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ಮುಕ್ತಗಂಗೋತ್ರಿ, ಮೈಸೂರು – ೫೭೦ ೦೦೬

KARNATAKA STATE OPEN UNIVERSITY
Mukthagangothri, Mysuru - 570 006

B.COM PROGRAMME
I-YEAR

COURSE - 3

1 - 3 BLOCKS

FINANCIAL ACCOUNTING - 1

VOLUME - 1

DEPARTMENT OF STUDIES AND RESEARCH IN COMMERCE

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I B.Com
Course - III
FINANCIAL ACCOUNTING-1

Department of Studies in Commerce

BLOCK - 1 INTRODUCTION TO FINANCIAL ACCOUNTING

BLOCK - 2 ACCOUNTING PROCESS

BLOCK - 3 PREPARATION OF FINAL ACCOUNTS AND RECTIFICATION OF ERRORS

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BLOCK - 1

BLOCK INTRODUCTION

This block emphasises on the fundamental understanding of Accounting objectives, systems, Concepts, Conventions and Various Indian Accounting Standards. This block acquaints you to the initial Journey of recording business transactions in the books of accounts.

This block consists of four units:

Unit -1: Introduction to Accounting

Unit -2: Accounting Concepts and Conventions.

Unit-3: Accounting Terms

Unit-4: Indian Accounting Standards

UNIT –1

INTRODUCTION TO ACCOUNTING

Structure:

1.0 OBJECTIVES

After studying this unit, you should be able to;

- Explain the meaning of Accounting.
- Discuss the importance of Accounting.
- Highlight the objectives of Accounting.
- Bring out the significance of Accounting.
- Give an account of Book keeping.
- Distinguish between Book keeping and Accounting.
- List out various Accounting Systems.

1.1 INTRODUCTION

Accounting is the language of business. It is a standard set of rules meaning a firm's financial performance. Assessing a company's financial performance is important for many groups including.

- Firm Officers.
- Investors.
- Lenders.
- General public

Standard financial statements serve as a yardstick of communicating financial performance to the general public.

1.2 MEANING AND DEFINITIONS OF ACCOUNTING

'Language is a means of communication' is a good old saying. Every human being wants to convey his feelings, emotions, anger, etc, through his own language. Similarly, business as a separate entity wants to express its result of operations, the financial position, etc, through its own language. As such accounting can be simply called the language of business. The very purpose of accounting is to communicate the results of business operations and other aspects. Thus, accounting enables the business to speak, to express, to compare and to realize itself.

After knowing the meaning of accounting, let us try to understand the various definitions of accounting. **The American Institute of Certified Public Accountants** 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 a financial character, and interpreting the results thereof". As per this definition, the various functions of accounting are - recording of transactions, classifying, summarizing, analysis and interpretation.

The American Accounting Association commonly denoted as "AAA" in 1966 defined accounting as "the process of identifying, measuring and communicating economic information to permit informed judgments and decisions by the users of information". According to this definition, accounting is a system which collects and processes financial information of an organization and reports the same to the users, enabling them to make right decisions.

1.3 NEED FOR ACCOUNTING

Now, let us know why accounting is necessary. Always the need for accounting stems from the fact of its importance. Take an example of a small trader, everyday he has to purchase the goods, sell them for cash or credit, pay electricity charges, phone bills, pay rent etc,. All these transactions cannot be remembered by the small trader. If this is the situation for a small businessman, imagine large organizations like partnership firms, joint stock companies where trading is more complex. Hence, accounting serves the purpose of all business organizations to identify these business transactions, record them in a systematic manner, classify the accounts, present them in a suitable form for further analysis and interpretation of the results. Further, the proprietor of the business can know the results and the financial position of his business.

1.4 SCOPE OF ACCOUNTING

The scope of accounting explains clearly the area covered by accounting. It includes data creation, data collection, data evaluation and data reporting.

a) Data creation: Primarily the transactions related to the business have to be identified. It refers to the inputs for accounting i.e., the raw materials required for the accounting process.

b) Data collection: The data collection for accounting is basically historic in nature i.e., it refers to the events which has already taken place. The data collected is to be recorded, classified and processed according to the principles of accounting.

c) Data evaluation: It is regarded as the most important activity in accounting during these days. The data has to be evaluated for controlling the activities of the business through various techniques like preparation of budgets, fixing standards for every activity etc. Further, the data is analyzed and interpreted either for internal use or external use.

d) Data reporting: The data reporting consists of two parts – external reporting and internal reporting. External reporting refers to the communication about the business to shareholders, government agencies and other outside parties. Internal reporting is concerned with the communication of results to management for decision making purposes.

1.5 IMPORTANCE OF ACCOUNTING

As already stated in the need for accounting, the importance of accounting depends upon its necessity. Accounting is not only important to the proprietor of the business; its importance is felt by all other parties concerned in the organization.

The main objective of any business is to earn profit. This is revealed only through an accounting system. The proprietor can know the profit earned or loss incurred through accounting. He can also know the financial position of the business.

Creditors and Banks, who have extended credit to the business, can know the position of the business. They can find out the capacity of the business to repay the interest and principal.

Employees, who are interested in the welfare of the business, can know whether the business has earned sufficient profit to get bonus.

Government is also interested in the accounting system to know the profitability of the organization for tax purposes.

1.6 OBJECTIVES OF ACCOUNTING

Let us now study for what purpose the accounting system has to be installed in an organization. The following are the main objectives of accounting:

a) To keep systematic records of financial transactions of the business.

b) To protect business properties from unjustified and unwarranted use.

c) To ascertain the profit earned or loss incurred on account of carrying the busi ness.

d) To ascertain the financial position of the business.

e) To facilitate rational decision making.

1.7 BOOK KEEPING

Book keeping is as old as money. It existed even in ancient times. Let us take the example of a tree. It has three main parts namely – the root, the stem and the branches. Book keeping is the root, accounting is the stem and the branches are financial accounting, cost accounting, management accounting, government accounting, human resources accounting, social responsibility accounting, tax accounting, environment accounting, and inflation accounting.etc.

Book keeping is defined as follows:

"Book-keeping is the art of recording business transactions in a systematic manner".

"Book-keeping may be defined as the science as well as the art of recording business transactions under appropriate accounts".

The above definitions clearly explain that the main objective of book-keeping is to record the business transactions in a set of books of accounts.

Thus, book-keeping is the primary foundation of accounting. Its function is limited to the recording of business transaction. As such, there are many differences between book-keeping and accounting.

1.8 BOOK KEEPING V/S ACCOUNTING

There may be certain similarities between book-keeping and accounting in the areas of identifying business transactions, recording these transactions in the books of accounts and maintenance of accounts. But there are lot of differences between these two in the following aspects:-

Basis of difference	Book-Keeping	Accounting
Stage	Book keeping is a primary stage	Accounting is a secondary stage. It begins where book keeping ends
Nature of Job	The job of book keeping is routine and clerical in nature.	The job of accounting is analytical in nature
Objective	To record transactions in orderly and systematic manner	To determine profit / loss & financial position of the business.
Knowledge and ability	It does not require special knowledge and ability. This work is done by machines.	It requires special knowledge and ability.
Postings	To make posting in the ledger and find balances only.	To examine this posting in order to find out accuracy and the preparation of trial balance.
Final accounts	Preparation of final accounts like trading, profit/loss account and balance sheet is not book keeping	Preparation of final accounts like trading, profit/loss account and balance sheet is included in accounting.
Liability	A book keeper is not liable for accountancy work.	An accountant is liable for the work of book keeper.

Source: R.G.Williams

1.9 ACCOUNTING SYSTEMS

The basic objective of accounting is to provide information which is useful for persons inside the organization and for persons or groups outside the organization. Therefore **accounting is popularly known as an information system.** The most popular way of classifying the systems of accounting are:

a) Single entry system

b) Double entry system.

A single entry system is one, under which a complete record of each and every transaction is not kept. For most of the transactions, only one aspect is recorded. Hence it is called single entry system. It is also known as crude method of recording business transactions. Details of this system of accounting can be studied under unit-4 of Block V.

A double entry system is one, under which a complete record of each and every transaction is kept. For every transaction both the aspects are recorded. Hence it is called Double entry system. It is the most scientific system of accounting developed by Luca Paciolo in the year 1494. It is based on the principle "for every debit there is a corresponding credit". Details of this system of accounting can be studied in unit-3 of this Block.

Another way of classifying the systems of accounting is:

a) Cash system of Accounting.

b) Mercantile system of accounting

c) Mixed or Hybrid system of accounting.

All business transactions ultimately result into realization of revenue or incurring of expenses. The above systems of accounting throw light upon how revenues and expenses are to be recognized. They are also known as Bases of Accounting or Approaches to Accounting.

1.10 CASH SYSTEM

Under cash system of accounting only actual cash receipts and actual cash payments are recorded. Credit transactions are not recorded at all. They are ignored until the cash is actually received or paid. Income or profit will be the difference between the cash receipts, Club,School,Colleges ,etc. prepare the Receipts and Payments Account. Similarly professionals like lawyers, doctors, chartered accountants, etc, maintain accounts under cash basis.

Merits:

a) This system of accounting is simple and appears to be realistic.

b) This system is more objective because only few judgments are required.

c) This is most suitable for those organizations where majority of transactions are on cash basis.

Demerits:

a) It does not give a true and fair view of profit/loss and financial position of the business.

b) It does not follow the matching principle of accounting.

c) It does not distinguish between capital and revenue items.

1.11 MERCANTILE SYSTEM

Under mercantile system of accounting, all the demerits of cash system of accounting are overcome. This system is popularly known as Accrual basis of accounting. It differentiates between receipts and income, payments and expenses. According to this system, all receipts are not income and all income are not receipts. Similarly, all payments are not expenses and all expenses are not payments. It considers both cash and credit transactions for revenue recognition. It also distinguishes between capital and revenue items. This system follows two accounting principles namely the revenue recognition principle and the matching principle.

According to revenue recognition principle the revenue of any business includes amount received during the period and also the amount receivable during the period. It is generally known as revenue outstanding or revenue accrued.

According to the matching principle the revenue of the business is matched with the expenses of the period. After understanding the meaning of the revenue recognition and the matching principle, let us get acquainted with the following accounting equations:

Income = Revenue receipts during the period – amount received for the last year - amount received for the next year + amount receivable for the period + amount received in the last year for the current year.

Expense = Revenue payments during the period – amount paid for the last year – amount paid for the next year + amount payable for the period + amount paid in the last year for the current year.

Merits:

a) It is more scientific compared to cash basis of accounting.

b) It gives a complete picture of the financial transactions because it considers all outstanding expenses, outstanding income, prepaid expenses and income received in advance.

c) It discloses correct profit/loss position and shows true and fair view of the financial position of the business.

Demerits:

b) This basis of accounting is too elaborate.

c) Calculation of profit/ loss involves lot of adjustments and is not suitable for professionals.

1.12 LET US SUM UP

Accounting and book keeping will play an important role for recording, classifying and summarising in a significant manner that is useful for preparing final accounts of any organization or company.

1.13 KEY WORDS

Double Entry - Complete record of each and every transaction is kept

Expenses - Revenue payment during the period

Income - Revenue reciept during the period

Single Entry - Complete record of each and every transaction is not kept

1.14 TERMINAL QUESTIONS

a) Define Accounting.

b) Define book-keeping.

c) Differentiate between book-keeping and accounting.

d) State the need for accounting.

e) Write a note on scope and importance of Accounting.

f) Distinguish between cash system and mercantile system of accounting.

1.15 REFERENCE

Accountancy – Volume 1	-	B.S.Raman.
Principles and Practice of Accounting	-	Patil and Korlahali.
Advanced Accounting	-	Shukla and Grewal.
Advanced Accounting	-	R.L.Gupta and Radhaswamy.
Introduction to Accountancy	-	S.N.Maheswari.

UNIT – 2

ACCOUNTING CONCEPTS AND CONVENTIONS

Structure

2.0 OBJECTIVES

After studying this unit you should be able to:

- Explain the Accounting Concepts.
- Discuss Different Accounting Conventions.
- State the Significance of Accounting concepts.

2.1 INTRODUCTION

Any activity we perform is facilitated, if we have a set of rules to guide our efforts. Take the example of driving a vehicle. The traffic rule says we have to drive the vehicle keeping to the left. If this rule was not there, then imagine the situation on the road. In order to convey the same meaning to the users of accounting information, accountants all over the world have developed certain rules, procedures and conventions. These rules and regulations have to be strictly followed by all accountants in recording, classifying, summarizing, analyzing, interpreting and presentation of accounting information. They are called Accounting Principles. The term "principle" refers to fundamental belief or general truth which once established does not change. These principles have become guidelines to establish standards for sound accounting practices and procedures in reporting the financial position and the results of the business organization.

Further, Accounting Principles can be classified into two categories:

(i) Accounting Concepts.

(ii) Accounting Conventions.

2.2 ACCOUNTING CONCEPTS

A concept is a self-evident proposition i.e., something taken for granted. Since they are general notions they are called concepts. Concepts are also termed as ground rules that govern accounting. Accounting concepts can be considered as basic assumptions or conditions upon which the science of accounting is based. These assumptions are most natural and are not forced ones. These concepts are mainly concerned with the maintenance of accounts.

a) Periodicity Concept:

Every business activity has a unique duration. Some business activity may end in a very short period of time, whereas others have a long duration. This concept insists that irrespective of the longevity of the business, the results and the financial position of the business should be reported at regular intervals of time. Further, this concept explains that every business activity should prepare their final accounts at a regular period of time, i.e., usually once in a year.

If the accounting period adopted is one year, it helps to take any corrective measure, to pay income tax, to absorb the seasonal fluctuations and for reporting to the outsiders. Most of the business activity follows a common financial year from 1st April to 31st march of the next year. This will help the proprietor to know the profit/loss and the financial position of the business every year. It not only helps him to compare the performance of his business from one period to another period, but also to compare his business performance with other similar businesses for the same period.

The principle of separating capital expenditure from revenue expenditure is based on the accounting period concept. All revenue expenditure for a particular period is transferred to the profit and loss account. All capital expenditure is carried forward to the extent its benefit will be utilized in future accounting periods and are termed as assets.

b) Dual Aspect Concept:

This is the fundamental concept of Accounting. According to this concept, every financial transaction has a two-fold aspect. Double entry system of accounting has been evolved based on this concept only. For every debit there is a corresponding credit. It clearly explains that every transaction involves a two way aspect. i.e., if there is a giver, there will be a receiver. The receiving account is termed as debtor and the given account is called creditor. Similarly, if anybody loses something, there will be always someone who is benefitted. For example, if the business purchases any asset, either it has to forego its cash balance or the liability to pay in future increases.

The statement of financial position is based on the dual aspect concept. All assets represent the resources owned by the business. All liabilities represent the amount payable by the business to different parties including the proprietor. Thus dual aspect concept is the foundation for the modern system of accounting.

c) Money Measurement Concept:

According to this concept only those transactions which can be measured in terms of money can be included in the books of accounts. This is because money is the only unit of measurement which is acceptable in all business activity. It is the only practical unit of measurement which can be employed to achieve similarity in the financial data. There are many units of measurement we come across in the quantitative data like production in tons, sales in quintals, assets in numbers. Etc.,. But these units of measurements cannot be used in financial data to bring similarity.

Take for example a business organization has Rs 20000 cash balance, 30 chairs, 20 tables, 2000 Sq metres of Buildings, 6 acres of land, 10 machineries. In order to compute the total assets of the business, all these individual assets has to be converted into a common unit of measurement i.e., money. Suppose these values are restated as cash balance Rs 20000, furniture Rs 50000, Buildings Rs 200000, Land Rs 500000 and machineries Rs 400000, then the total assets of the business will be 20000 + 50000 + 200000 + 500000 + 400000 = 1170000.

This concept never entertains qualitative data which cannot be measured in terms of money. Take for example; sales of the business may increase due to the efficiency of the sales manager but it cannot be accounted. Similarly the skill of the worker, intelligence of the supervisor cannot find place in the books of accounts.

This concept is criticized on two important grounds. They are:

1) It restricts the scope of the accounting because it never records transactions which are not expressed in monetary terms.
2) It does not take into account the effect of Inflation because it assumes the money value to be constant.

d) Realisation Concept:

According to this concept the recording of the transaction can be made only when there is a realisation. The term realisation does not mean the money should be realized from the sale of goods or assets. It refers to the completion of the event or the transaction. This concept is based on the assumption that profit cannot be made without realisation of sale proceeds. There is a good old saying "nothing can be said until the goods are sold". Take for example a business organization receives an order for supply of goods on 1st April. It purchases Raw materials on 15th April and produces the finished goods on 30th April. It delivers the goods on 15th May and receives the money on 31st may. According to this concept, the sale of goods has to be entered not on 1st April or 31st May. It has to be recorded only on 15th May. Thus the whole of Accountancy is based on realisation concept. This is because all efforts in the business are directed towards utmost realisation.

e) Business Entity Concept:

According to this concept, business unit is separate and distinct from the person or proprietor who runs the business. Every business has a unique identity irrespective of the form of organization. The affairs and activities of the business are separately recorded in the books of accounts. The activities and the transactions related to the proprietor are not mixed with the activities of the business. Take for example, the capital introduced by the proprietor is considered as a liability in the business because the business has to repay this amount of capital after the business is closed. Similarly, all transactions related to the proprietor like life insurance premium paid, Income tax paid, goods taken for personal use, cash withdrawn for personal use are considered as drawings and deducted from the capital introduced.

As per this concept, all the books of accounts are maintained in the name of the business, but not in the name of the proprietor. Business as a separate entity can enter into agreement with others and others can also enter into an agreement with the business.

f) Cost Concept:

According to this concept an asset is recorded in the books of account at the price paid for it. The price paid for acquiring the asset is called the cost price. Thus a cost price means the total expenses incurred to purchase the asset. It includes the purchase price and all expenses incurred to make the asset in a workable condition. Literally, the term "cost" means all expenses incurred in manufacturing of a product or rendering of a service.

Take for example, a business unit purchases furniture for Rs 29000 and pays carriage of Rs 1000. Then the furniture is recorded in the books of accounts at a total cost price of Rs 29000 +1000 = 30000. Further, the value of furniture goes on reducing every year with the amount of depreciation charged by the business unit.

Market value of the asset is not considered while recording an asset because it goes on changing. Take for example the value of land and buildings; even though the market price is always more than the cost price, this asset is recorded only at cost price. There will be lot of ups and downs in the market price of an asset. This will not only affect the earnings of the business but also the financial statements do not show a true and fair view of the business affairs.

Thus cost concept brings objectivity in the accounts. It is not influenced with the biased opinion about the assets. It brings uniformity in comparison of the financial position. It is criticized by many accountants on the following two grounds:

a) It does not consider the inflationary tendencies.

b) Assets are used and are in workable condition even after they are fully depreciated.

g) Going Concern Concept:

According to this concept, it is assumed that every business unit that is established shall carry on their activities for a longer period of time. This concept clearly explains the life of the business organization. No business wants to close down their activities in a short period of time. A business unit is deemed to be a going concern but not a gone concern. It is assumed that the business will run for an indefinite period of time. As such the financial transactions are recorded in the books of accounts based on this concept.

Take for example, the purchase of machinery is considered to be a capital expenditure and it is treated as an asset in the balance sheet. The main assumption behind it is the machinery is used for several years for the production of goods and therefore the benefits derived from this asset is spread over a number of years as long as the business is in existence.

Similarly, prepaid expenses is treated as an asset even though it is not saleable, because it is assumed that the business unit will continue in future and the benefit of this expense is utilized in future.

Further the cost concept discussed in the previous part is based on the going concern concept. Market value of the assets or realizable value of the assets is not considered because the business will continue in future and the assets are not immediately sold. The cost concept suffers from certain limitations:

a) It is not valid in case the business enterprise has a shorter life.

b) When an organization is declared as a sick unit.

c) When the organization is wound up/dissolved/liquidated.

h) Accounting Equivalence Concept:

This concept is the foundation for the principles of double entry system. That is for every debit there is a corresponding credit. The assumption of this concept is that the owner provides funds for the purchase of assets; As such the assets of any business should be equal to the funds provided by the proprietor, which is generally termed as equity. Further, if the owners' contribution to the assets is not sufficient, then the assets may be acquired with the borrowed funds. As such at any point of time the following accounting equation is stated:

Assets = Equity + liabilities.

