹ 100. Charge full year's interest on deposit with Mr. Amio.

Q-7. From the following balances extracted from the books of Mr. Abbas on 30th June 2010, prepare Final Accounts after making entries in regard to the following adjustments and the closing of accounts.

NOTES

Particulars	Amount	Particulars	Amount
Stock on 1st July 2009	96,000	Returns Inwards	
Wages	28,000	Sundry Debtors	35,000
Salaries	4,000	Office Expenses	5,000
Purchases	5,000	Income Tax	500
Purchases	1,20,000	Drawings	6,500
Interest on Overdraft	200	J.Jehangir's Capital	50,000
Bills Receivable	6,000	Bills Payable	5,000
Rent	2,000	Bank Loan (Cr.)	4,000
Plant & Machinery	20,000	Sales	2,50,000
Travelling Expenses	5,000	Reserve for Bad Debts	5,000
Repairs to Plant	1,600	Discount on Purchases	4,000
Cash in hand	200	Sundry Creditors	23,300
Cash at Bank	1,800	Returns Outwards	1,500
Buildings	5,000		

Stock on 30th June 2010 was ₹ 35,000. Write of ₹ 3,000 Bad Debts and maintain a Reserve of 5% on Debtors. Depreciate Plant and Machinery by 10%. Allow interest on Capital at 5% per annum. Wages and Salaries are unpaid to the extent of ₹ 1,500 and ₹ 450. Rent at ₹ 200 per month for the last two months is unpaid.

Q-8. From the following balance of Mrs. Shantibala prepare Trading and Profit & Loss Account and Balance Sheet as at 31st December 2010

Particulars	Amount	Particulars	Amount
Shantibala's Capital	20,500	Cash in hand	55
Creditors	15,000	Drawings	2,500
Creditor- expenses	3,400	Purchases	85,500
Rent Received	300	Carriage Inwards	750
Purchases Returns	2,000	Wages (Manufacturing)	11,500
Sales	1,44,800	Power	4,500
Bad debts reserve (1 Jan. 2010)	300	Rent and Insurance	9,950
Advertising developments	4,000	Salaries and Wages	17,200
Goodwill	2,500	Discount Received	900
Plant and Machinery	10,000	General charges	4,500
Travellers Samples	1,350	Sales Returns	300
Stock on (1st January 2010)	16,000	Travellers Commission	1,445
Debtors	7,500	Travellers Salaries	4,550
Cash at Bank	1,000	Discounts allowed	2,500

The Closing Stock was ₹ 11,500, but there has been a loss by fire on December 20th 2010, to the extent of ₹ 10,000, not covered by Insurance. Depreciate Plant and Machinery by 10%

and Travellers samples by 2.5% increase the Bad debts Reserve to ₹ 1,000. Write 50% off advertising Development Account. Annual premium on insurance expiring 1st March 2010 was ₹ 600

NOTES

Q-9. From the following Trial balance of Mr. Apurba prepare Trading and Profit & Loss Account (after passing the required adjusting and closing entries), for the year ended 31st December 2010 and a Balance Sheet as on that date

Trial Balance

Debits	***Amount***	***Credits***	***Amount***
Plant and Machinery	19,000	Apurba's Capital Account	80,000
Manufacturing Wages	34,000	Sundry Creditors	67,700
Salaries	15,000	Bank Loan	10,000
Fixtures and Fittings	9,000	Purchases Returns	1,000
Carriage inwards	1,000	Sales	2,46,000
Carriage outwards	2,000	Reserve for Bad & Doubtful Debts	2,000
Freehold works	25,000		
Manufacturing expenses	9,000		
Insurance and Taxes	4,000		
Goodwill	50,000		
General expenses	8,000		
Factory Fuel & Power	1,000		
Sundry Debtors	78,000		
Lighting - Factory	900		
Stable Expenses for distribution	2,000		
Stock, (1st January 2010)	34,000		
Horses and Carts	5,000		
Purchases	97,000		
Sales Returns	3,000		
Discount	900		
Bad debts	1,000		
Interest on Bank	400		
Cash at Bank	7,000		
Cash in hand	500		
	4,06,700		**4,06,700**

Adjustments:

(i) Stock on 31st December 2010 was ₹ 29,000

(ii) Depreciation: - Plant and Machinery, 10 % Fixtures and Fittings, 5 %; Horses and Carts, ₹ 1,000

(iii) Bring reserve for Bad and doubtful debts to 5 %.

NOTES

(iv) Unexpected insurance ₹ 300 and Taxes ₹ 200

(v) A commission of 1% on the Gross Profit to be provided for works Manager.

(vi) A Commission of 5 % on Net Profit (after charging the works Manager commission) to be credited to the General Manager.

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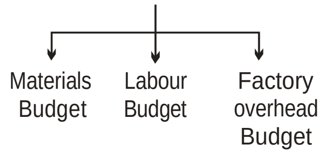
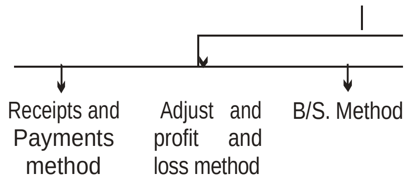


budget



1. On the basis of Time

(a) ***Long–term budgets:*** These budgets are prepared for long–term planning of the business which varies between 5 to 10 years. It is done by the top level management, which is generally not known to lower levels of management. *Example:* Capital expenditure, R & D, Long-term finance etc.

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12-B Status from UGC

Programme Name- MBA
Semester-I

Course Name-Accounting for Managers

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