This concept has given birth to many accounting equations. To name a few:

Capital = Assets – liabilities.

Capital employed = Fixed assets + working capital

Working capital = current assets –current liabilities.

i) Objective Evidence Concept:

This concept is for the validity of the financial transactions recorded in the books of accounts. Every transaction entered in the books of accounts should be supported with some evidence. For example, any purchase of goods should have vouchers and invoices. Any sale of goods should have a copy of the orders received from the customer along with vouchers. Physical verification of the stock report should be the basis for recording the value of the stock. Statement of bank account should be taken as the basis for recording the cash at bank balance. The word "objectivity" denotes reliability, trustworthiness and verifiability. This will definitely ensure that the transactions recorded are based on the facts. It will not give any room for suspicion among the users of accounting information. Further, this will ensure the smooth working of the auditing also.

Certain transactions, for which the evidence cannot be produced, are based on the judgements of the business enterprise. These judgements are further based on the past experiences of the business enterprise. For example the provision for doubtful debts, depends upon the past experience of the business.

j) Matching Concept:

This concept is directly based on the periodicity concept discussed earlier. According to the periodicity concept, the financial statements has to be prepared at regular intervals of time, usually once in a year, to know the results and the financial position of the business.

In order to know the results of the business, i.e., profit/loss earned during a particular period, the revenues relating to that period has to be matched with the costs/expenses incurred to earn that revenue. This is called Matching concept. The difference between the revenue/income and the costs/expenses will be the profit/loss earned during that period. It can be explained clearly as follows:

Profit = Revenue/Income – Costs/Expenses.

Loss = Costs/Expenses – Revenue/Income.

Recognition of the revenue for that particular period is really a difficult task. All incomes whether received or not, but related to that particular period should be considered as a revenue. Similarly all expenses whether paid or not, but related to a particular period should be considered as the expenses for that period. Then only the results of the business show a true and fair view of the business operations. There are certain expenses like preliminary expenses, advertisement expenses; etc which is considered as deferred revenue expenses, the benefit is spread over a number of years. Such expenses are not completely charged during that particular period. They are spread over for a number of years.

k) Accrual Concept:

This concept differentiates between payments and expenses on one side, and receipts and income on the other side. The word **Accrual** means items relating to that particular period, whether received or not, whether paid or not. In order to ascertain the true profit or loss earned during that period, all revenue incomes related to that particular period should be compared with all revenue expenses to that particular period. The essence of this accrual concept is that revenue is recognized when it is realized, irrespective of whether the cash is received or not. Similarly, the expenses are recognized in the financial year in which they help in earning the revenue, whether cash is paid or not. On account of this concept, items like outstanding expenses, prepaid expenses, accrued income, income received in advance are considered in the preparation of the financial statements.

Further, this concept has helped the business enterprises to show a correct picture of profit/ loss earned during a particular period and a true financial position of the business.

l) Capital Concept:

The assumption of this concept is that the capital contributed by the proprietor must be recorded separately. Capital is the foundation of any business. The reward for the capital is the profit, as stated in the economic theory. The proprietor of the business may contribute the capital either in cash or in the form of other assets (goods, furniture, buildings, etc.). Sometimes he may contribute partly in cash and partly in the form of other assets.

Further, in case of a sole trading concern, partnership firm, the profit earned during the year is added back to the capital contributed by the proprietor /partner. It may be difficult to calculate the profit earning capacity of the business. In case of limited companies the profit of the company is kept separately. This concept helps to calculate Return on equity or Return on Investment.

2.3 ACCOUNTING CONVENTIONS

The term "conventions" refers to the customs or traditions. Just like we follow certain customs/traditions at the time of birth, marriage and death of an individual, Accountancy is also based on usages and customs which are in practice since long time. They guide the accountant while preparing the financial statements. Conventions are also known as doctrines. These conventions are used by the accountants while preparing the financial statements.

a) Convention of Consistency:

Consistency refers to uniformity in practice. In accounting, certain policies and practices needs uniformity, otherwise the financial statements do not show a true and fair view of the financial position. Further, the profit/loss shown in the profit and loss account does not reflect the correct picture. The accounting practices should be the same for a number of years. Frequent changes in the accounting practices or policies leads to biased information in the financial statements.

Let us take an example of the depreciation of buildings. The value of the buildings is estimated to be Rs 5, 00,000. Suppose, in the first year the business depreciates the buildings by10% under straight line method. The value of the buildings at the end of the first year will be Rs 5, 00,000 – Rs 50,000 = Rs 4, 50,000. In the second year, if the business depreciates the buildings by using reducing balance method, then the value of the buildings at the end of the second year will be Rs 4,50,000 –Rs 45,000 = Rs 4,05,000. This is a situation where there is no consistency in the accounting policy regarding depreciation. This will increase the profit by Rs 5,000 with a similar increase in the value of buildings in the asset side of the Balance sheet.

Further the convention of consistency does not insist that the same accounting practices should be continued forever. These practices should be maintained at least for a certain number of years. Any change in such accounting policies should be justified in the preparation of the financial statements.

b) Convention of Full Disclosure:

During olden days people used to speak truth. Honesty was considered a greatest asset, a man can possess. The same convention was extended to the field of accounting. It refers to the disclosure of the information in the preparation of the financial statements. All types of material information must be disclosed in the financial statements so that the users of the information can form a correct opinion about the business activity.

Any concealment of material information leads to dishonesty and may indirectly assist the organization to create secret reserves. The users of the information may not be able to form a true opinion about the business activity. Immaterial information may not be disclosed in the preparation of the financial statements. Thus, full and fair information which is adequate for the users of the information to form an opinion about the organization must be disclosed.

c) Convention of Conservatism:

Conservatism is as old as human civilization. It does not mean to be orthodox. It refers to the concept of bewareness. Future is uncertain; as such one has to be very sensitive about the future. The savings habit among us is the best example of conservatism. To meet the unforeseen contingencies in future, we save and deposit the same in banks, post office, in gold or in any of the investment opportunities available.

Convention of conservatism in Accounting refers to "anticipate no profits, but provide for all possible losses". This is the practice that is followed from a long time in the preparation of financial statements. The valuation of all current assets is based on this convention. All current assets like stock, sundry debtors, bills receivable are valued at cost price or market price which-ever less is. We provide for bad and doubtful debts, discount on debtors in the preparation of profit/loss account. Similarly, we account for depreciation of assets, but never consider the appre-ciation of assets. This attitude in accounting safeguards the interest of the proprietor in general and the interest of the business in particular. Every businessman should not anticipate the future profits, because if the profits are not realized as per the expectations of the businessman it will ruin the business.

d) Convention of Materiality:

This convention is a popular convention followed all over the world. According to this convention, accounting information should represent only material facts. Facts which are immaterial should be either merged with the material facts or it should be ignored. The idea behind it is that, the users of the information should be provided with only relevant material information. Accounting data should not be overloaded with both relevant and irrelevant data which leads to confusion among the users of the information. Further the financial statements should not be inflated with immaterial information.

Let us take an example of a business having the stock of a stapler, a poker, pins, gum bottle, adhesives, broom stick etc.,. Such information is immaterial to the users of information. Thus, material information will give a relevant picture to the users of the information.

2.4 LET US SUM UP

This unit gives you the details of preparing the financial statements, and to know the accounting principles, viz, i.e, accounting concepts and conventions. It also speaks about the various concepts which are helpful in preparing the financial statements. The importance of various conventions are highlighted so as to enable you to prepare the financial statements accurately and properly.

2.5 KEY WORDS

Concepts - It is a self evident proportion, something taken for granted

Conventions - It is refers to the customs or traditions

2.6 TERMINAL QUESTIONS

1. Explain the various accounting concepts in detail
2. Disscuss the accounting conventions
3. Bringout the differences between accounting concepts and conventions
4. Write a note on
   - a) Realization concept
   - b) Accrual concept
   - c) Going concern concept
   - d) Money measurement concept

5. Write a note on

a) Convention of full disclosure

b) Convention of conservatism

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UNIT- 3

ACCOUNTING TERMS

Structure

3.0 OBJECTIVES

After studying this unit, you should be able to;

- Explain the transaction and Goods.
- Discuss the Assets and liablities.
- Give an account of capital and drawings.
- State the meaning of debtor and creditor.
- State the types of accounts dealing the books of accounts.

3.1 INTRODUCTION

After understanding the Accounting principles, Accounting concepts and Accounting conventions, let us try to understand the various terms that are used in Accounting. These terms are used only in accounting language. These terminologies help us to understand the various functions in accounting like recording, classifying, presentation, analysis and interpretation of the financial statements. These terms are the base on which Accounting Structure is built. They are the foundation in accounting, which have helped the development of financial accounting.

3.2 TRANSACTION

A transaction is an event, an activity or dealing in the business, which is expressed in monetary terms or in money's worth. Since the term transaction is always in relation to the business it is generally known as "a business transaction". Any event or an activity which takes place between the business and others or between others and the business, expressed in terms of money is called a business transaction. For example, purchase of goods, sale of goods, payment of rent, payment of salary, commission received, interest received, etc. are called business transaction.

There are certain other events in the business like placing orders, receiving invoices, selection of an employee, dismissal of the worker, etc., which cannot be considered as a business transaction. Further, business transactions can be classified as follows:

a) Cash transaction. b) Credit transaction. c) Barter transaction and d) Paper transaction.

a) Cash Transaction:

Any business transaction which involves receipt of cash or payment of cash **immediately** is called a Cash transaction. For example, purchase of goods or assets for cash, sale of goods or assets for cash, payment of salary, receipt of rent, etc.

b) Credit Transaction:

Any business transaction which does not involve receipt of cash or payment of cash immediately is called a Credit transaction. The receipt or payment is postponed to some future date. For example, purchase of goods or assets on credit, sale of goods or assets on credit, salary due, rent receivable, etc.

c) Barter Transaction:

Any business transaction which does not involve exchange of cash immediately or in the future date is called a barter transaction. There will be an exchange of some items only without involving the cash transaction. For example, exchange of old furniture for goods, giving wages to the worker in the form of goods, etc.

d) Paper Transaction:

Any business transaction which does not involve either payment of cash or receipt of cash immediately or in the future date is called a paper transaction. These transactions are generally known as non-cash transaction. They are the treatments which are made in the preparation of the financial statements, like depreciation of a fixed asset, loss due to theft, bad debts written off, etc.

3.3 GOODS

The term "goods" refers to any commodities, articles, products or things which are dealt by the business. It refers to the different items in the business, which the trader deals. In other words, all types of products, commodities, articles purchased by the trader/business for the purpose of reselling it are called goods. For example, if the Furniture dealer purchases tables, chairs, almirah, etc. it is called **Goods.** If the same tables, chairs, almirah is purchased by any business for office use it is called **Assets**. Similarly, if an electronic dealer purchases television, computer, printer etc. it is called **Goods**. If the same television, computer, printer is purchased for office use by any other business it becomes **Assets.**

Further, Goods account is particularly general in nature. It can be classified into different categories depending upon the transactions that arise in the business. They can be categorized as Purchases, Sales, Purchases returns, Sales returns, Opening stock and Closing stock.

Purchases mean goods purchased by the business for the purpose of reselling it or for the purpose of manufacturing a product.

Sales refer to the goods sold by the business on cash basis or credit basis.

Purchases returns means the goods returned back to the suppliers by the business. It is also called **Returns outwards**.

Sales returns means the goods returned back by the customers to the business. It is also called **Returns Inwards**.

Opening stock means unsold goods lying in the business in the beginning of the year or at the end of the previous year.

Closing stock means unsold goods left in the business at the end of the year.

3.4 CAPITAL AND DRAWINGS

For doing any business, it is the primary duty of the owner/proprietor to introduce some amount of money or money's worth into the business. This is called **Capital.** Therefore capital can be defined as the amount introduced by the owner/proprietor into the business. Many a times the owner may introduce money's worth into the business. This is also called **capital.** For example, the owner of the business has brought furniture worth Rs 25,000, goods worth Rs 50,000, Cash of Rs 75,000, then the total capital introduced by the owner will be Rs 25,000 + Rs 50,000 + Rs 75,000 = 1,50,000.

Further, this capital is also called as **NET WORTH** or **NET ASSETS** of the business. The owner/proprietor need not bring only assets into the business. He can also bring the liabilities into the business. Taking the previous example, where the total assets introduced by the owner were Rs 1, 50,000, the owner also brings a liability of **payment due to suppliers** of Rs 30,000 in to the business. Then the capital introduced by the owner will be Rs 1, 50,000 – Rs 30,000 = Rs 1.20.000.

Therefore it is clear that the capital introduced will always be the difference between the Assets introduced into the business and the Liabilities introduced into the business by the owner. This has given birth to the most popular definition of capital "Capital is defined as the excess of assets over liabilities".

An Accounting equation for capital can be shown as follows:

Capital = Assets – Liabilities.

With the help of the above Accounting equation, we can derive other equations like,

Assets = Capital + Liabilities.

Liabilities = Assets – Capital.

Drawings are just the reverse of Capital. Any amount withdrawn by the owner/proprietor for his personal use from the business is called Drawings. Drawings reduce the capital of the owner. The owner may withdraw some amount of money for his personal use; he may personally use the product, commodities, etc. purchased for the business; he may pay his life insurance premium, income tax, etc, out of the business funds; they all constitute for Drawings. This total amount of drawings should always be deducted from the capital introduced, which will give the net capital.

3.5 DEBTOR AND CREDITOR

Debtor and Creditor arise due to the transactions between the business and other persons. Today, on account of heavy competition most of the transactions take place on credit only. This concept of credit transactions are not limited to trading or manufacturing sectors, they are also extended to service sector. A 'Debtor' is therefore a person who owes some amount of money to the business. He is a person who has received some benefit from the business, but not yet repaid the value for the benefit received. He is due to the business.

Further, if the benefit received by the debtor is in the form of goods received then such a debtor is called as the Trade Debtor. If the benefit received is in the form of loan taken, then such a debtor is called as a Loan Debtor. If the benefit received by the debtor is in the form of business assets taken over, then such a debtor is called as the Debtor for Assets Sold. If the benefit received is in the form of any other service taken from the business, then such a debtor is called as the Debtor for Service Rendered.

The amount due from the debtor to the business is generally called as a debt. A Debtor is always an asset to the business because the amount due from the debtor is recoverable. These debts are further classified as good debts, doubtful debts and bad debts. A good debt is one which can be recovered in full. A doubtful debt is one which may or may not be recovered. A bad debt is one which cannot be recovered at all.

A 'Creditor' is a person to whom the business owes money. He is a person who has rendered some benefit to the business, but has not yet received any value for the benefits given. The business is due to him. Hence creditor is considered as a liability of the business.

Further, if the benefit rendered by the creditor is in the form of goods supplied to the business, it is called as Trade Creditor. If the benefit given by the creditor is in the form of loan given to the business, it is called as a Loan Creditor. If the benefit given by the creditor is in the form of assets given to the business, it is called Creditor for Asset purchased. If the benefit given by the creditor is in the form of any service to the business, it is called Creditor for Services .For example, Salary outstanding to employees. Rent outstanding to the owner, wages outstanding to the workers, etc.

3.6 EXPENSES AND INCOME

Expenses refer to the expenditure incurred in return for getting some benefits. These expenses are always based on accrual concept. This concept differentiates between the payments and expenses. In the previous unit, we have understood that all expenses are not payments and all payments are not expenses. Further, the periodicity concept classifies the expenses into Revenue expenses, deferred revenue expenses and Capital expenses.

A revenue expense is one which is incurred to earn the Income for that period. These expenses are charged to the profit/loss account for that period. They are common expenses which are incurred every year like wages, carriage, salaries, commission, rent, postage, printing and stationery, etc.

Deferred expenses are those expenses which are incurred in return to certain benefits that are spread over a number of years. The benefits derived from these expenses are not limited to a particular period. For example, advertising expenses, research expenses, etc. Hence the term 'Deferred' means postponement.

Capital expenses are those expenses which are incurred in particular to acquire assets. The benefit derived from these expenses is long lasting i.e. these expenses are made for a longer period of time. For example, amount spent for purchase of machinery is a capital expense because this machinery is used to produce the products for a longer period of time. Similarly, amount spent on land and buildings, furniture purchased are called capital expenses.

An 'Income' refers to the earnings of the business. It is generally called as 'Revenue'. Every business earns profit only by selling the products purchased/manufactured or by rendering the services. In the previous unit, we have studied the Matching concept where the revenue of that particular period is matched with the expenses of that period. Without Income/revenue no business can survive. Sale of goods, receipts from various services rendered, rent received, interest received, commission received, etc., are the various items of Income.

Therefore, we can conclude that Expenses and Income are like the two sides of a coin. Both of them are inseparable. Every business has both expenses and income. The difference of which will be the financial result of the business. If the Income exceeds Expenses then the result will be the profit to the business. If the Expenses exceed Income then the result will be the loss to the business.

3.7 ASSETS AND LIABILITIES

The origin of the word 'Asset' is attributed to the French terminology 'Assez" which means 'enough'. So Asset means enough of the things owned by the business. It refers to the sufficient things or value in possession of the business. Further, while explaining the concept of expenses and income in the previous section we have come across the term Capital expense, which is also called as an asset.

An Asset can be classified on the basis of the physical substance as Tangible Asset and Intangible Asset. A Tangible Asset is one which has a physical substance, i.e., it can be seen, felt and touched. For example, assets like land and buildings, plant and machinery, furniture and fixtures, etc. are Tangible assets. An Intangible Asset is one which does not have any physical substance, i.e., it cannot be seen, felt or touched. For example, assets like goodwill, patent rights, copyrights, etc. are Intangible assets.

On the basis of the time/period, assets are classified as fixed assets and Current assets. All assets whose life or identity is more than one year are generally called as fixed assets. For example, Land, Buildings, Machinery, Furniture, etc., are called fixed assets. Further, fixed assets are also classified as tangible and intangible fixed assets. All assets whose life or identity is less than one year are called as Current Assets. For example, sundry debtors, bills receivable, stock of goods, cash in hand/at bank, etc. are called current assets.

On the basis of Liquidity, assets are classified as liquid assets and illiquid assets. A Liquid asset is one which can be easily converted into cash. For example, sundry debtors, bills receivable, marketable securities, etc., are liquid assets. Liquid assets are also called as Quick assets. An illiquid asset is one which cannot be converted into cash immediately. For example, stock of goods/ inventory, expenses paid in advance, etc., are illiquid assets. An illiquid asset is also known as non-quick asset. Both liquid assets and illiquid assets belong to the category of Current assets.

There are other category of assets like fictitious assets and wasting assets. In case of Joint Stock Company form of business organization, there are certain expenses which cannot be charged wholly to the profit/loss account for the same period, hence they are capitalized temporarily. They are called Fictitious Assets. These assets are meant only for namesake, they do not have any realizable value. For example, preliminary expenses, discount on issue of shares and debentures, Underwriting commission, etc. In case of mining business, oil refineries there are assets which go on extinguishing, as and when the extraction is made. Such assets are called as Wasting Assets. For example gold mines, copper mines. Iron ore mines, petroleum products, etc.

A liability is also derived from the French terminology called 'lier', which means to bind. Therefore a liability binds the business from the claims of others. A liability is also called as an obligation which the business has to pay to different parties. It is the amount due to parties like owner, creditor, employee, worker, government, etc.

From the point of view of the parties the liability is classified as owner's liability and outsiders' liability. All amounts due to the owner/proprietor are called the owner's liability. All amounts due to the outsiders like creditors, government, employee, banks, financial institutions, etc. are called outsider's liability.

From the point of the time/period the liability is classified as long term liability and short term liability. Long term liability is the liability which has to be paid in the long run, i.e., more than one year. They are also called Fixed Liability. For example, owner's liability, long term loans, long term creditors, etc. Short term liability is the liability which has to be paid in the short run, i.e., within in one year. They are also called Current Liability. For example, sundry creditors, bills payable, outstanding expenses, bank overdraft, etc.

Any liability arising on account of trading only is called a trade liability. For example, sundry creditors and bills payable are trade liabilities. Any liability which has to be settled immediately on demand is called a Quick liability. It is also called as a liquid liability. For example, sundry creditors, bills payable, outstanding expenses, etc. Any liability which need not be settled immediately is called as a Non-quick liability. It is also called as an illiquid liability. For example, bank overdraft, cash credit, etc.

3.8 DEBIT AND CREDIT

Debit and credit are the two sides of the double entry system coin. Both are inseparable. 'For every debit there should be a corresponding credit' was coined by luca paciolo in the 15th century. It was the greatest contribution made for the growth and development of the modern accounting system. Both these words are derived from the Latin terminologies.

The word debit is derived from the Latin word 'debere' which means 'to owe'. Therefore debit means the amount owed by an account. It is the amount of benefit enjoyed by that account. This benefit received by an account is therefore entered in the left hand side of the account. Literally, any entry made in the left hand side of an account is called as the debit side of an account. All expenses, assets, losses show debit balances.

The word credit is also derived from the Latin word 'Credere' which means 'to believe'. Therefore credit means the amount owed to an account for the benefit given by that account in the belief that its value will be repaid at a later date. Hence, 'Credit' stands for the term belief which is the most important deciding factor in any transaction. The benefit is given by an account with the firm belief that it can recover the same in some future date. Any entry made in the right hand side of an account is called as the credit side of an account. All Incomes, Liabilities, Profits and Gains show credit balances.

3.9 TYPES OF ACCOUNTS

Before understanding the different types of accounts, it is necessary to know the meaning of an account. An account commonly abbreviated as 'A/C' refers to a summarized record of all transactions related to a person, thing or a service for a given period of time. This account gives us the net result of the various transactions related to a particular person, a thing or a service for a particular period.

Further, accounts are classified into two broad categories – namely:

a) Personal Accounts. b) Impersonal Accounts.

Personal Accounts:

All accounts of persons with whom a concern carries on business are called as personal accounts. Personal accounts may be accounts of natural/physical persons like Ramesh's account, Yogesh's account, Mahesh's account, etc. Personal accounts can be accounts of institutions, banks, colleges, schools, firms, etc., like KSOU account, IGNOU account, Vysya Bank account, etc. Personal accounts can also be the accounts representing certain persons, which are called Representative personal accounts like outstanding salary account, outstanding rent account, prepaid insurance account, etc.

Impersonal Accounts

All other accounts which are not in the name of either physical or artificial persons are called as Impersonal accounts. These accounts are further classified into two main categories – namely:

a) Real Accounts b) Nominal Accounts

Real Accounts:

These accounts are that part of Impersonal accounts which are related to the assets/properties owned by a business concern. These accounts are also called as assets accounts or properties accounts. These accounts show the various assets possessed by the business. It includes both tangible assets and intangible assets. Land account, buildings account, machinery account, cash account, goodwill account, copyrights account are real accounts.

Nominal Accounts:

These accounts are that part of Impersonal accounts which are related to the Income, expenses, profits, gains and losses for a particular period. These accounts are also called as Fictitious Accounts. They are called nominal accounts because they do not have any physical substance; they cannot be seen or touched. They do not have any virtual existence like tangible assets. They exist only in names. These accounts relate to the various revenue expenses like salary, rent, printing and stationery, postage and telegram, etc. They also relate to the various Incomes like Interest received, commission received, discount received, profit on sale of an asset, gain on revaluation of Investments, etc.

3.10 BOOKS OF ACCOUNTS

It refers to the books in which the business transactions are recorded. The books of accounts generally consist of two different segments – namely:

a) Journal or subsidiary books and

b) Ledger.

Journal:

The word 'journal' is derived from the French terminology 'Jour' which means a day. It is a daily record of business transactions. As and when the business transactions are identified they are immediately entered in the journal book. Therefore journal is also called books of prime entry or original entry. Every day the transactions are recorded in this book, in the order of the date.

Subsidiary books:

They are the sub-divisions of Journal. These subsidiary books are maintained to keep a track of a particular activity separately in the business. Certain activities have to be recognized separately because these activities occupy more importance than other activities. The important subsidiary books maintained by the business are Purchases book, Sales book, Purchase Returns book, Sales returns book, Cash book, Bills receivable book, Bills payable book, etc.

Purchases book is maintained because every day goods are purchased for the business and it has to be recorded separately. It is meant for only goods purchased on credit.

Sales book is maintained separately because every day sales takes place both on cash and credit basis This book is maintained to record only for the goods sold on credit.

Purchases returns book is maintained to record all purchases of goods returned back to the suppliers. This book is also called Returns outwards.

Sales returns book is maintained to record all sales of goods returned back by the customers. This book is also known as Returns Inwards.

A Cash book is maintained to record all types of Cash Receipts and Cash Payments made during the accounting period. It is also called Receipts and Payments Book.

Bills Receivable book is maintained to record all types of bill transactions which are receivable by the business. It includes all amount receivable from customers who have accepted the bills for the goods sold to them.

Bills Payable book is maintained to record all types of bill transactions which are payable by the business. It includes all amounts payable by the business through bills for goods purchased from the suppliers.

All other transactions which cannot find place in the above subsidiary books are recorded separately in "journal Proper'. They include adjustment entries like stock of goods, outstanding expenses, etc.

Ledger:

The word 'ledger' is derived from the Dutch terminology 'Legger' which means to lie. Therefore, ledger means where the various accounts lie or kept. After the transactions are first recorded in the journal or subsidiary books they are next recorded in the Ledger Accounts. Ledger is a book of secondary record and also a book of final entry. It contains all the accounts of the business in a well arranged form. After the entries are made in the journal, they are posted to their respective ledger accounts. Ledger gives the final picture of the net benefit received or given by that particular account. It is like a Ready Reckoner for the businessman to know the position of any account as on a particular date. It is chronologically recorded weekly, fortnightly or monthly depending upon the requirements of the organization.

3.11 RULES FOR RECORDING OF TRANSACTION

After understanding the Double Entry System of book keeping, which clearly explains that 'for every debit there is a corresponding credit', we should be able to understand how the recording of transactions takes place under this system. Further in the Dual Aspect Concept, we have also understood that every transaction has to be viewed in two ways; the receiver and the giver. As such, the account which receives the benefit of the transaction must be debited and the account which gives the benefit of the transaction must be credited. This is the fundamental or general rule of recording the transactions.

Further, the Rules for recording the transactions can be classified on the basis of types of Accounts. As there are three types of accounts, there are three different types of Rules for recording the transactions.

Rules for recording transactions related to Personal Accounts:

Personal accounts are the accounts related to either natural persons or artificial persons. As such there will be either a Receiver or a Giver. In case of a Personal account the rule for recording is:

Debit the Receiver

and

Credit the Giver.

As per the above rule, the receiver of the benefits should always be debited. Similarly the giver of the benefits should always be credited. The fact behind this rule is the receiver of the benefits is a debtor; hence his account should be debited. The giver of the benefits is a creditor; hence his account should be credited.

For example, Ramesh has supplied goods worth Rs 10,000 to the business. In this transaction, Mr. Ramesh has given the benefit to the business by supplying the goods worth Rs 10,000. Therefore his account should be credited.

In another example, the business has sold goods to Mr. Yogesh for Rs 20,000. In this transaction, Mr. Yogesh has received the benefit from the business by receiving goods worth Rs 20,000. Therefore his account should be debited.

Rules for recording transactions related to Real Accounts:

Real accounts are the accounts related to different assets or properties owned by the business. As such, these assets/properties are either purchased or sold. The effect of these transactions will either increase an asset or decrease an asset. If an asset is purchased the asset increases; if an asset is sold the asset decreases. The Rule for recording the transactions related to Real Accounts is:

Debit what comes in

and

Credit what goes out

As per the above rule, if the Asset is purchased the asset comes into the business, hence it should be debited; if the Asset is sold the asset goes out of the business and therefore it should be credited.

For example, a businessman purchases computer worth Rs 25,000 for his business. The computer being an asset comes into the business and therefore it should be debited. If the computer is purchased for cash, then cash decreases in the business and it should be credited. If the computer is purchased by issuing a cheque, then the bank balance of the business decreases, then Bank account should be credited. If the computer is purchased on credit, then the liability of the business increases, then the Supplier of the Computer Account should be credited.

In another example, if the business sells its old furniture for Rs 5,000, the furniture goes out of the business, and then Furniture Account should be credited. If the furniture is sold for cash, cash comes into the business, and then Cash Account should be debited. If the furniture is sold and a cheque is received from the buyer, the bank balance of the business increases, and then the Bank Account should be debited. If the furniture is sold on credit, then the buyer of the old furniture account should be debited.

Rules for recording transactions related to Nominal Accounts:

As already explained in the previous section, a Nominal Account is the account of expenses, income, profit, losses and gains. These accounts exists only in names, hence they are also called fictitious accounts. The Rules for recording the transactions relating to the Nominal Accounts is:

Debit all Expenses and Losses

and

Credit all Incomes and Gains

As per the above rule, all expenses incurred by the business should be debited because the benefit/service is received by the business and the payment for this benefits/service is due. The service provider is in the position of a debtor to the business. Similarly, all incomes received by the business should be credited because this amount is received by the business and the giver of this income is in the position of a creditor to the business.

For example, if the business pays a rent of Rs 6,000, then rent is considered to be an expense and it should be debited. This transaction clearly explains that the owner of the building has given the benefit to the business by providing the space to run the business and he is in a position of a debtor.

In another example, bank interest received Rs 10,000; then the interest received from the Bank is an income and hence it should be credited.

3.12 LET US SUM UP

The different terminologies used in Accounting gives a clear insight about the Accounting System. The accounting cycle begins with the identifying of the business transactions. A transaction is an event or an activity in the business which can be expressed in monetary terms.

'Goods' refers to any item purchased by the business for the purpose of resale. It differs from an asset, which is purchased for the purpose of using it in the business for a longer period of time.

Capital is the amount or money's worth introduced into the business, whereas drawings refer to the amount/goods withdrawn from the business for the personal use. A Debtor is the person who owes the money to the business, whereas a creditor is the person to whom the business owes the money.

Expenses are the amount spent by the business for earning the revenue during a given period of time. Income/Revenue is the amount earned by the business for a given period of time. The difference between the Income and Expenses will show the profit/loss of the business.

Assets are the properties owned by the business for the purpose of earning the revenue. Liabilities are the amount due to different parties in the business including the owner of the business. Debit and Credit are the two important aspects on which the Double Entry System of Accounting is recorded.

There are three important types of Accounts, namely Personal accounts, Real accounts and Nominal accounts. The Rule for recording the Personal Accounts is "Debit the Receiver and Credit the Giver'. The Rule for recording the Real Accounts is "Debit what comes in and Credit what goes out'. The Rule for recording the Nominal Accounts is "Debit all expenses and losses and Credit all Incomes and Gains".

The two important set of books to be maintained by any business organization to record the accounting transactions are the Journal/Subsidiary books and the Ledger Accounts. Journal is a book of prime entry and the ledger is an account of the final entry. After the transactions are recorded in the Journal, they are later on posted to the respective ledger Accounts.

3.13 KEY WORDS

Personal account : Debit the receiver, Credit the giver

Real account : Debit what comes in, Credit what goes out

Nominal account : Debit all expenses and losses, Credit all incomes and gains

3.14 TERMINAL QUESTIONS

a) What do you mean by a transaction?

b) Differentiate between goods and an asset.

c) Define Capital.

d) How does capital differ from drawings?

e) Distinguish between a debtor and a creditor.

f) State the different types of expense.

g) Differentiate between an asset and a liability.

h) Explain the terms 'Debit' and 'Credit'.

i) Briefly explain the different types of accounts with illustrations.

j) State the Rules for recording the transactions relating to different types of accounts.

k) List out the various books of accounts stating their purpose.

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UNIT - 4

INDIAN ACCOUNTING STANDARDS

Structure

4.0 OBJECTIVES

After studying this unit, you should be able to:

- Explain meaning accounting standards.
- Highlight the scope of accounting standards.
- Disscuss the evolution of accounting standards.
- Briefly explain the various accounting standards.

4.1 INTRODUCTION

In unit-2 of this block you have studied the Accounting principles, various concepts and conventions of Accounting in detail. You have understood that the Accounting principles are classified into accounting concepts and accounting conventions. Further, concepts are concerned with the maintenance of accounts, whereas conventions are concerned with the preparation of the financial statements. In practice, this accounting principle is generally known as "Generally Accepted Accounting Principles" (GAAPs). These principles have given lot of options to the practicing chartered accountants in presentation of the financial statements.

It is said that the financial statements can be prepared in 147 ways as per the existing accounting principles. This statement may be confusing to you, but this statement is a fact because of the flexibility in the accounting policies and practices. Let us take an example of the depreciation. Assets may be depreciated in Straight line method, reducing balance method, Annuity method, etc. This effects the profit position of the organization and further affects the financial position. Similarly the valuation of stock can be done in FIFO, LIFO, Simple average, weighted average, etc. These examples reveal that the present "GAAPs" lack consistency, comparability, adequacy and correctness of the financial statements.

So, Accountants all over the world thought the necessity of regulating the existing accounting principles. Such a regulation of the accounting principles to avoid misleading, distortions picture in the financial statements is popularly known as **accounting standards.**

4.2 MEANING AND DEFINITIONS OF ACCOUNTING STANDARDS

After understanding the emergence of accounting standards, let us understand what we mean by accounting standards. Accounting Standards can be understood as more refined, more regulated, more transparent, more consistent and more adequate form of the existing accounting principles. Accounting standards ensures transparency, consistency, comparability, adequacy and the correctness of the financial statements. Today users of accounting information demand more and more of disclosures in the financial information leading to adequacy and transparency in the data.

"Accounting standards are the policy documents issued by the recognized expert accountancy body relating to various aspects of measurement, treatment and disclosure of accounting transactions and events". By T.P.Ghosh. This definition clearly explains the details of the information to be disclosed by the business organization in the presentation of the financial statements.

"Accounting standards are the medium of practices which is imposed on the accountants by professional bodies, conventions and laws". By Kohlar. As per the above definition the accountants have to follow certain set of practices as imposed by professional bodies.

4.3 NEED FOR ACCOUNTING STANDARDS

Accounting Standards play a very important role in the presentation of financial statements in the present day business world. Today the business environment has become more complex and complicated. The users of the information need more information to be disclosed for proper understanding of the financial statements. The importance of these Accounting Standards is felt by all forms of business organizations in general and in company form of business organization in particular. The need for these accounting standards can be analyzed through their importances, which are as follows:

a) Accounting Standards removes complexities in accounting practices.
b) They simplify the accounting principles and processes.
c) They bring uniformity in accounting policies.
d) Accounting standards help in comparison of the financial statements.
e) They guarantee adequacy and transparency in the financial statements.

4.4 SCOPE OF ACCOUNTING STANDARDS

The scope of Accounting Standards can be listed as follows:

a) Accounting standards are issued which are in accordance with the existing laws, prevailing customs, usages and the business environment of our country.

b) These standards are applicable only to items which are material and from the date specified by the issuing authority.

c) Accounting Standards are in the nature of laws but not laws. They cannot override the existing laws which govern the preparation and presentation of financial statements.

d) Accounting Standards should address only the basic matters to the extent possible. It should not make the Accounting principles more complex.

4.5 EVOLUTION OF ACCOUNTING STANDARDS

An attempt to standardize the accounting system is almost seven decades old. In 1942, The Institute of Chartered Accountants in England and Wales began making recommendations to standardize the accounting practices. But only in 1969 the Institute established an **Accounting Standards Committee** to look after this process. Similarly in USA the **Financial Accounting Standards Board** was formed in 1973. In 1972, an international Congress of Accountants was organized to ensure the desired level of uniformity in accounting practices. In India **Accounting Standards board** was established in April 1977 to look after the uniformity of accounting practices. Till now, there are about **"41" International Accounting Standards and "32" Indian Accounting standards.** At present most of the International Accounting standards have changed to International Financial Reporting Standards (IFRS). On this line, our country is also making progress in the form of "Convergence of Accounting standards".

4.6 MERITS AND DEMERITS

Introduction of accounting standards have their own merits and demerits:

Merits: a) Standards eliminate all confusing variations in the accounting treatment.

b) Standards may call for disclosure beyond that required by law.

c) It facilitates comparison of financial statements – inter firm and Intra firm.

Demerits: a) The choice between different alternative accounting treatments may become difficult.

b) Accounting standards may lead to rigidity of accounting practices.

c) Standards cannot override the statute.

4.7 BRIEF STUDY OF VARIOUS INDIAN ACCOUNTING STANDARDS

Let us now try to understand the various accounting standards in India and the purpose for which these standards are laid down. The following table will give an idea of different Accounting Standards in India, their title and their effective date.

Number	Title	Effective Date(s) 1st April of
AS 1	Disclosure of Accounting Policies	1991/1993
AS 2 (Revised)	Valuation of Inventories	1999
AS 3 (Revised)	Cash Flow Statements	2001
AS 4	Contingencies and Events Occurring after Balance Sheet Date	1996
AS 5 (Revised)	Net Profit or Loss for the period, Prior Period items and changes in Accounting Policies	1996
AS 6 (Revised)	Depreciation Accounting	1995
AS 7 (Revised)	Construction Contracts	2003
AS 8	(Withdrawn)	
AS 9	Revenue Recognition	1991/1993
AS 10	Accounting for Fixed Assets	1991/1993
AS 11 (Revised)	The Effects of Changes in Foreign Exchange Rates	1995
AS 12	Accounting for Government Grants	1994
AS 13	Accounting for Investments	1995
AS 14	Accounting for Amalgamations	1995
AS 15	Employee Benefits (Revised 2005)	2006
AS 16	Borrowing Cost	2000
AS 17	Segment Reporting	2001
AS 18	Related Party Disclosures	2001
AS 19	Leases	2001
AS 20	Earnings Per Share	2001
AS 21	Consolidated Financial Statements	2001
AS 22	Accounting for Taxes on Income	2001

AS 23	Accounting for Investments in Associates in Consolidated Financial Statements	2002
AS 24	Discontinuing Operations	2004-05
AS 25	Interim Financial Reporting	2002
AS 26	Intangible assets	2003-04
AS 27	Financial Reporting of Interests in Joint Ventures	2002
AS 28	Impairment of Assets	2004-05
AS 29	Provisions, Contingent Liabilities and Contingent Assets	2004
AS 30	Financial Instruments: Recognition and Measurement	2011
AS 31 & 32	Financial Instruments: Presentation and Disclosure	2011

AS = Accounting Standard.

AS 1 Disclosure of Accounting Policies:

Accounting policies refers to the method of treatment of different items in the financial statements. For example, providing depreciation on fixed assets under straight line method is an accounting policy. Similarly valuing stock under FIFO method is another accounting policy. The standard defines accounting policies as referring to the specific accounting principles and the methods of applying those principles adopted by the organization in the preparation and presentation of financial statements. Such accounting policies must be disclosed by every organization, which in turn helps the users of the financial statements.

Further, as per AS 1, if the fundamental accounting concepts like going concern, consistency and accrual concept are followed in financial statements, specific disclosure is not required.

AS 2 Valuation of Inventories:

As per AS 2 Inventories are assets:

- held for sale in the ordinary course of business;
- In the process of production for such sale; or

- In the form of materials or supplies to be consumed in the production process or in the rendering of services.

Cost of Inventories has been defined by AS 2 as follows:

"The costs of inventories should comprise all costs of purchase, costs of conversion and other costs incurred in bringing the inventories in their present location and condition". It should not include abnormal amounts of waste materials, labour and other production costs, storage costs, administrative overheads, selling and distribution costs. Inventories should be assigned by using FIFO method or weighted average cost formula.

Further, as per AS 2 the financial statements should disclose the accounting policies adopted in valuing Inventories.

AS 3 Cash Flow Statements:

As per AS 3 an enterprise should prepare a Cash Flow Statement and should present it for each period. It helps the users of the information to know how the enterprise has generated the cash and used the cash for different purposes. **Cash** consists of cash in hand and demand deposit with banks. **Cash Equivalents** are short term, liquid investments that are readily convertible into cash. **Cash Flows** are inflows and outflows of cash and cash equivalents. Cash flow statement can be prepared either in the direct method or indirect method depending upon the type of enterprise.

According to this standard a cash flow statement should report cash flows during the period from operating, investing and financing activities. **Operating Activities** are the principal revenue producing activities of the enterprise like amount received from customers, payment made to suppliers and employees, income tax etc.,. **Investing Activities** are the acquisition and disposal of long term assets and other investments (excluding Marketable securities). **Financing Activities** are activities that result in changes in the equity capital, preference share capital and other long term borrowings.

AS 4 Contingencies and Events Occurring after the Balance Sheet Date:

It refers to the treatment of the contingencies and events occurring after the balance sheet date. A **contingency** is a situation which may or may not arise. If a contingency is likely to result in a loss, the estimate of that loss should be provided in the financial statements. On the other hand if a contingency is likely to result in a gain, the estimate of that gain should not be provided in the financial statements. Dividends proposed or declared by the organization after the balance sheet date but before approval of the financial statements, should be adjusted.

As per this standard the following disclosures has to be made in the financial statements for contingencies:

- The nature of the contingency
- The uncertainties which may affect the future outcome,
- The estimate of the financial effect or a statement that such an estimate cannot be made.

As per this standard the following disclosures has to be made in the financial statements for Events occurring after the Balance Sheet date:

- The nature of the event
- The estimate of the financial effect or a statement that such an estimate cannot be made.

AS 5 Net Profit or Loss for the Period, Prior Period Items and Changes in Accounting Policies:

This standard deals with disclosure of profit or loss from ordinary activities, extraordinary items and prior period items in the statement of profit or loss, accounting for changes in accounting estimates and disclosure of changes in accounting policies. The main object of this standard is to bring uniformity in the preparation and presentation of financial statements. It further helps in comparison of financial statements between different periods and different firms. There may be differences in accounting practices in the treatment of extraordinary items and prior period items. This standard suggests a uniform way of treatment of such items. Extraordinary items like loss on sale /revaluation of assets/investments, Intangible assets like goodwill, patents written off.etc.

As per this standard, any change in accounting policy should be made only if the adoption of a different accounting policy is required by law or it helps in a more appropriate presentation of the financial statements. Any change in accounting policy which has a material effect should be disclosed.

AS 6 Depreciation Accounting:

This is revised and effective from 1995 and it is mandatory in nature. According to this standard the depreciation on any asset should be allocated on a systematic basis to each accounting period during the useful life of the asset. The method of depreciation should be applied uniformly from period to period. A change from one method to another method should be made only when it is required as per law or it helps in a better presentation of financial statements. When such a change in the new method of depreciation is made, depreciation should be recalculated in accordance with the new method from the date of asset coming into use. The useful life of a depreciable asset should be estimated after considering the following factors:

- Expected physical wear and tear;
- Obsolescence;
- Legal or other limits on the use of the asset.

The following information should be disclosed in the financial statements:

- The historical cost or other amount substituted for historical cost of each class of depreciable assets.
- Total depreciation for the period of each class of assets
- The related accumulated depreciation.
- Depreciation methods used; and
- Depreciation rates or the useful lives of the assets, if they are different from the principal rates specified in the statute governing the principles.

AS 7 Accounting for Construction Contracts:

This standard is for construction works undertaken by non corporate bodies and it is effective from 1991. The contract work where the outcome of the contract can be reliably estimated, then the percentage of completion method can be used. For **fixed price contracts** this degree of reliability would be provided if the following conditions are satisfied:

- Total contract revenues to be received can be reliably estimated;
- Both the costs to complete the contract and the stage of contract performance completed at the reporting date can be reasonably estimated; and
- The costs attributable to the contract can be clearly identified so that actual experience can be compared with prior estimates.

In case of **cost plus contracts** this degree of reliability would be provided only if both the following conditions are satisfied:

- Costs attributable to the contract can be clearly identified; and
- Costs other than those that are reimbursable under the contract can be reliably estimated.

While calculating the profit on these contracts, all possible unforeseen losses must be provided irrespective of the stage of completion. The allocation of costs should be clearly made for each contract which is common for different types of contract.

AS 8 Accounting for Research and Development:

This standard was effective from 1-4-1991 but later on withdrawn.

AS 9 Recognition of Revenue:

This standard is meant for recognition of revenue i.e., income. With regard sale of goods, the recognition of revenue can be made only when the seller of the goods has transferred the ownership to the buyer. In case of rendering of services revenue has to be recognized either under the completed service contract or under the proportionate completion method. Interest has to be recognized on a time proportion basis taking into account the amount outstanding and the rate applicable. Royalties should be recognized on an accrual basis as per the agreement. Dividends from investment in shares are recognized when the owner's right to receive payment is established. This standard insists the accrual basis to be adopted for revenue recognition.

AS 10 Accounting for Fixed Assets:

As per this standard fixed assets are accounted on cost basis. Cost includes purchase price, installation cost and finance cost for the period upto the date the asset become ready for use. If the asset is constructed like buildings, it shall be accounted for at cost. If an asset is exchanged then the market value of the asset or the net book value of the asset given up will be accounted. Goodwill will be accounted only when it is paid for.

AS 11 Effects of Changes in Foreign Exchange Rates:

This standard relates to the changes in the foreign currency Rates, and how it should be accounted for. The effect of changes has to be incorporated in the financial statements or carried forward. Exchange differences should be recognized as income or expenses in the period in which they arise except in case of acquisition of fixed assets. Exchange differences arising on replacement of liabilities incurred for the purpose of acquiring fixed assets should be adjusted to its carrying amount. Exchange differences in case of forward contracts should be recognized as income or expenses over the life of the contract. All these exchange differences, and their treatment in the financial statements should be clearly disclosed in the presentation of the financial statements.

AS 12 Accounting for Government Grants:

This standard relates to the accounting for the grants received/receivable from the government. Grants in the form of non monetary assets given at a concessional rate should be accounted for at their acquisition cost; and those given free of cost should be accounted at a nominal cost. Grants receivable as compensation for expenses or losses incurred should be recognized and disclosed in the profit and loss account as an extraordinary item. Contingency related to a government grant arising after the grant has been recognized should be treated according to AS 4. Grants that become refundable should be treated as an extraordinary item in accordance with AS 5. All these Grants and their treatment should be properly disclosed in the preparation and presentation of the financial statements.

AS 13 Accounting for Investments:

This standard is effective from 1-4-1995 and is also mandatory in nature. It deals with the accounting for Investments. The term **Investments** means money invested outside the business organization, usually in shares, securities and other financial instruments. These investments should be classified as current investments and long term investments and the same has to be disclosed. Further, current investments should be disclosed at lower of cost and fair market value. Long term Investments should be disclosed at cost. Accounting policies adopted, Income from investments, profit or loss on disposal and charges on such investments should be properly disclosed in the financial statements.

AS 14 Accounting for Amalgamation:

This standard is meant for recording transactions relating to the amalgamation of companies. As per this standard, Amalgamation is classified as **Amalgamation in the nature of merger** and **Amalgamation in the nature of purchase**. In case of Amalgamation in the nature of merger, the purchase consideration payable by the transferee company is calculated under pooling of Interest method. In case of Amalgamation in the nature of purchase, the purchase consideration is calculated under purchase method.

Under Amalgamation in the nature of merger, the transferee company should record all assets and liabilities taken over from the transferor company, at the book values only, without any revaluation. In case of Amalgamation in the nature of purchase, the transferee company can record the values of assets and liabilities taken over from the transferor company under fair values, but should maintain the statutory reserves. The excess or deficit on account of Amalgamation in the nature of purchase should be transferred to goodwill or capital reserve.

AS 15 Accounting for Retirement Benefits in the Financial Statement of Employers:

This standard is meant for recording the Retirement Benefits to the employees. The method adopted for calculating retirement benefits for the period should be disclosed. If the costs related to gratuity and other benefit schemes are based on the **actuarial valuation**, then, whether the actuarial valuation was made at the end of the period or at an earlier date should be disclosed. The method adopted for computing accrual of Retirement benefits should be disclosed clearly in the financial statements.

AS 16 Borrowing Costs:

As per this standard, the cost of borrowing for acquiring Qualifying assets has to be recorded in the financial statements. Qualifying assets means those assets like manufacturing plant, power generation facilities, inventories etc., that require a substantial period of time to bring them in a saleable condition. Borrowing costs that are directly attributable for acquiring, construction or production of a qualifying asset should be capitalized. The amount of borrowing costs eligible for capitalization should be ascertained by applying a capitalization rate based on **weighted average of the borrowing costs**. This is calculated taking into account the different costs of borrowing and the proportion of each borrowing in the total borrowings.

Further, capitalization of borrowing costs should be ceased when the qualifying assets become assets in a saleable condition. When the periods are extended due to interruption in development, these costs should be suspended. The financial statements should disclose:

- The accounting policy adopted for borrowing costs.
- The amount of borrowing costs capitalized during the period.

AS 17 Segment Reporting:

Segment refers to the division. Generally big business organizations produce different products and render different types of services. Their geographical area is widely spread. It becomes necessary to report the performance of these organizations product-wise, region-wise etc. Such a form of reporting is called **Segment Reporting**.

As per this standard, a business segment or geographical segment should be identified as reportable segment if:

- Its revenue from sales to external customers and from transactions with other segments is 10% or more of the total revenue; or

- Its segment result, whether profit or loss is 10% or more of the combined result of all segments in profit/loss; or
- Its segment assets are 10% or more of the total assets of all segments.

The financial statements should disclose the following for each reportable segment:

- Segment revenue;
- Segment result;
- Total carrying amount of segment assets (cost and depreciation) and liabilities.

AS 18 Related Party Disclosures:

Related parties include holding companies, subsidiaries and other subsidiaries, associates and joint ventures, key management personnel and relatives of each personnel and individuals having substantial voting power of the reporting enterprise. This standard is established to bring transparency in the management of the business affairs. There should not be any vested interests in the hands of few people. The reporting enterprise should disclose clearly the following in the financial statements:

- o Name of the transacting related party.
- o A description of the relationship between the parties.
- o A description of the nature of transaction.
- o Volume of the transactions.
- o Any other elements of the related party transactions necessary for an understanding of the financial statements.

AS 19 Leases:

A lease is an agreement between two parties namely lessor and the lessee, wherein the lessor agrees to give the possession of his assets to be used by lessee for a certain period of time in return to a fixed/flexible amount of a reward generally called **Royalties.** Further, the lease can be either operating lease or financial lease. In case of financial lease the lease payment should be apportioned between finance charges and the reduction of the outstanding liability. The finance charges should be allocated to periods during the period of lease,

The lessor should present an asset given under operating lease in its balance sheet. Lease income from operating leases should be recognized in the statement of profit and loss on straight line basis over the lease term. The depreciation on the leased assets should be on a basis consistent with AS 6. This standard clearly states how sale and leaseback transactions should be recorded; the profit/loss arising out of these transactions should be recorded in the books of both the parties, etc. Therefore, this standard clearly specifies the accounting pattern for both operating and financial leases.

AS 20 Earnings per Share:

This standard is applicable to all enterprises whose equity shares or potential equity shares are listed in a recognized stock exchange in India. The main objective of this standard is to prescribe principles for the determination and presentation of Earnings per Share. All enterprises should present both **basic earnings per share** and also **diluted earnings per share**.

Basic earnings per share should be calculated as follows:

$$\frac{\text{Profit/loss available to equity shareholders during the period}}{\text{Weighted number of equity shares outstanding during the period}}$$

Diluted earnings per share should be calculated **after adjusting the net profit/loss available for equity shareholders and the weighted number of shares outstanding with the effects of all dilutive potential equity shares.** For example, if the enterprise has issued any convertible preference shares or convertible debentures then these issues will dilute the basic earnings per share.

AS 21 Consolidated Financial Statements:

This standard is meant for the **holding company** which has acquired a majority of shares (atleast 51%) in another company called **subsidiary company**. A holding company should prepare the consolidated financial statements apart from its own financial statements. For preparing the consolidated financial statements the financial statements of the parent (holding) and its subsidiaries should be combined line byline basis by adding together like items of assets, liabilities, income and expenses.

While preparing the consolidated financial statements as per this standard, the following steps should be observed:

- The cost of the investment in each subsidiary and the parents' portion of equity of each subsidiary should be eliminated.
- Any excess or deficit in the investment of the holding compared to the equity of the subsidiary should be treated as goodwill or capital reserve.

- Minority interest should be calculated after taking into account the remaining shares in the subsidiary and other benefits attributable to the minority shareholders.
- Mutual transactions between holding and the subsidiary should be eliminated.
- Unrealized profit on account of unsold goods in the financial statements should be eliminated.

Further, the consolidated financial statements should disclose:

- A list of all subsidiaries.
- The nature of relationship between the parent and a subsidiary.
- The effect of the acquisition and disposal of subsidiaries on the financial position on the reporting date.

AS 22 Accounting for Taxes on Income:

This standard is for the computation of taxes on Accounting Income. An accounting income is the net profit /loss for a period. Taxes have to be paid on the net profit earned during the period. It is revenue for the government. These taxes are classified as current tax and deferred tax. **A current tax** is the amount of Income tax payable or recoverable in respect of the taxable income or loss for a period. **A deferred tax** is the tax effect of timing differences. Timing differences are the differences between taxable income and accounting income for a period that originate in one period and are capable of reversal in one or more subsequent periods. Tax expense, comprising both current tax and deferred tax should be included in the determination of the net profit/loss for the period.

Deferred tax assets and liabilities should be distinguished from assets and liabilities representing current tax for the period. Deferred tax assets and liabilities should be disclosed under a separate heading in the Balance Sheet of the enterprise, separately from current assets and liabilities.

AS 23 Accounting for Investments in Associates in Consolidated Financial Statements:

An Associate is an enterprise in which the investor has **significant influence** and which is neither a subsidiary nor a joint venture of the investor. Significant influence is the power to participate in the financial/operating policy decisions of the investee but not control over those policies. As per this standard, Accounting for Investment in an Associate should be done according to equity method. Equity method of accounting is a method whereby the investment is initially recorded at cost, identifying any goodwill/capital reserve arising at the time of acquisition. The carrying amount of the investment is later on adjusted for the post acquisition change in the investor's share of net assets of the investee.

AS 24 Discontinuing Operations:

Many business enterprises may discontinue /abandon certain business operations due to heavy competition or it is not possible to run those operations in a profitable manner. This standard lays down the principles for reporting information about the discontinuing operations. It helps the users of the information to understand the profit earning capacity, cash flows and the financial position of the continuing operations.

As per this standard, a discontinuing operation is defined as **"A discontinuing operation is a component of an enterprise:**

a) That the enterprise, pursuant to a single plan, is:

- Disposing of substantially in its entirety, such as by selling the component in a single transaction or by merger or spin-off of membership of the component to the enterprises' shareholders; or
- Disposing of piecemeal, such as by selling off the component's assets and settling its liabilities individually; or
- Terminating through abandonment; and

b) That represents a separate line of business or geographical area of operations; and

c) That can be distinguished operationally and for financial reporting purposes."

The above definition clearly explains the situations when an operation is considered to be a discontinuing operation. The standard further states the information relating to a discontinuing operation should include in detail the description, the business or geographical segments, the nature of the initial disclosure event, the period of discontinuance and its effects on the earning capacity, the financial position of the enterprise after the discontinuance.

AS 25 Interim Financial Reporting:

This standard specifies the form and procedure of reporting the Interim Financial Statements. An Interim financial statement is a financial statement which is prepared and presented in between two annual financial statements. This is usually done for business organizations which want to declare dividends in between two financial periods, usually called an interim dividend. According to AS 25 "Interim financial report means a financial report containing either a complete set of financial statements or a set of condensed financial statements for an interim period."

This standard insists that the form and content of these financial statements should be according to the requirements as applicable to annual complete set of financial statements. It should include balance sheet, statement of profit/loss, cash flow statement and other important notes. The business enterprises should disclose all events or transactions that are material to an understanding of the current interim period. Further, Interim reports should be able to be compared with the annual financial statements as of the end of the immediately preceding financial year. All other necessary disclosures as per AS 1 should be made in the preparation and the presentation of the interim reports.

AS 26 Intangible Assets:

This standard suggests the method of recording the value of intangible assets in the financial statements. "An Intangible asset is an identifiable non-monetary asset, without physical substance, held for use in the production or supply of goods or services, for rental to others, or for administrative purposes". For example goodwill, patent rights, copyrights.etc. According to this standard, an intangible asset should be recognized only if:

- It is probable that the future economic benefits that are attributable to the asset will flow to the enterprise; and
- The cost of the asset can be measured reliably.

Further, this standard specifies that internally generated goodwill, internally generated brands, Research expenses and other publishing's should not be recognized as intangible assets. It lays down the treatment of depreciation for such intangible assets. All these principles should be disclosed in the preparation and presentation of financial statements.

AS 27 Financial Reporting of Interests in Joint Ventures:

This standard refers to the principles and procedures for accounting for interests in joint ventures and reporting of Joint venture assets, liabilities, income and expenses in the financial statements of venturers and investors. Let us try to understand the important concepts used in this standard.

A **joint venture** is a contractual arrangement whereby two or more parties undertake an economic activity, which is subject to joint control.

A **venturer** is a party to a joint venture and has control over that joint venture.

An **Investor** in a joint venture is a party to a joint venture and does not have joint control over that joint venture.

According to this standard, a venturer should recognize in its separate financial statements and consequently in its consolidated financial statements;

a) The assets that it controls and liabilities that it incurs and

b) The expenses that it incurs and the share of the income that it earns from the joint venture.

A venturer should disclose its share of contingent liabilities, the aggregate amount of commitments in respect of its interests in joint ventures separately and the list of all joint ventures.

AS 28 Impairment of Assets:

The main objective of this standard is that, the assets are carried at no more than their recoverable amount. If as asset is shown at a price more than its recoverable amount in the balance sheet then such a difference is called **impairment**. Such impairment loss should be immediately charged to the profit/loss account of the same period. In order to show a true and fair view of the financial position of the enterprise, the assets should be recorded at the values recoverable only. Any value of the asset more than the recoverable value is considered an impairment loss. All the above information must be properly disclosed in the preparation and presentation of financial statements.

AS 29 Provisions, Contingent liabilities and Contingent Assets:

The objective of this standard is to recognize and measure the provisions, contingent assets and contingent liabilities. Let us try to understand the important concepts;

A **Provision** is a liability which can be measured only by using a substantial degree of estimation.

A **Contingent liability** is a possible obligation that arises from past events and the existence of which will be confirmed only by the occurrence or non-occurrence of one or more uncertain future events not wholly within the control of the enterprise.

A **Contingent Asset** is a possible asset that arises from past events the existence of which will be confirmed only by the occurrence or non-occurrence of one or more uncertain future events not wholly within the control of the enterprise.

As per AS 29, a Provision should be recognized only when:

- An enterprise has a present obligation as a result of past events;
- It is probable that an outflow of resources embodying economic benefits will be required to settle the obligation; and

- A reliable estimate can be made of the amount of the obligation.

No Provision should be recognized if the above conditions are not met. An enterprise should not recognize a Contingent Liability and a Contingent Asset. The details of the Provisions made and their treatment must be disclosed in the preparation of the financial statements.

AS 30 Financial Instruments: Recognition and Measurement:

This standard is set up for establishing principles for recognizing and measuring financial instruments. **It becomes mandatory in respect of accounting periods commencing on or after 1-4-2011.** According to this standard, a financial asset or financial liability at fair value through profit or loss is a financial asset or financial liability that is held for trading. Held- to-maturity investments are also financial assets with fixed or determinable payments and fixed maturity that an entity has the positive intention and ability to hold to maturity. Loans and receivables also come under the category of non-derivative financial assets which have fixed or determinable payments that are not quoted in an active market. Last category of financial instruments is available-for-sale financial assets.

According to this standard, an entity should recognize a financial asset or a financial liability on its balance sheet when, and only when, the entity becomes a party to the contractual provisions of the instrument. When a financial asset or financial liability is recognized initially, an entity should measure a financial asset or financial liability at fair value through profit or loss on the date of acquisition or issue plus/minus transaction costs that are directly attributable to the acquisition or issue of the financial asset or financial liability.

AS 31 Financial Instruments-Presentation:

The objective of this standard is to establish principles for presenting financial instruments as liabilities or equity and for offsetting financial assets and financial liabilities. **It becomes mandatory in respect of accounting periods commencing on or after 1-4-2011.** It mainly applies to the classification of financial Instruments, from the point of view of the issuer, into financial assets, financial liabilities and equity instruments; the classification of related interest, dividends, losses and gains; and the circumstances in which financial assets and financial liabilities should be offset. As per AS 31, a **financial instrument** is a contract that gives rise to a financial asset of one entity and a financial liability or equity instrument of another entity. It includes cash, an equity instrument of another entity, a contractual right to receive cash or another financial asset from another entity, etc.,

AS 32 Financial Instruments: Disclosures:

This standard mainly emphasises on the disclosures to be made in the financial statements about the financial instruments. **It becomes mandatory in respect of accounting periods commencing on or after 1-4-2011.** The Financial instruments should be properly classified and properly disclosed at its fair value in the financial statements.

4.8 LET US SUM UP

Accounting standards play an important role to facilitate uniform preparation and presentation of the financial statements. The present practices in the field of accounting give rise to different forms of presentation of financial statements. In order to overcome these complexities, the Accounting Standards Board has made an attempt to introduce Accounting Standards.

These standards help in easy comparison of the financial statements between two different periods and also between two different firms engaging in the similar type of business. The users of the financial information get a true and better picture of the financial results and the financial position of the business enterprise. Accounting standards brings transparency, comparability, adequacy and reliability in the presentation of the financial statements. More and more disclosures are insisted upon enterprises, such that the users of the financial information can judge the performance of the organization clearly.

There are in total 32 Accounting Standards framed in India (except AS 8 which is withdrawn) compared to 41 International Accounting Standards. Every other country is making a sincere attempt to introduce accounting standards in order to bring uniformity in the preparation and presentation of the financial statements.

4.9 KEY WORDS

AS : Accounting standard

AS1: Disclosure of accounting policies

AS2: Valuation of inventories

AS3: Cash flow statements

AS4: Contingencies and events occuring after the balance sheet date.

4.10 TERMINAL QUESTIONS

1) What are Accounting Standards? State the main objectives of such standards.

2) Write a note on the evolution of Accounting Standards.

3) Draw a note on the scope of Accounting Standards.

4) State the merits and demerits of Accounting Standards.

5) Briefly enumerate the provisions of Indian Accounting Standard 6.

6) Give the important provisions of Accounting Standard 8

7) When can revenue be recognized in the case of a transaction of sale of goods as per Accounting Standard-9

8) What do you mean by intangible asset as per Accounting Standard-26

9) What do you understand by impairment of asset as per Accounting Standard-28

4.11 REFERENCE

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I B.Com
Course - III
FINANCIAL ACCOUNTING-1

Department of Studies in Commerce

BLOCK 2

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BLOCK - 2

BLOCK INTRODUCTION

This block emphasises on the prepration of Journal,Ledger,Subsidiary Books & Trial Balance, which is very much necessary for the preparation of final accounts.

This block consists of four units:-

Unit -5: Deals with the Introduction, Need and Importance of Journal and Journalising.

Unit -6: Gives and account of Ledger, Distinguish between Journal and Ledger - Ledger Posting - Format.

Unit-7: Gives an insight into - Introduction , Features and Advantages of Subsidiary Books.

Unit-8: Speaks about Trial Balance, Features, Objectives, Advantages, Format and Specimen of Trial Balance.

UNIT -5

JOURNAL

Structure:

5.0 OBJECTIVES

After studying this unit, you should be able to;

- Give the meaning of Journal
- Explain the features, Need, Format and Importance of Journal.
- State Journalising and Rules
- Give the Narration of Journal entries.

5.1 INTRODUCTION

The size of the business concern and the volume of business transction determines the nature of accounting work. If the size of the business and volume of transactions are numerous, books of accounts are maintained under the modern method which consists of the maintenance of subsidiary books, ledger accounts and final accounts.

5.2 MEANING AND DEFINITIONS OF JOURNAL

The word journal is derived from the **French** word **'jour'** which means a **day.** Therefore, journal means a **daily record.** It is a book in which day to day transactions of a business are recorded in the order of date.

5.3 FEATURES OF JOURNAL

Journal has the following features :

1. It is a book of prime, first or original entry.
2. It is a day book, each day's transactions are recorded on the same day.
3. It records the transactions chronologically, i.e. in the order of date.
4. It shows the debit and credit aspect of each transaction.
5. It is a subsidiary book, i.e., to the ledger it is a subordinate book.
6. It always provides a brief explanation of each entry in the form of a narration.

5.4 NEED FOR JOURNAL

No doubt, a businessman can record all transactions in the various ledger accounts straight away without recording them in the journal. However, in practice, straight away recording has been avoided. Because, if transactions are recorded straight away in various ledger accounts, there are chances of committing mistakes. So, in practice, such a procedure is avoided and journal is used in practice.

5.5 FORMAT OF JOURNAL

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

- The first column i.e., the 'date' column is used for recording the date on which a particular transaction takes place.
- The second column i.e., the 'particulars' column, is used for recording the names of the accounts for a particular transaction.
- The third column, i.e., L.F. (the abbreviation of the term Ledger Folio) is used for recording page number of the ledger to which the journal entry is passed.
- The fourth column, i.e., 'Dr' column, is used for recording the amount to be debited.
- The fifth column, i.e., 'Cr' column, is used for recording the amount to be credited.

5.6 IMPORTANCE OF JOURNAL

If the transactions are directly recorded in the ledger, there are instances of committing mistakes. In order to avoid the happening of such mistakes, transactions are first entered in the journal.

The following statements explain the importance of journal.

1. It gives date wise record of all transactions, this helps quick and easy reference of any transaction.
2. It supplies complete record of all transactions at one place.
3. It provides narration to each entry, this helps to understand the nature and objective of the entry.
4. It avoids the need of making ledger entries immediately, i.e., as soon as transactions take place. Entries in the ledger can be made periodically.
5. It helps to avoid mistakes or errors in the books of accounts.
6. It facilitates rectification of errors easily and quickly.
7. It is a book of primary entry, therefore, it acts as an evidence to support legal issues.
8. It helps in understanding the principles of double entry system. As entries in the journal are classified into debit and credit.

5.7 JOURNALISING

Journalising means recording a transaction in the journal and the form in which it is recorded is known as **journal entry.**

Steps Required for Journalising

For journalizing a transaction, the following steps have to be considered :

1. Firstly, we should ascertain the two accounts involved in the transaction. While ascertaining the two accounts, the account of the firm (in whose books the transaction is recorded) should not be taken into account, as the entry is passed in the books of that firm.
2. Secondly, we have to ascertain the nature of the accounts involved, i.e., whether the accounts are personal, real and nominal accounts.
3. Thirdly, we have to apply the appropriate rules of debit and credit to decide which account is to be debited and which account is to be credited.
4. Finally, the entry should be passed in the journal.

5.8 POINTS TO BE NOTED WHILE PASSING JOURNAL ENTRIES

The following points should be considered while passing journal entries :

1. For the purpose of accounting, the business and the proprietor of the business must be considered as two separate parties. All transactions are recorded in the books of the business and not in the books of the proprietor.

2. All business transactions are recorded in the books of the business from the view point of business, and not from the view point of the proprietor.

3. Whenever the proprietor of a business brings in cash or any other assets into the business, an account called 'Capital account' should be opened in the name of the proprietor. Suppose, the proprietor brings in cash, the two accounts involved are - (a) cash account and (b) capital account.

4. Whenever the proprietor of a business withdraws cash, goods or anything from the business for domestic or personal use, the accounts involved are - a) Drawings account, and b) cash account.

5. When it is not clearly stated in the transaction whether the goods are bought for cash or on credit or goods are sold for cash or on credit, it should be presumed that it is for cash if the party's name is not given. If the party's name is clearly given, then it should be presumed as credit transaction.

6. Whenever there is a return, i.e. purchases or sales returns, appropriate adjustment entries have to be made in the books of accounts.

7. Cash discount is allowed by the business to its debtor at the time of receipt of money from the debtor for his prompt payment or the discount received by a business from its creditor at the time of payment of money to the creditor for the prompt payment made to him. These transactions have to be properly recorded in the books of account.

8. Trade discount is a reduction in the selling price allowed by a seller to buyer, to help the buyer to sell goods at the catalogue price. It must be remembered that, trade discount is calculated on the purchase price of the goods including delivery charges. It is deducted from the catalogue price and only the net price is taken while recording the transaction in the books. That means, trade discount will not appear in the books of the firm.

5.9 MARKING ENTRIES IN THE JOURNAL

As discussed earlier, whenever a transaction is given, accounts involved in that transaction have to be identified. Thereafter, the nature of accounts involved in it should be decided. Then rules of debit and credit are applied to record the account to be debited and credited.

In order to understand the actual method of making entries in the journal, a few examples have been given.

Illustration 1

Journalise the transactions in the books of Raghu.

2010

January 1 Raghu commenced business with cash Rs. 10,000

--- " --- 3 Paid into bank Rs. 2,000

--- " --- 4 Bought goods for cash Rs. 3,000

--- " --- 6 Bought office furniture for cash Rs. 2,000

--- " --- 7 Sold goods for cash Rs. 1,200

--- " --- 8 Sold goods to Vinay Rs. 1,000

--- " --- 9 Bought goods from Hari Rs. 2,000

--- " --- 10 Paid rent to landlord Rs. 1,500

--- " --- 11 Sold furniture for cash Rs. 1,000

--- " --- 13 Received commission from Sachin Rs. 500

--- " --- 14 Sold goods to Shankar Rs. 5,000

--- " --- 17 Bought goods from Prabhu Rs. 6,000

--- " --- 20 Paid Carriage Rs. 150

--- " --- 24 Paid postage Rs. 120

--- " --- 26 Withdraw cash from personal use Rs. 1,000

Journal Entries				
Date	Particulars	L.F.	Debit	Credit
2010			Rs.	Rs.
January 1	Cash A/c Dr. To Capital A/c (Being cash introduced by the proprietor)		10,000	10,000
January 3	Bank A/c Dr. To Cash A/c (Being cash paid into bank)		2000	2,000
January 4	Purchases A/c Dr. To Cash A/c (Being goods purchased for cash)		3,000	3000
January 6	Office Furniture A/c Dr. To Cash A/c (Being the furniture bought for cash)		2,000	2,000
January 7	Cash A/c Dr. To Sales A/c (Being goods sold for cash)		1200	1200
January 8	Vinay's A/c Dr. To Sales A/c (Being good hold to Vinay on Credit)		1,000	1,000
January 9	Purchases A/c Dr. To Hari's A/c (Being goods bought from Hari on Credit)		2,000	2,000
January 10	Rent A/c Dr. To Cash A/c (Being rent paid)		1,500	1,500

January 11	Cash A/c Dr. To Furniture A/c (Being Furniture sold for cash)		1,000	 1,000
January 13	Cash A/c Dr. To Sachin's A/c (Being Commission received)		500	 500
January 14	Shankar's A/c Dr. To Sales A/c (Being goods sold to Shankar on credit)		5,000	 5,000
January 17	Purchases A/c Dr. To Prabhu's A/c (Being goods purchased from Prabhu on Credit)		6,000	 6,000
January 20	Carriage A/c Dr. To Cash A/c (Being carriage paid)		150	 150
January 24	Postage A/c Dr. To Cash A/c (Being postage paid)		250	 250
January	Drawings A/c Dr. To Cash A/c (Being cash withdrawn by the proprietor for his personal use)		1000	 1000
	Total		**36,600**	**36,600**

Illustration 2

2010 March 1 Guru started his business with the following

	Rs.
Cash in hand	3,000
Cash at Bank	7,000
Goods in hand	5,000
Furniture	4,000
Buildings	10,000
Due by Mohan	1,200
Due to Ramu	1,600
Due to Ramesh	2,400

His transactions during the month are :

March 2	Purchased goods from Ramesh Rs. 2,400 subject to a trade discount of 10%
---"--- 3	Sold goods to Shankar subject to a trade discount of 10%, Rs. 5,000
---"--- 8	Received from Mohan Rs. 1,000, discount allowed to him Rs. 200
---"--- 10	Received from Shankar in full settlement of his account Rs. 4,200
---"--- 15	Paid to Ramu in full settlement of his account Rs. 1,400
---"--- 20	Paid to Ramesh Rs. 2000, discount allowed to him Rs. 160
---"--- 24	Paid Salaries Rs. 10,000, rent Rs. 3,000 and interest Rs. 2,000
---"--- 26	Sold goods to Umesh Rs. 5,000 and for cash Rs. 7,000
---"--- 28	Purchased goods for cash Rs. 18,000 and on credit from Veeresh Rs. 2000

Journal Entries

Date	Particulars		L.F.	Debit	Credit
				Rs.	Rs.
2010					
March 1	Cash A/c	Dr.		3,000	
	Bank A/c	Dr.		7,000	
	Stock A/c	Dr.		5,000	
	Furniture A/c	Dr.		4,000	

	Buildings A/c Dr.		10,000	
	Mohan's A/c Dr.		1,200	
	To Ramu's A/c			1,600
	To Ramesh's A/c			2,400
	To Capital A/c			26,200
	(Being the assets and liabilities introduced by the proprietor into the business)			
March 2	Purchases A/c Dr.		2,160	
	To Ramesh's A/c			2,160
	(Being the purchase of goods worth Rs. 2,400 at a trade discount of 10%)			
March 3	Shankar's A/c Dr.		4,500	
	To Sales A/c			4,500
	(Being the sale of goods to Shankar worth Rs. 5,000 subject to a trade discount of 10%)			
March 8	Cash A/c Dr.		1,000	
	Discount A/c Dr.		200	
	To Mohan's a/c			1,200
	(Being Cash received from Mohan and discount allowed to him)			
March 10	Cash A/c Dr.		4,200	
	Discount A/c Dr.		300	
	To Shankar's A/c			4,500
	(Being Cash received from Shankar and discount allowed to him)			
March 15	Ramu's A/c Dr.		1,600	
	To Cash A/c			1,400
	To Discount A/c			200
	(Being the payment of Rs. 1,400 to Ramu in full settlement of his account for Rs. 1,600)			

March 20	Ramesh's A/c Dr. To Cash A/c To Discount A/c (Being the amount due to Ramesh paid and a discount of Rs. 160 allowed by him)		2,160	 2,000 160
March 22	Cash A/c Dr. To Commission A/c To Interest A/c (Being commission and interest received)		2,000	 1,600 400
March 24	Salaries A/c Dr. Rent A/c Dr. Interest A/c Dr. To Cash A/c (Being salaries, rent and interest paid)		10,000 3,000 2,000	 15,000
March 26	Cash A/c Dr. Umesh's A/c Dr. To Sales A/c (Being the goods sold partly for cash and party on credit)		7,000 5,000	 12,000
March 28	Purchases A/c Dr. To Cash A/c To Veeresh's A/c (Being the goods purchased partly for cash and partly for credit)		20,000	 18,000 2000
	Total		**95,320**	**95,320**

Illustration 3

Pass journal entries for the following transactions :

2010

Jan 1. Depreciation charged on furniture Rs. 1000

Jan 2. Rent due, but not paid Rs. 500

Jan 3 Goods given as charity Rs. 1,500

Jan 4 Bad debts written off Rs. 1,000

Jan 5 Bad debts recovered Rs. 1,500

Jan 6 Goods distributed as samples Rs. 500

Jan 7 Goods withdrawn by the proprietor for his personal use Rs. 1500

Jan 8 Loss of goods by fire Rs. 2,000

Jan 9 Loss of Cash by theft Rs. 2,500

Jan 10 Advance received from Vijay for supply of goods Rs. 2,000

Jan 11 Advance paid to Vasanth for supply of goods Rs. 3,000

Jan 12 Lorry hire charges paid Rs. 2,500

Jan 13 Invoice received from Amar Rs. 4,000

Jan 15 Sold goods to Suresh of the list price of Rs. 2,000 less 5% trade discount and 2% cash discount, for cash

Jan 16 Bought from Viswas goods of the list price of Rs. 10,000, less 10% trade discount and 5% cash discount, for cash

Solution :

Journal Entries

Date	Particulars	L.F.	Debit	Credit
			Rs.	Rs.
2010				
January 1	Depreciation A/c Dr.		1,000	
	To Furniture A/c			1,000
	(Being the depreciation charged on furniture)			

January 2	Rent A/c To Outstanding Rent A/c (Being the rent due, but not paid)	Dr.	500	500
January 3	Charity A/c To Purchases A/c (Being Charity paid)	Dr.	1,500	1,500
January 4	Bad Debts A/c To Sundry Debtors A/c (Being the bad debts written off)	Dr.	1,000	1,000
January 5	Cash A/c To Bad debts Recovered A/c (Being the bad debts recovered)	Dr.	1,500	1,500
January 6	Advertisement A/c To Purchases A/c (Being the goods distributed as samples)	Dr.	500	500
January 7	Drawings A/c To Purchases A/c (Being the goods withdrawn by the proprietor for his personal use)	Dr.	1,500	1,500
January 8	Loss of Goods by Fire A/c To Purchases A/c (Being the loss of goods by fire)	Dr.	2,000	2,000
January 9	Loss of Cash by Theft A/c To Cash A/c (Being the loss of Cash by theft)	Dr.	2,500	2,500
January 10	Cash A/c To Advance Received A/c (Being the advance received for supply of goods)	Dr.	2,000	2,000

January 11	Advance given A/c Dr. To Cash A/c (Being the advance given to a supplier for supply of goods)		3,000	 3,000
January 12	Lorry hire charges A/c Dr. To Cash A/c (Being lorry hire charges paid)		2,500	 2,500
January 15	Cash A/c (2000-100=1900-38) Dr. Discount allowed A/c To Sales A/c (2000-100) (Being the goods of the list price of Rs. 2,000 sold at 5% trade discount and 2% cash discount)		1862 38	 1,900
January 16	Purchase A/c (10,000-1000) Dr. To Cash A/c (9000-450) To Discount received A/c (Being the goods of the list price of Rs. 10,000 purchased at 10% trade discount and 5% cash discount for cash)		9,000	 8,550 450
	Total		**30,400**	**30,400**

Illustration 4

Show how the following transactions would appear in the journals of Ajay and Chandan :

2010

January 1 Ajay bought goods from Chandan Rs. 2,000

January 2 Chandan bought goods from Ajay Rs. 3,000 for cash

January 3 Chandan received cash from Ajay Rs. 1,560 and allowed him discount Rs. 40.

January 8 Ajay made cash sales of Rs. 1400 to Chandan

January 15 Chandan supplied goods worth Rs. 600 for Ajay's domestic use

January 19	Ajay supplied to Chandan, Machinery worth Rs. 2,000 in exchange for building worth Rs. 2,000, goods of Rs. 1,600, and cash of Rs. 400.
January 22	Chandan charged Ajay Commission of Rs. 100
January 25	Chandan received a cheque for Rs. 2,000 from Ajay in full settlement of Rs. 2,100
January 27	Ajay's cheque was paid into the bank
January 30	Ajay advanced a loan of Rs. 4000 to chandan.
January 31	Ajay received Rs. 1,000 from Chandan for repairing the motor cycle of Chandan.

In the Books of Ajay

Journal Entries

Date	Particulars		L.F.	Debit	Credit
2010				Rs.	Rs.
Jan 1	Purchases A/c	Dr.		2,000	
	To Chandan's A/c				2,000
	(Being goods purchased from Chandan on Credit)				
Jan 2	Cash A/c	Dr.		3,000	
	To Sales A/c				3,000
	(Being goods sold for Cash)				
Jan 3	Chandan's A/c	Dr.		1,600	
	To Cash A/c				1560
	To Discount received A/c				40
	(Being the cash paid to Chandan and discount received from him)				
Jan 8	Cash A/c	Dr.		1400	
	To Sales A/c				1400
	(Being cash sale of goods)				
Jan 15	Drawings A/c	Dr.		600	
	To Chandan's A/c				600
	(Being goods received from Chandan on credit for personal use)				

Jan 19	Building A/c Dr. Purchases A/c Dr. Cash A/c Dr. To Machinery A/c (Being building exchanged for machinery, goods and cash)		2,000 1600 400	 4,000
Jan 22	Commission A/c Dr. To Chandan's A/c (Being commission due to Chandan)		100	 100
Jan 25	Chandan's A/c Dr. To Bank A/c To Discount Received A/c (Being the cheque issued to Chandan and discount received from him)		2,100	 2,000 100
Jan 30	Chandan's Loan A/c Dr. To Cash A/c (Being loan advanced to Chandan)		4,000	 4,000
Jan 31	Cash A/c Dr. To Repairs A/c (Being the repair charges received)		1,000	 1,000
	Total		**19,800**	**19,800**

In the books of Chandan
Journal Entries

Date	Particulars	L.F.	Debit	Credit
2010			Rs.	Rs.
Jan. 1	Ajay's A/c Dr.		2,000	
	To Sales A/c			2,000
	(Being goods sold to Ajay on credit)			
Jan 2	Purchases A/c Dr.		3,000	
	To Cash A/c			3,000
	(Being good purchased for Cash)			
Jan 3	Cash A/c		1,560	
	Discount Allowed A/c Dr.		40	
	To Ajay's A/c			1,600
	(Being cash received from Ajay and discount allowed to him)			
Jan 8	Purchases A/c Dr.		1,400	
	To Cash A/c			1,400
	(Being goods purchased for cash)			
Jan 15	Ajay's A/c Dr.		600	
	To Sales A/c			600
	(Being goods sold to Ajay on Credit)			
Jan 19	Machinery A/c Dr.		4,000	
	To Buildings A/c			2,000
	To Sales A/c			1,600
	To Cash A/c			400
	(Being machinery, goods and cash exchanged for machinery purchased)			

Jan 22	Ajay's A/c Dr. To Commission A/c (Being Commission charged to Ajay)		100	 100
Jan 25	Cash A/c Dr. Discount Allowed A/c Dr. To Ajay's A/c (Being Cash received from Ajay and discount allowed to him)		2,000 100	 2,100
Jan 27	Bank A/c Dr. To Cash A/c (Being Ajay's cheque deposited into bank)		2,000	 2,000
Jan 30	Cash A/c Dr. To Ajay's loan A/c (Being loan received from Ajay)		4,000	 4,000
Jan 31	Drawings A/c Dr. To Cash A/c (Being repair charges of vehicle paid in cash)		1,000	 1,000
	Total		**21,800**	**21,800**

5.10 LET US SUM UP

Journal means daily recording of transactions in a book. It is playing a crucial role for maintaining the daily transactions entered into seperate book.

5.11 KEY WORDS

Journal : Daily recording transactions in a book.

Journalising : Passing an entry for a transaction in the journal is called Journalising

5.12 TERMINAL QUESTIONS

1. Explain the meaning of journal, State its features.
2. Discuss the importance of journal
3. What is journalizing? State its rules.
4. Give the format of a journal.
5. Journalise the following transactions in the books of Manohar

2010

July 1	Commenced business with a loan from friend, Anand Rs. 10,000
July 2	Opened a current a/c with Canara bank Rs. 2500
July 4	Paid office rent Rs. 2000, telephone bill Rs. 1000
July 6	Gave loan to Anil Rs. 6000
July 10	Bought office furniture Rs. 5000
July 12	Drew for personal use Rs. 1000
July 20	Sold to Vijay Rs. 2000
July 28	Paid to advance to supplier Rs. 1000
July 30	Bought Scooter for office use Rs. 3000
July 31	Sent a cheque to Suman on account Rs. 3000.

6. Jan. 1. Jayaram started business with the following assets and liabilities

Cash in hand	2000
Goods in hand	3000
Furniture	1500
Buildings	5000
Due by Shiva	1000
Due to Komal	3000

His transactions for the month are:

Jan 2	purchased goods from subhash subject to a trade discount of 10%	10,000
Jan 4	Sold goods to Naveen Subject to a trade discount of 5%	5000
Jan 6	Received from Shiva on account	500
Jan 7	Received from Naveen	1500
Jan 20	Paid to Komal	2500
Jan 26	Drew for office use	1000

5.13 REFERENCE

Accountancy	- B.S. Raman
Accountancy	- H.R. Appanniah, P.N. Reddy
Financial Accounting-I	- B.S. Raman
Advanced Accountancy	- Anil Kumar

UNIT - 6

LEDGER

Structure:

6.0 Objectives

6.1 Introduction

6.2 Meaning and Definitions of Ledger

6.3 Features of a Ledger

6.4. Need and Importance of Ledger

6.5 Distinction between Journal and Ledger

6.6 Format of Ledger

6.7 Ledger Posting

6.8 Balancing of Ledger Accounts

6.9. Procedure for Balancing of an Account

6.10 Let Us Sum Up

6.11 Key Words

6.12 Terminal Questions

6.13 Reference

6.0 OBJECTIVES

After Studying this unit, you should be able to

- Explain the meaning and definitions of ledger
- Discuss the features of a ledger
- Assess the need and importance of ledger
- Bring out the distinction between journal and ledger
- Chalkout a format of ledger
- Carryout the ledger posting
- Give an account of balancing of ledger accounts
- Highlight the procedure for balancing of an account
- Describe the preparation of ledger accounts.

6.1 INTRODUCTION

After all the transactions are recorded in a single journal, the entries in the journal are posted to appropriate accounts in the ledger. Postings to ledger accounts are made periodically, say, weekly, fortnightly, monthly, or quarterly to know the actual position of each account on any particular date. Therefore, it is essential to have a detailed discussion on the topic 'ledger'

6.2 MEANING AND DEFINITIONS OF LEDGER

The term 'Ledger' is derived from the **'Dutch'** word **'Legger'** which means to **'Lie'.** Therefore, Ledger refers to a book where different accounts are kept. It is a book where transactions of the same nature are classified and grouped together in one place in the form of an account, popularly known as **'Posting'.** A Ledger contains all types of accounts personal, Real and Nominal accounts. Accounting to **L.C. Croppor,** "The book in which a trader's all transactions are recorded in a classified permanent form is called a ledger".

6.3 FEATURES OF A LEDGER

The main features of a ledger are :

i. It is a book of final entry - because, the transactions recorded in the journal are finally recorded in the ledger

ii. It is an analytical record of transactions - Because, transactions are classified in the ledger.

iii. It is a secondary record - As the entries in the Ledger are derived from the primary record.

iv. It is a principal book of accounts - Because it supplies information needed for the finalisation of accounts.

v. It is a permanent record of all transactions.

6.4. NEED AND IMPORTANCE OF LEDGER

As we know that, all transactions are recorded in the journal in the order of dates. on account of this, transactions of similar nature may be found on different pages of the journal. Therefore, it is not possible to know the net effect of transactions of similar nature on any particular date. This limitation gave rise to the preparation of ledger accounts. The ledger, being the permanent and final record, provides the exact position of each account on any particular date.

In the ledger, transactions of the same nature are grouped together in one place in the form of an account through an activity, known as positing. The following statements explain the importance of a ledger:

i. It provides complete information of all accounts at one place.

ii. It provides final position of each account on any particular date.

iii. It provides a permanent record of all the transactions.

iv. It helps in the preparation of final accounts.

v. It helps to findout different items of revenues and expenses.

vi. It helps to findout the amount due from each debtor and the amount due to each creditor.

vii. It helps to findout the assets of business and their values as well as liabilities and their amounts.

6.5 DISTINCTION BETWEEN JOURNAL AND LEDGER

Journal	Ledger
i. It is book of first or prime entry.	i. It is a book of final entry.
ii. It is subsidiary book	ii. It is a principal book.
iii. It is a daily record-transactions are recorded daily.	iii. It is a periodical record - transactions are recorded weekly, monthly, fortnightly etc.
iv. Narration is written for each transaction.	iv. Narration is not written in the ledger.
v. Recording of transactions in the journal is known as 'journalising'.	v. Recording of transactions in the ledger is called 'posting'.
vi. Both the aspects of each transaction are recorded in this book.	vi. Only one aspect of each transaction is recorded.
vii. Information about a particular account is not found in one place.	vii. Information about a particular account is found in one place.
viii. It helps in the preparation of a ledger.	viii. It helps in the preparation of trail balance and final accounts.
ix. In the journal page numbers of ledger are entered.	ix. In the ledger page number of journal is entered.
x. In the case of legal issues, journal is considered as the main evidence.	x. In the case of legal issues. Ledger is regarded as an addition evidence.
xi. A business enterprise may avoid the journal book.	xi. A business enterprise cannot escape from preparing ledger accounts.

6.6 FORMAT OF LEDGER

Dr. **Cr.**

1	2	3	4	5	6	7	8
Date	particulars	LF	Amount	Date	particulars	LF	amount

A ledger account is divided into two sides, Viz, (i) Debit side or left hand side and (2) Credit side or right hand side. The debit side is meant for recording debit aspect of a transaction and credit side is meant for credit aspect of a transaction.

The **date** columns are used for recording date of transactions. The **particulars** columns are used for recording the details of the transaction. The **L.F.** columns are used for recording page numbers of the journal from where the transactions are posted. The **amount** columns are used for recording the amount of the transactions.

Alternative form of ledger account

Banks and other institutions have adopted an alternative form of ledger account to know the balance of an account after each transaction. Such format of ledger account appear as follows:

Ledger Account

Date 1	particulars 2	LF 3	Debit 4	Credit 5	Debit/Credit 6	Balance 7
			Rs.	Rs.	Rs.	Rs.

6.7 LEDGER POSTING

The process of transferring the entries form the journal to the ledger is called positing

Steps in posting

The following steps have been considered while posting the entries from the journal to the ledger:

1. A separate account should be opened for each account found in the Ledger.
2. For all those transactions which relate to any particular account, only one account is opened.
3. The name of the account should be written at the top and in the center of each account.
4. The word Dr. (abbreviation of debit) should be written at the left hand top corner and the word Cr. (abbreviation of credit) should be written at the right hand top corner of the account.

5. The journal entries should be posted to the ledger accounts in the order of their dates.

6. The date of each entry should be entered in the date column against to it.

7. Every entry on the debit side of account should begin with the word **'To'** and every entry on credit side of an account should begin with the word **'By'.**

8. page number of the journal should be entered in the J.F. column.

9. Every ledger account should be balanced periodically.

6.8 BALANCING OF LEDGER ACCOUNTS

As soon as all the transactions have been posted to various accounts, the balances of these accounts are ascertained. The difference between the two sides is called the balance.

Balancing of a ledger account is the process of ascertaining whether a particular account has received more benefits or has given more benefits. In other words, it is the process of finding out the difference between the total of the debit side and the credit side of an account.

There are two types of balances. They are : 1. Debit balance, and 2. Credit balance.

1. **Debit balance :** When a ledger account is balanced, if the debit side total of any account is greater than the credit side total, the balance is called debit balance.

2. **Credit balance :** When a ledger account is balanced, if the credit side total of an account is greater than the debit side total, the balance is called credit balance.

6.9. PROCEDURE FOR BALANCING OF AN ACCOUNT

While balancing a ledger account, the following procedure is adopted:

i) Each of the two sides of the account is totalled up and difference between the two total is ascertained.

ii) The difference is entered in the amount column of the lighter side to make the totals of both the sides equal.

iii) Enter the difference on the lighter side by writing against in particular column "By Balance C/d" or "To Balanced C/d"

iv) Lastly, bring down the balance on the bigger side below the total amount by writing against in the particular column "To balance b/d" or "By Balance b/d". This indicate the balance brought down from the previous balancing period.

Illustration : 1

Journalise the following transactions and post them to ledger and balance the accounts:

2010

Jan.1	Commenced business with cash Rs. 20,000
Jan. 5	Bought goods for cash Rs. 5000
Jan 6	Sold goods for cash Rs 6000
Jan 10	Purchased goods from Kiran Rs. 3000
Jan 15	Sold goods to Rajeev Rs. 5000
Jan 20	Drew for personal use Rs. 1000

Solution :

Journal entries

Date	Particulars		L.F.	Debit	Credit
				Rs.	Rs.
2010					
Jan.1	Cash A/c	Dr.		20,000	
	To capital A/c				20,000
	(Being commenced business with cash)				
Jan. 5	Purchases A/c	Dr		5000	
	To Cash A/c				5000
	(Being goods purchased for cash)				
Jan. 6	Cash A/c	Dr.		6000	
	To Sales A/c				6000
	(Being goods sold for cash)				

Jan. 10	Purchases A/c Dr. To Kiran's A/c (Being goods sold to kiran on Credit)		3000	 3000
Jan. 15	Rajeev's A/c Dr. To Sales A/c (Being goods sold to Rajeev on credit)		5000	 5000
Jan. 20	Drawings A/c Dr. To Cash A/c (Being cash withdrawn for personal use)		1000	 1000
	Total		**40,000**	**40,000**

Cash A/c

Dr. **Cr.**

Date	Particulars	LF	Amount	Date	Particulars	LF	Amount
2010			Rs.	2010			Rs.
Jan.1	To Capital A/c		20,000	Jan. 5	By Purchases A/c		5,000
Jan. 6	To Sales A/c		6,000	Jan 20	By Drawings A/c		1,000
				Jan.31	By Balance C/d		20,000
			26,000				26,000
Feb.1	To Balance B/d		20,000				

Capital A/c

Dr. **Cr.**

Date	Particulars	LF	Amount	Date	particulars	LF	Amount
2010			Rs.	2010			Rs.
Jan.31	To Balance C/d		20,000	Jan. 1	By Cash A/c		20,000
			20,000				20,000
				Feb.1	By Balance b/d		20,000

Dr. **Purchases A/c** **Cr.**

Date	particulars	LF	Amount	Date	particulars	LF	Amount
2010			Rs.	2010			Rs.
Jan.5	To Cash A/c		5,000	Jan. 31	By Balance c/d		8,000
Jan.10	To. Kiran's A/c		3,000				
			8,000				8,000
Feb.1	To Balance b/d		8,000				

Dr. **Sales A/c** **Cr.**

Date	Particulars	LF	Amount	Date	Particulars	LF	Amount
2010			Rs.	2010			Rs.
Jan.31	To Balance c/d		11,000	Jan. 6	By Cash A/c		6,000
				Jan. 15	By Rajeev's A/c		5,000
			11,000				11,000
				Feb.1	By Balance b/d		11,000

Dr. **Kiran's A/c** **Cr.**

Date	Particulars	LF	Amount	Date	Karticulars	LF	Amount
2010			Rs.	2010			Rs.
Jan.31	To Balance c/d		3,000	Jan. 10	By Purchases A/c		3,000
			3,000				3,000
				Feb.1	By Balance b/d		3,000

Dr. **Rajeev's A/c** **Cr.**

Date	Particulars	LF	Amount	Date	Particulars	LF	Amount
2010			Rs.	2010			Rs.
Jan.15	To Sales A/c		5,000	Jan. 31	By Balance c/d		5,000
			5,000				5,000
Feb.1	To Balance b/d		5,000				

Dr. **Drawings A/c** **Cr.**

Date	particulars	LF	Amount	Date	particulars	LF	Amount
2010			Rs.	2010			Rs.
Jan.20	To Cash A/c		1,000	Jan. 31	By Balance c/d		1,000
			1,000				1,000
Feb.1	To Balance b/d		1,000				

Illustration : 2

Guru was carrying on a business, he had the following assets and liabilities on 1st January, 2010

	Rs.
Furniture	12,000
Cash	14,000
Amount due to Ravi	10,000
Amount due from Raghu	15,000

His transactions during January, 2010 were as follows:

January	1,	Purchased goods from Ravi Rs. 20,000
- " -	5,	Sold goods to Raghu Rs. 16,000
- " -	15,	Purchased furniture Rs. 11,000
- " -	20,	Paid to Ravi on account Rs. 1000
- " -	25,	Drew Cash for personal use Rs. 1200
- " -	28,	Bought in additional cash Rs. 1000
- " -	31,	Paid Rent, Rs. 2000

- " - 31, Paid Wages Rs. 5000

- " - 31, Paid Stationery Rs. 1500

Journalise the above transactions and post then to the appropriate ledger accounts.

Solution :

Journal Entries

Date	Particulars		L.F.	Debit	Credit
				Rs.	Rs.
2010 Jan.1	Furnirure A/c	Dr		12,000	
	Cash A/c	Dr		14,000	
	Raghu's A/c	Dr		15,000	
	To Ravi's A/c				10,000
	To Capital A/c				31,000
	(Being the opening assets, liabilities and capital brought into business)				
Jan. 1	Purchases A/c	Dr		20,000	
	To Ravi's A/c				20,000
	(Being the goods purchased from Ravi on credit)				
Jan. 5	Raghu's A/c	Dr		16,000	
	To Sales A/c				16,000
	(Being the goods sold to Raghu on credit)				
Jan. 15	Furniture A/c	Dr		11,000	
	To Cash A/c				11,000
	(Being the furniture purchased)				
Jan. 20	Ravi's A/c	Dr		1,000	
	To Cash A/c				1,000
	(Being the cash paid to Ravi on account)				
Jan. 25	Drawings A/c	Dr		1,200	
	To Cash A/c				1,200
	(Being the cash withdrawn for personal use)				

Jan. 28	Cash A/c To Capital A/c (Being the additional cash brought in)	Dr.	1,000	 1,000
Jan. 30	Rent A/c Wages A/c Stationery A/c To Cash (Being cash paid for rent, wages and stationery)	Dr. Dr. Dr.	2,000 5,000 1,500	 8,500
	Total		**99,700**	**99,700**

Ledger Accounts

Dr. **Capital A/c** **Cr.**

Date	Particulars	LF	Amount	Date	Particulars	LF	Amount
2010			Rs.	2010			Rs.
Jan.31	To Balance c/d		32,000	Jan. 1	By Balance b/d		31,000
				Jan 28	By Cash A/c		1000
			32000				32000
				Feb.1	By Balance b/d		32,000

Dr. **Drawings A/c** **Cr.**

Date	Particulars	LF	Amount	Date	Particulars	LF	Amount
2010			Rs.	2010			Rs.
Jan.25	To Cash a/c		1,200	Jan. 31	By Balance c/d		1,200
			1,200				1,200
Feb.1	To Balance b/d		1,200				

Raghu's A/c

Dr. **Cr.**

Date	Particulars	LF	Amount	Date	Particulars	LF	Amount
2010			Rs.	2010			Rs.
Jan.1	To Balance b/d		15,000	Jan. 31	By Balance c/d		31,000
Jan.5	To. Sales A/c		16,000				
			31,000				31,000
Feb.1	To Balance b/d		31,000				

Ravi's A/c

Dr. **Cr.**

Date	Particulars	LF	Amount	Date	Particulars	LF	Amount
2010			Rs.	2010			Rs.
Jan.20	To Cash A/c		1,000	Jan. 1	By Balance b/d		10,000
Jan.31	To. Balance c/d		29,000	Jan. 1	By purchases A/c		20,000
			30,000				30,000
				Feb 1	By balance b/d		29,000

Furniture A/c

Dr. **Cr.**

Date	Particulars	LF	Amount	Date	Particulars	LF	Amount
2010			Rs.	2010			Rs.
Jan.1	To Balance b/d		12,000	Jan. 31	By Balance c/d		23,000
Jan.15	To Cash A/c		11,000				
			23,000				23,000
Feb.1	To Balance b/d		23,000				

Purchases A/c

Dr. **Cr.**

Date	particulars	LF	Amount	Date	Particulars	LF	Amount
2010			Rs.	2010			
Jan.1	To Ravi's A/c		20,000	Jan. 31	By Balance c/d		20,000
			20,000				20,000
Feb.1	To Balance b/d		20,000				

Sales A/c

Dr. Cr.

Date	Particulars	LF	Amount	Date	Particulars	LF	Amount
2010			Rs.	2010			Rs.
Jan.31	To Balance c/d		16,000	Jan. 5	By Raghu's A/c		16,000
			16,000				16,000
				Feb 1	By Balance b/d		16,000

Rent A/c

Dr. Cr.

Date	Particulars	LF	Amount	Date	Particulars	LF	Amount
2010			Rs.	2010			Rs.
Jan.31	To Cash A/c		2,000	Jan. 31	By Balance c/d		2,000
			2,000				2,000
Feb.1	To Balance b/d		2,000				

Wages A/c

Dr. Cr.

Date	Particulars	LF	Amount	Date	Particulars	LF	Amount
2010			Rs.	2010			Rs.
Jan.31	To Cash A/c		5,000	Jan. 31	By Balance c/d		5,000
			5,000				5,000
Feb.1	To Balance b/d		5,000				

Stationery A/c

Dr. Cr.

Date	Particulars	LF	Amount	Date	Particulars	LF	Amount
2010			Rs.	2010			Rs.
Jan.31	To Cash A/c		1,500	Jan. 31	By Balance c/d		1,500
			1,500				1,500
Feb.1	To Balance b/d		1,500				

Illustration : 3

Prepare Anand'sAccount in the ledger of Ganesh, and Ganesh's account in the Ledger of Anand for the following transactions between them.

2010

January	1	Opening debit of Ganesh to Anand Rs. 1,000
- " -	5	Anand sold goods to Ganesh Rs. 4000
- " -	10	Ganesh returned goods to Anand Rs 200
- " -	12	Anand received cash from Ganesh Rs. 1400 and allowed Ganesh discount Rs. 100
- " -	15	Ganesh sold goods to Anand on account Rs 2000
- " -	20	Anand returned goods to Ganesh Rs. 150
- " -	24	Ganesh paid cash to Anand Rs 600
- " -	31	Anand received cash from Ganesh in full settlement Rs. 800

In the Ledger of Ganesh
Anand's Account

Dr. **Cr.**

Date	Particulars	LF	Amount	Date	Particulars	LF	Amount
2010			Rs.	2010			Rs.
Jan.10	To Purchases Returns A/c		200	Jan. 1	By Balance b/d		1,000
				Jan.5	By Purchases A/c		4,000
Jan.12	To Cash A/c 150		1,400	Jan 20	By Sales Returns A/c		150
Jan.12	To Discount Received A/c		100				
Jan.15	To Sales A/c		2,000				
Jan.25	To Cash A/c		600				
Jan.31	To Cash A/c		800				
Jan.31	To Discount Received A/c (Balancing Figure)		50				
			5,150				5,150

In the Ledger Account of Anand
Ganesh's Account

Dr. **Cr.**

Date	particulars	LF	Amount	Date	particulars	LF	Amount
2010			Rs.	2010			Rs.
Jan.1	To Balance b/d		1,000	Jan.10	By Sales Returns A/c		200
Jan.5	To Sales A/c		4,000	Jan.12	By Cash A/c		1,400
Jan.20	To Purcheses Returns A/c		150	Jan.12	By Discount Allowed A/c		100
				Jan.15	By Purchses A/c		2,000
				Jan.24	By Cash A/c		600
				Jan.31	By Cash A/c		800
				Jan.31	By Discount Allowed A/c (Balancing Figure)		50
			5,150				5,150

Illustration : 4

From the following transactions write out a cash accout :

2010

March	1	Swamy commenced his business with cash Rs. 70,000
- " -	3	Paid into Canara Bank Rs. 24,000
- " -	4	Bought goods from Swaroop for Rs. 20,000
- " -	5	Bought stationery for office use Rs. 200
- " -	6	Cash sales Rs. 5000
- " -	11	Sold goods to sapna Rs. 12000
- " -	15	Paid to Swaroop on account Rs. 15000
- " -	18	Received from sapna Rs. 8000
- " -	21	purchased fan, Chairs and mixer for his house Rs. 1800
- " -	25	Received interest on investments Rs. 400
- " -	28	Paid commission to Varun Rs. 800

Cash Account

Dr. Cr.

Date	Particulars	LF	Amunt	Date	Particulars	LF	Amount
2010			Rs.	2010			Rs.
Mar.1	To Capital A/c		70,000	Mar.1	By Bank A/c		24,000
Mar.6	To Sales A/c		5,000	Mar.5	By Stationery A/c		200
Mar.18	To Sapna's A/c		8,000	Mar.15	By Swaroop's A/c		15,000
Mar.25	To Interest on Investments A/c		400	Mar.21	By Drawings A/c		1,800
					By Commission A/c		800
				Mar.31	By Balance c/d		41,600
			83,400				83,400
April 1	To Balance B/d		41,600				

Notes :

1. Cash transactions only are entered in the cash account. Transactions of 4th March and 11th March, 2010 are not cash transcations. Therefore, they will not appear in the cash a/c
2. Fan, table and mixer purchased by the proprietor is treated as drawings.

Illustration : 5

Prepare Personal Account of Shankar from the following particulars:

2010			Rs.
March	1	Debit Balance to Shankar's A/c	2000
- " -	2	Sold goods on Credit to Shankar	5000
- " -	6	Received from Shankar and	6000
		allowed him discount	200
- " -	10	Shankar bought goods on credit	3000
- " -	15	Received cash from Shankar	4000
		allowed him discount	100
- " -	20	Purchased goods on credit from Shankar	2000
- " -	25	Paid cash to Shankar	1000
- " -	28	Returned goods to Shankar	500
- " -	31	paid cash to Shankar in full settlement of his account	680

Shankar's Account

Dr. **Cr.**

Date	Particulars	LF	Amount	Date	Particulars	LF	Amount
2010			Rs.	2010			Rs.
Mar.1	To Balance b/d		2,000	Mar.6	By Cash A/c		6,000
Mar.2	To Sales A/c		5,000		By Discount A/c		200
Mar.10	To Sales A/c		3,000	Mar.15	By Cash A/c		4,000
Mar.25	To Cash A/c		1,000		By Discount A/c		100
Mar.28	To Returns outwards A/c		500	Mar.20	By Purchases A/c		2,000
Mar.31	To Cash A/c		680				
Mar.31	To Discount		120				
			12,300				12,300

6.10 LET US SUM UP

Ledger means posting the entries from the journal. The Ledger balances show the actual position of each account of any particular day. From the ledger account balances we are preparing trial balance.

6.11 KEY WORDS

Credit balance : When a ledger account is balanced, if the credit side total of an account is greater than the debit side total, the balance is called credit balance.

Debit balance : When a ledger account is balanced, if the debit side total of any account is greater than the credit side total, the balance is called debit balance.

Ledger : A Ledger contains all types of accounts, personal, real and nominal accounts.

6.12 TERMINAL QUESTIONS

1. What is ledger? State its features.
2. Discuss the importance of ledger.
3. Bring out the differences between the Jounral and Ledger
4. Discuss the steps in posting
5. What is balancing of ledger account?
6. Briefly explain the procedure of balancing a ledger account.
7. Journalise the following transactions and post them into ledger accounts:

2010		Rs.
July 1	Naveen Commenced business with cash	25,000
July 2	Paid into bank	5000
July 3	Bought goods from Umesh	10,000
July 10	Drew for office use	2000
July 12	Drew for personal use	3000
July 14	Paid to Umesh	4000
July 16	Sold goods to Janaki	15,000
July 18	Returned goods to Umesh	50
July 22	Received from Janaki	3000
July 25	Cash Sales	10,000
July 28	Bought office furniture	5000
July 29	Bought machinery	6000
July 30	Introduced additional Capital	20,000

7. Record the following transactions in the personal account of Raman

2010		Rs.
Jan.1	Sold goods to Raman	5420
Jan 4	Received from Raman Cash	5150
	And allowed him discount	270
Jan 15	Raman bought goods	6000
Jan 28	Received from Raman on account	2000
Feb. 1	Balance from last month b/d	4000
Feb. 13	Sold goods to Raman	10,000
Feb. 20	Received from Raman Cash 3,960	
	And allowed him discount	40
Feb. 28	Received cash in full settlement of Raman's A/c	9800

6.13 REFERENCE

Accountancy - B.S. Raman

Accountancy - H.R. Appanniah, P.N. Reddy

Financial Accounting - I - B.S. Raman

Advanced Accountancy - Anil Kumar

UNIT -7

SUBSIDIARY BOOKS

Structure:

7.0 OBJECTIVES

After studying this unit, you should be able to;

- Give the meaning of subsidary books.
- Explain the features and advantages of subsidary books.
- Highlight the preparation of ledger account.
- Discuss the preparation of subsidiary books.

7.1 INTRODUCTION

Under the modern system of accounting, all business transactions are first recorded in a number of books as and when they take place. The books in which business transactions recorded so are called **subsidiary books.** There after, the entries from the subsidiary books are posted to the appropriate books, in the books of final entry called the ledger. Ledger accounts are balanced periodically to findout the balance of each ledger account. Lastly, a trial balance is prepared from the ledger balances and final accounts are prepared to know the net result and position of the business.

7.2 MEANING OF SUBSIDIARY BOOKS

The various books of original entry maintained for chronological recording of similar types of transactions are called **subsidiary books**. The subsidiary books are also called special journals, as each such book is maintained for recording specific transactions.

7.3 FEATURES OF SUBSIDIARY BOOKS

The main features of subsidiary books are as follows:

1. Subsidiary books are books of original entry, because all transactions are first recorded in these books before they are entered in the ledger.
2. These books are subordinate or assistant to the principal book i.e. ledger.
3. Each class of transactions are separately recorded i.e. separate journal is maintained for recording each class of transaction.
4. They are day books, as transactions are recorded in these books on the same day in which they take place.
5. They are special journals, since each subsidiary book is kept for recording specific nature of transactions.

7.4 ADVANTAGES OF SUBSIDIARY BOOKS

The following statements reveal the advantages of Subsidiary Books.

1. They facilitate classification of transactions according to their nature. This help to know the periodical totals of transactions of same nature. For example, the sales book gives the position of credit sales of a particular period.
2. Reference to any particular transaction becomes easier. Because same nature of transactions are recorded in a special journal.
3. This system provide an opportunity to divide accounting work among different persons. This results in specialization of work and proper functioning.
4. This system facilitate systematic recording of business transactions, this reduces the possibility of errors and frauds.
5. This system reduce the chances of errors in accounting, because both the recording of transactions in the subsidiary books and the posting to ledger accounts are simplified.
6. Under this system, different types of transactions are recorded in different special journals by independent clerks. This results in internal check, which helps to check errors and frauds.
7. This system is flexible in nature, in the sense that, a business firm can maintain such special journals which it feels sufficient and necessary.

7.5 USUAL SUBSIDIARY BOOKS

The usual subsidiary books that are maintained by a concern are as follows:

	Subsidiary Books	Nature of Transactions Recorded
1.	Purchases book	All credit purchases of goods
2.	Sales book	All credit sales of goods
3.	Purchases Returns Book	All goods returned by the trader to his suppliers.
4.	Sales Returns Book	All goods returned to the trader by his customers
5.	Cash Book	To record all receipts and payments of cash.
6.	Bills receivable book	The record all bills of exchange and promissory notes received by the trader from his customers
7.	Bills payable book	To record all bills of exchange accepted and promissory notes given by the trader to his creditors.
8.	Journal proper	To record all those transactions that cannot be recorded in any of the above subsidiary books.

7.6 PURCHASES BOOK

A special journal used for recording only credit purchases of goods is called a **purchases book.** It is also called purchases journal or Inward Invoice Book. It should be remembered that -

(1) Cash purchases of goods should be recorded in the cash book and not in the purchases book.

(2) Only purchase of goods should be recorded in purchase journal. If a business concern buys an item with the object of use in the business (not for resale), It is treated as purchase of an asset, not of goods.

Whenever goods are purchased on credit basis, an invoice or bill is sent by the supplier of goods, to the purchaser of goods. The invoice contains the details of goods Purchased at list price, trade discount, invoice number and the amount payable. The invoice is the basis for writing the purchases book. The proforma of the purchases book is given below.

Purchases Book

Date	Particulars	LF	Inward Invoice No.	Amount Rs.

The **'Date'** column is meant for recording the date on which the invoice is received. The **'particulars'** column is meant for recording the names of the suppliers of goods. The **'Inward Invoice Number'** column is meant for recording the serial number of each inward invoice. The serial number is entered for easy and quick reference of the concerned invoice. The **ledger folio** column is meant for recording the page numbers of the ledger where suppliers' accounts are opened. The **'amount'** column is meant for recording the net amount of the invoice.

Trade discount and cash discount

In the content of the study of purchases book, it is essential to understand about the terms trade discount and cash discount.

Trade Discount

Trade discount is an allowance or a deduction made from the invoice price, list price or catalogue price of goods sold. It is allowed by the manufacturer to wholesaler or wholesaler to retailer as a sort of inducement to purchase more or to continue the business with the supplier. Trade discount doesnot appear in the books of both the parties, i.e., either in the books of the seller or in the books of the buyer. Both the parties record the net amount in their respective books.

Cash Discount

Cash discount is allowed to induce the party to adhere to the terms of payment agreement. Some times it is given to promote mutual business between the parties to transaction. cash discount received is accounted for in the ledger and it is not deducted from the invoice.

Illustration 1:

Enter the following transactions in the purchases book of M/s Suman Traders, grocery dealers.

2010

Jan. 1 Bought from Bharani Traders, Bangalore, 10 bags of rice at Rs. 1000 per bag.

Jan. 5 Bought from Maharaj Traders, Mandya, 30 bags of sugar at Rs. 2000 per bag.

Jan. 10 Bought from Raman flour mills, Tumkur, 10 bags of Wheat flour at Rs. 1500 per bag.

Jan. 15 Bought from Nilgiri Tea company, Ooty, 10 boxes of tea at Rs. 500 per box.

Jan. 25 Bought from Ganesh coffee works, Belur, 10 kgs of coffee powder at Rs. 1000 per kg.

Purchases Book

Date	Particulars	LF	Inward Invoice No.	Amount Rs.
2010	Bharani Traders, Bangalore		1	10,000
Jan.5	Maharaja Traders, Mandya		2	60,000
Jan 10	Raman Flour Mills, Tumkur		3	15,000
Jan 15	Nilgiri Tea Company, Ooty		4	5,000
Jan 25	Ganesh Coffee works, Belur		5	10,000
				1,00,000

Illustration 2

Enter the following transactions in the purchases books

2010

March 1.	Bought from Bhagawan Traders, Bangalore : 10 bags of rice at Rs. 1000 per bag. 50 bags of Sugar at Rs. 1500 per bag. 20 bags of Dal at Rs. 1000 per bag. Less : Trade discout, 10%
March 10	Bought from Nandan Traders, Belur 10 kgs of cardamom at Rs. 1000 per kg. 5 bags of tea powder at Rs. 2000 per bag. 10 bags of wheat flour at Rs. 1000 per bag. Less : Trade discount, 20%
March 25	Bought from Bhandari Brothers, Bhadravathi 5 bags of special rice at Rs. 1500 per bag. 10 bags of gur at Rs. 1000 per bag. Less : Trade discount, 10%

Purchases Book

Date	Particulars	Inward Invoice No.	LF	Details Rs.	Amount Rs.
2010					
March 1.	Bought from Bhagawan Traders, Bangalore :				
	10 bags of rice at Rs. 1000 per bag.			10,000	
	50 bags of Sugar at Rs. 1500 per bag.			75,000	
	20 bags of Dal at Rs. 1000 per bag.			20,000	
				1,05,000	
	Less : Trade discout, 10%			10,500	
					94,500

March 10	Bought from Nandan Traders, Belur			
	10 kgs of cardamom at Rs. 1000 per kg.	10,000		
	5 bags of tea powder at Rs. 2000 per bag.		10,000	
	10 bags of wheat flour at Rs. 1000 per bag.		10,000	
			30,000	
	Less : Trade discount, 20%		6,000	
				24,000
March 25	Bought from Bhandari Brothers, Bhadravathi			
	5 bags of special rice at Rs. 1500 per bag.		7,500	
	10 bags of gur at Rs. 1000 per bag.		10,000	
			17,500	
	Less : Trade discount, 10%		1,750	
				15750
	Total			**1,34,250**

Posting from the purchases book

While posting the entries from the purchase book a separate account for each supplier is opened in the ledger. Further, a purchases account is also opened for recording purchases. Accounts of suppliers in the ledger account are credited with invoice price of goods supplied by them. For this purpose, on the credit side of each supplier's account, we should write "By purchases Account".

The purchases account opened in the ledger must be debited with the monthly total of the purchases book, because purchases are debit entries. Therefore, we must write on the debit side of the purchases book **'To sundries'.** This process complete the double entry of the purchases book.

Illustration 3

Enter the following transactions in the purchases book of **Rao and company** and post them into respective ledger accounts.

2010

Jan, 1 Purchased from poonam Silks, Bangalore

100 Handloom sarees at Rs. 2000 each.

50 Fancy sarees at Rs. 500 each

Less : Trade discount at 10%

Jan 10 Purchased from Shanthala Silks, Mysore

50 Border line sarees at Rs. 400 each

100 Sarees with blouse pieces at Rs. 200 each.

Jan 15 Purchased from Kuberan Silks, Bangalore

40 Kanchi sarees at Rs. 400 each

50 Banaras sarees at Rs. 1000 each

Less : Trade Discount at 10%

Jan 25 Purchased from Simha Silks, Mysore

100 Cotton sarees at Rs. 900 each

100 Handloom silk sarees at Rs. 1000 each

Soluction

In the Books of Rao and Company

Purchases Book

Date	Particulars	Inward Invoice No.	LF	Details Rs.	Amount Rs.
2010	**Poonam Silks, Bangalore**				
Jan 1	100 Handloom sarees at Rs. 2000 each.			2,00,000	
	50 Fancy sarees at Rs. 500 each			25,000	
				2,25,000	
	Less : Trade discount at 10%			22,500	
					2,02,500
Jan 10	**Shanthala Silks, Mysore**				
	50 Border line sarees at Rs. 400 each			20,000	
	100 Sarees with blouse pieces at Rs. 200 each.			20,000	
					40,000

Jan 15	**Kuberan Silks, Bangalore**				
	40 Kanchi sarees at Rs. 400 each			16,000	
	50 Banaras sarees at Rs. 1000 each			50,000	
				66,000	
	Less : Trade Discount at 10%			6600	
					59,400
Jan 25	**Simha Silks, Mysore**				
	100 Cotton sarees at Rs. 900 each			90000	
	100 Handloom silk sarees at Rs. 1000 each			100000	
					1,90,000
		Total			**4,91,900**

Ledger Book

Dr. **Purchases Account** **Cr.**

Date	Particulars	LF	Rs.	Date	Particulars	LF	Rs.
2010 Jan.31	To Sundries as per Purchase book		4,91,900				

Dr. **Poonam Silks Account, Bangalore** **Cr.**

Date	Particulars	LF	Rs.	Date	Particulars	LF	Rs.
				2010 Jan.1	By purchases A/c		2,02,500

Dr. **Shanthala Silks Account, Mysore** Cr.

Date	Particulars	LF	Rs.	Date	Particulars	LF	Rs.
				2010 Jan.10	By purchases A/c		40,000

Dr. **Kuberan Silks Account, Bangalore** Cr.

Date	Particulars	LF	Rs.	Date	Particulars	LF	Rs.
				2010 Jan.15	By purchases A/c		59,400

Dr. **Simha Silks Account, Mysore** Cr.

Date	Particulars	LF	Rs.	Date	Particulars	LF	Rs.
				2010 Jan.1	By purchases A/c		1,90,000

Sales Book

The Sales Book is used for recording only credit sale of goods. Credit sale of things other than goods should be entered in the journal proper, and not in the sales book. Cash sales of goods should be entered in the cash book. Ruling of the sales book is similar to ruling of purchases book.

Sales Invoice

Whenever goods are sold by a trader on credit he will rise a statement giving the particulars of the quantity, quality, price of the goods sold. This statement is called an **'Invoice'.** The invoice issued by the seller is known as **'Outward Invoice'.**

Form of sales book:

Sales book

Date	Particulars	Outward Invoice No.	LF	Details Rs.	Amount Rs.

Illustration 1:

Enter the following transactions in the sales book of Madhura, a provision marchant.

2010

March1.	Sold to Aravind and company, 10 bags of Wheat at Rs. 1000 per bag.
March 5	Sold to Abid, Mysore, 10 bags of Sugar at Rs. 200 per bag.
March 10	Sold Anand, Hassan, 10 bags of Rice at Rs. 1000 per bag.
March 15	Sold to Mahendra, shimoga 20 bags of Groundnut at Rs. 900 per bag.
March 25	Sold Avinash, Belur, 15 bags of Wheat flour at Rs. 1500 per bag.

Solution

Sales Book

Date	Particulars	Outward Invoice No.	LF	Amount Rs.
2010				
March 1	Aravind and Co., Bellary (10 x Rs. 1000)		1	10,000
March 5	Abid, Mysore (10 x Rs. 2000)		2	20,000
March 10	Anand, Hassan (10 x Rs 1000)		3	10,000
March 15	Mahedra, Shimoga (20 x Rs 900)		4	18,000
March 25	Avinash, Belur (15 x Rs. 1500)		5	22,500
	Total			**80,500**

Postings from the Sales Book

While posting the entries from the sales book, a separate account for each customer (buyer of goods) is opened in the ledger. Further, a Sales Account is also opened for recording the sales. Accounts of customers in the ledger account are debited with the amount of goods sold on Credit. For this purpose, on the debit side of each customer's account, we should write **"To Sales Account".** The sales account opened in the ledger must be credited with the monthly total of sales book, because sales are credit entries. Therefore, on the credit side of the sales book, we must write **"By sundries".** This process complete the double entry of the sales book.

Illustration 2

Enter the following credit sales transactions for the month of March, 2010.

2010

March 1 Sold to Amaranath Electronics, Bangalore.
100 philips tubes at Rs. 100 per picece
50 philips mixer at Rs. 900 per piece

March 10 Sold to National Electronics, Shimoga
20 DVD players at Rs. 500 per piece
10 Music Systems at Rs. 2000 per piece

March 20 Sold to Star Electronics, Tumkur
10 Electric iron boxes at Rs. 500 per piece
20 Electric ovens at Rs. 1000 per piece

The trader allowed 10% discount on all sales. Also show the posting of these transactions into respective ledger accounts.

Solution

Sales book

Date	Particulars	Outward Invoice No.	LF	Details Rs.	Amount Rs.
2010					
March 1	**Amaranath Electronics, Bangalore.**				
	100 philips tubes at Rs. 100 per picece			10,000	
	50 philips mixer at Rs. 900 per piece			45,000	
				55,000	
	Less : Trade discount at 10%			5,500	
					49,500
March 10	**National Electronics, Shimoga**				
	20 DVD players at Rs. 500 per piece			10,000	
	10 Music Systems at Rs. 2000 per piece			20,000	
				30,000	
	Less : Trade discount at 10%			3,000	
					27,000

March 20	**Star Electronics, Tumkur**				
	10 Electric iron boxes at Rs. 500 per piece			5,000	
	20 electric ovens at Rs. 1000 per piece			20,000	
				25,000	
	Less : Trade discount at 10%			2,500	
					22,500
	Total				**99,000**

Ledger Book
Sales Account

Dr. **Cr.**

Date	Particulars	LF	Rs.	Date	Particulars	LF	Rs.
				2010 Mar.31	By Sundries as per Sales book		99,000

Amarnath Electronics A/c, Bangalore

Dr. **Cr.**

Date	Particulars	LF	Rs.	Date	Particulars	LF	Rs.
2010 Mar.10	To Sales A/c		49,500				

National Electronics A/c, Shimoga

Dr. **Cr.**

Date	Particulars	LF	Rs.	Date	Particulars	LF	Rs.
2010 Mar.10	To Sales A/c		27,000				

Star Electronics A/c, Thumkur

Dr. **Cr.**

Date	Particulars	LF	Rs.	Date	Particulars	LF	Rs.
2010 Mar.20	To Sales A/c		22,500				

PURCHASES RETURNS BOOK

It is a book which records the details of return of goods to the suppliers. If goods supplied are not according to terms and conditions agreed upon between the business enterprise and the suppliers, such goods are returned to parties who supplied such goods. This book is also called Returns outwards book.

At the time of return of goods, a document called **debit note** is prepared to show details of goods returned and the amount of such goods is properly adjusted in the books. Ruling of purchases return book is similar to purchases book except that invoice number column is replaced by a debit note number column.

Form of Purchases Return Book

Purchases Return Book

Date	Particulars	Debit Note No.	L.F.	Amount Rs.

Circumstances under which debit note is prepared

The debit note is prepared by the purchaser of goods and sent to the supplier of goods in the following circumstances:

1. when goods are defective and needs replacement
2. When goods are damaged during transport
3. When quantities and qualities of goods sent does not agree with invoice.
4. When higher prices changed
5. When goods received are not according to time schedule
6. Any other valid reason.

When debit note is sent, it inform the supplier that his account is debited to the extent of the:

- Goods returned
- Details of goods returned
- Net value of goods returned
- The Reasons for such return, if any

Form of Debit Note

Debit Note

Telegram

Telephone

Debit Note No:

Place :

Date:

From: (Name and address of sender of goods)

....

....

....

To (Name and address of supplier)

....

....

....

Sir,

We are debiting your account with Rs. ………...... value of undermentioned goods to you for reasons given below.

Name and Date of your Invoice	Description of goods returned	Quantity	Rate Rs.	Amount

Reasons for return : 1

2

3

Prepared by ....

Checked by ....

Signature of Manager

Illustration 1:

Enter the following transactions in the purchases returns book.

2010

March 1 Returned goods worth Rs. 1000 to Guru Traders, Hubli

March 10 Returned goods worth Rs. 3000 to Shiva traders, Belur

March 20 Returned goods worth Rs. 10000 to SLV Brothers, Bangalore.

March 25 Allowance claimed from swaroop, Hampi for shortage of Rs. 500

Solution :

Purchases Returns Book

Date	Particulars	Debit Note No.	L.F.	Amount Rs.
2010				
March 1	Guru Traders, Hubli	1		1000
March 10	Shiva Traders, Belur	2		3000
March 20	SLV Brothers Bangalore	3		10000
March 25	Swaroop, Hampi	4		500
	Total			**14,500**

Ledger Posting

Each supplier's account in the ledger is debited with the value of the goods returned or the amount of allowance claimed. For this purpose, on the debit side of each suppliers account we must write **'To purchases returns account".** Similarly, the purchases returns account should be credited with the monthly total of the purchases returns book. For this purpose, on the credit side of the purchases returns account, we must write **'By sundries'.** Thus, the double entry of the purchases returns account is completed.

Illustrution 2

Enter the following transactions in the purchases returns book and post them into ledger.

2010

Jan. 1 Returned to Baliga Brothers

2 mixers at Rs. 1000 each

Jan 20 Returned to sham and company

5 travel bags at Rs. 20 per bag.

Jan. 25 Returned to star Associates

10 Dozens of pens at Rs. 20 per dozen

Purchases Returns book

Date	Particulars	Debit Note. No.	LF	Details	Amount Rs.
2010					
Jan. 1	**Baliga Brothers**				
	2 mixers at Rs. 1000 each				2,000
Jan 20	**Sham and company**				
	5 travel bags at Rs. 20 per bag.				1,000
Jan. 25	**Star Associates**				
	10 dozens of pens at Rs. 20 per dozen				2,000
	Total				**5,000**

Ledger Book

Purchase Returns Account

Dr. **Cr.**

Date	Particulars	LF	Rs.	Date	Particulars	LF	Rs.
				2010			
				Jan.31	By Sundries As per Purchases Return Book		5,000

Dr. **Sham and Co. A/c** **Cr.**

Date	Particulars	LF	Rs.	Date	Particulars	LF	Rs.
2010							
Mar.10	To Purchases return A/c		1,000				

Dr. **Baliga Brothers A/c** **Cr.**

Date	Particulars	LF	Rs.	Date	Particulars	LF	Rs.
2010							
Mar.10	To Purchases return A/c		2,000				

Dr. **Star Associates A/c** **Cr.**

Date	Particulars	LF	Rs.	Date	Particulars	LF	Rs.
2010							
Mar.10	To Purchases return A/c		2,000				

Sales Returns Book

It is a book prepared to record goods returned by customers. When a trader sells goods on credit, his customers return some of the goods due to different reasons. Such returns are recorded in a separate book called **sales returns book.** This book is also known as Returns Inwards Book.

The ruling of sales returns book and recording of transactions in it, is similar to sales book except that invoice column which is replaced by credit note column.

Credit Note

Whenever goods are taken back from a customer or an allowance is granted to him, a statement called **"Credit Note"** is prepared by the trader.

Form of Credit Note

Credit Note

Telegram :------------------------ Credit Note No.: -----------
Telephone :----------------------- Palce :-----------------------
Date:-------------------------

From : (Name and address of sender)

....
....
....

To, (Name and address to whom returned)

....
....
....

Sir,

We are crediting your account with Rs. ..... value of under mentioned goods received from you for the reasons noted in your delivery note number

No. and Date of your Invoice	Particulars Description of goods returned	Quantity	Rate Rs.	Amount Rs.

Prepared by .... Checked by ....

Signature of Manager

Form of sales Returns Book

Sales Returns Book

Date	Particulars	Credit Note No.	L.F.	Details Rs.	Amount Rs.

Illustration 1:

Enter the following transactions in the sales returns book

2010

Jan 1 Returned goods by Raghulal and Co.,
10 plastic jars at Rs. 50 per jar
50 Glass bowls at Rs. 100 per bowl.

Jan. 25 Returned goods by Rehan Brothers
100 Steel plates at Rs.10 Per plate
50 pawns at Rs. 20 per piece

Solution :

Sales Returns Book

Date	Particulars	Credit Note No.	L.F.	Details Rs.	Amount Rs.
2010					
Jan 1	**Raghulal and Co.,**				
	10 plastic jars at Rs. 50 per jar			500	
	50 Glass bowls at Rs. 100 per bowl.			5,000	
					5,500
Jan. 25	**Rehan Brothers**				
	100 Steel plates at Rs.10 Per plate			1,000	
	50 pawns at Rs. 20 per piece			1,000	
					2,000
		Total			**7,500**

Ledger posting

Each customer's account in the ledger is credited with the value of the goods returned or the amount of allowance claimed. For this purpose, on the credit side of each customers account, we must write **"By sales returns A/c".** Similarly, the sales returns account should be debited with the monthly total of the sales returns book. For this purpose, on the debit side of the sales returns account, We must write **To Sundries.** Thus, the double entry of the sales returns account is completed.

Illustration 2

Enter the following transactions in the sales returns book and post these transactions into ledger account.

2010

Jan. 10 Mohan Das and company returned;
50 Units sold at Rs. 100 per unit

Jan. 15 Bhagath and company returned;
100 units sold at Rs. 200 per unit

Jan. 25 Komal Traders returned
200 units at Rs. 50 per unit.

Date	Particulars	Credit Note No.	L.F.	Details Rs.	Amount Rs.
2010					
Jan. 10	**Mohan Das and company**				
	50 Units sold at Rs. 100 per unit				5,000
Jan. 15	**Bhagath and company**				
	100 units sold at Rs. 200 per unit				20,000
Jan. 25	**Komal Traders**				
	200 units at Rs. 50 per unit.				10,000
	Total				**35,000**

Ledger Book

Dr. **Sales Returns Account** **Cr.**

Date	Particulars	JF	Rs.	Date	Particulars	JF	Rs.
2010							
Jan.31	To Sundries as per Sales returns book		35,000				

Mohan Das and company Account

Dr. **Cr.**

Date	Particulars	LF	Rs.	Date	Particulars	LF	Rs.
				2010			
				Jan.10	By sales Retunrs A/c		5,000

Bhagath and company Account

Dr. **Cr.**

Date	Particulars	LF	Rs.	Date	Particulars	LF	Rs.
				2010			
				Jan.15	By sales Returns A/c		20,000

Komal Traders Account

Dr. **Cr.**

Date	Particulars	LF	Rs.	Date	Particulars	LF	Rs.
				2010			
				Jan.25	By sales Returns A/c		10,000

Bills Receivable Book

In case of credit sales, a bill of exchange payable at some future date is drawn by the seller and the same is accepted by the purchaser. A bill of exchange is an instrument which promises to pay the amount specified therein on the expiry of the period for which the bill is drawn.

When bills and promissory notes received by a concern are large in numbers, it is, generally advantageous to maintain a separate subsidiary book known as **Bills Receivable Book.** Thus, a Bills Receivable book is used for recording all the bills and promissory notes received by the concern from outside parties.

Bills Receivable Book

No. of Bill	Date of receipt	Date of bill	From whom received	Drawer	Acceptor	Where paya-ble	Term	due dat e	LF	Amount	Cash book folio	Remarks
1	2	3	4	5	6	7	8	9	10	11	12	13

It should be remembered that Bills Receivable Book is used for recording only bills and promissory notes received by a business firm. Bills and promissory notes realized on due dates, discounted, endorsed to others, sent to bank for collection and dishonoured are not recorded in the Bills Receivable Book. They are recorded either in the cashbook or in the journal proper.

Ledger Posting :

After preparing Bills Receivable Book, Postings are made to the accounts of various parties from whom the bills and promissory notes have been received and also to Bills Receivable Account. Accounts of acceptors of bills in the ledger are credited with the amount of bills accepted by them as **"By Bills Receivable Account".** The Bills Receivable Account should be debited with the monthly total of bills receivable book.

Bills Payable Book

Bills payable book is maintained by the acceptor of the bill for recording the bills accepted by him in favour of other parties and the promissory notes given by the acceptor to other parties. It should be remembered that Bills payable and promissory notes met or paid on the due dates and bills payable and promissory notes dishonoured are not recorded in the bills payable book. They are entered either in the cash book or in the journal proper.

Form of Bills payable Book

Bills payable Book

No. of Bill	Date of Bill	To Whom Given	Drawer	Payee	Where paya-ble	Term of Bill	Due date	LF	Amount Rs.	Due Date	Cash book folio	Remarks
1	2	3	4	5	6	7	8	9	10	11	12	13

After preparing the Bills payable book, postings are made to the accounts of various drawers in whose favour the bills have been accepted and to whom promissory notes have been issued and also Bills payable Account. Account of each drawer in whose favour the bill accepted is debited with the amount of the individual bill or promissory note shown against his name as **"To Bills Payable Account"**. The Bills payable Account is credited with the monthly total of bills payable book.

Illustration :

Enter the following transactions in Bill Receivable and Bills payable Books and post them in the ledger.

2010

Jan 1 Drew on Abhay at 2 months for Rs. 600

Jan 5 Received from Avinash his acceptance for Rs. 400 at 3 months

Jan 7 Accepted Arun's draft for Rs. 1,600 at 2 months

Jan 9 Gave an acceptance at 2 months to Bharani's for Rs. 1200

Jan 15 Chandra drew on me at 3 months for Rs. 600

Jan 20 Received from Vijay, Varun's acceptance for Rs. 400 at 3 months.

Jan 25 Received from Janardhan a bill for Rs. 400 at 2 months accepted by Anjan

Jan 27 Accepted a 2 months bill for Rs. 200 in favour of Jakir.

Bills Receivable Book

No. of Bill	Date of receipt	Date of bill	From whom received	Drawer	Acceptor	Where payable	Term	Due date	LF	Amount	Cash book folio	Remarks
1	2	3	4	5	6	7	8	9	10	11	12	13
	2010	2010						2010		Rs.		
1.	Jan.1	Jan.1	Abhay	Self	Abhay	Mysore	2 months	Mar.4	-	600	-	-
2.	Jan.5	Jan.5	Avinash	self	Avinash	Tumkur	3 months	Apr.8	-	400	-	-
3.	Jan.20	Jan.20	Vijay	Varun	Varun	Mysore	3 months	Apri.23	-	400	-	-
4.	Jan.25	Jan.25	Jana rdhan	Jana rdhan	Anjan	Tumkur	2 months	Mar.28	-	200	-	-
										1600		

Bills Payable Book

No. of Bill	Date of Bill	To Whom Given	Drawer	Payee	Where payable	Term of Bill	Due date	LF	Amount Rs.	Due Date	Cash book folio	Remarks
1	2	3	4	5	6	7	8	9	10	11	12	13
	2010						2010					
1	Jan.7	Arun	Arun	Arun	Mysore	2 months	Mar.10		1600	-	-	-
2.	Jan.9	Bharani	Bharani	Bharani	Belur	2 months	Apir.18	-	1200	-	-	-
3.	Jan.15	Chandra	Chandra	Chandra	Tumkur	2 months	Apir.18	-	600	-	-	-
4.	Jan.27	Jakir	Jakir	Jakir	Bidar	2 months	Mar.30	-	200	-	-	-
									3600			

Bills Receivable Book

Abhay's Account

Dr. Cr.

Date	Particulars	LF	Amount	Date	Particulars	LF	Amount
			Rs.	2010 Jan.1	By Bills/ Receivable A/c		Rs. 600

Avinash's Account

Dr. Cr.

Date	Particulars	LF	Amount	Date	Particulars	LF	Amount
			Rs.	2010 Jan.5	By Bills Receivable A/c		Rs. 400

Dr. **Vijay's Account** Cr.

Date	Particulars	LF	Amount	Date	Particulars	LF	Amount
			Rs.	2010 Jan.20	By Bills Receivable A/c		Rs. 400

Dr. **Janardhan's Account** Cr.

Date	Particulars	LF	Amount	Date	Particulars	LF	Amount
			Rs.	2010 Jan.25	By Bills Receivable A/c		Rs. 400

Dr. **Bills Receivable Account** Cr.

Date	Particulars	LF	Amount	Date	Particulars	LF	Amount
2010 Jan.31	To Sundries A/c		Rs. 1600				Rs.

Dr. **Arun's Account** Cr.

Date	Particulars	LF	Amount	Date	Particulars	LF	Amount
2010 Jan.1	To Bills Payable A/c		Rs. 1600				Rs.

Dr. **Bharani's Account** Cr.

Date	Particulars	LF	Amount	Date	Particulars	LF	Amount
2010 Jan.9	To Bills Payable A/c		Rs. 1200				Rs.

Dr. **Chandru's Account** Cr.

Date	Particulars	LF	Amount	Date	Particulars	LF	Amount
2010 Jan.15	To Bills Payable A/c		Rs. 600				Rs.

Dr. **Jakir's Account** Cr.

Date	Particulars	LF	Amount	Date	Particulars	LF	Amount
			Rs.				Rs.
2010 Jan.17	To Bills Payable A/c		200				

Dr. **Bills Payable Account** Cr.

Date	Particulars	LF	Amount	Date	Particulars	LF	Amount
			Rs.				Rs.
				2010 Jan.31	By Sundries A/c		3600

JOURNAL PROPER

All those transactions for which no special journal is maintained are recorded by passing journal entries in a separate book. The book maintained for recording such entries is called **journal proper** or **general journal.**

Transactions Recoded in the Journal Proper

Journal proper is used for recording the following transactions :

1. **Opening entries :** The entry passed at the beginning of a new accounting year for recording the closing balances of assets, liabilities and capital of the previous year brought forward to the current year as opening balances.

2. **Transfer entry :** An entry passed for recording the amounts transferred from one account to another is called a transfer entry. For example, the balance of drawing account is transferred to capital account at the end of the year.

3. **Rectification entries :** The entries passed to rectify errors in recording transactions in books of original entries and their posting to various ledger accounts.

4. **Adjusting entries :** These entries are passed at the end of the accounting year to update ledger accounts on the basis of accrual.

5. **Other entries :** In addition to the about entries, the following transactions are also recorded in journal proper :

a) At the time of dishonour of cheques - the entry for cancellation.

b) Purchase and sale of items on credit basis (other than goods)

c) Goods withdrawn by the proprietor for personal use.

d) Endorsement and dishonour of Bills

e) Consignment and joint venture transactions

f) Loss of goods by theft, fire etc.

g) To record amounts which have become irrecoverable.

Journal V/s Journal Proper - Differences

Journal	Journal proper
1. Refers to single journal maintained under the traditional method of accounting	1. Refers to journal maintained as one of the subsidiary books maintained under the modern system of accounting.
2. In the journal all kinds of transactions are recorded in it.	2. In the journal proper, only the residuary transactions are recorded.

Subsidiary Book V/s Ledger - Differences

Subsidiary Book	Ledger
1. It is a book of original or primary entry	1. It is a book of secondary or final entry
2. It records transactions in chronological order	2. It contains analytical record of transactions
3. It provides complete information about business transactions with details	3. It does not provide information at one place and transactions are recorded in separate books.
4. The process of recording transactions in subsidiary books is called **journalizing**	4. The process of recording transactions in the ledger is called **posting**
5. Financial statements cannot be prepared directly from subsidiary books	5. Financial statements are prepared from the balances of ledger accounts.

Other Illustrations

Illustration 1

Enter the following transactions in proper subsidiary books and post them into ledger :

2010		Rs.
Jan 1	Bought from Babitha	25,000
Jan 3	Sold to Chandan	20,000
Jan 5	Sold to David	13,000
Jan 6	Chandan returned goods	2,000
Jan 8	Purchased from Eswar	16,000
Jan 9	Accepted David's claim for shortage	500
Jan 10	Sold to Farooq less 5%	15,000
Jan 12	Returned to Eswar	1,000
Jan 15	Allowed Farooq for damaged goods	2,000
Jan 18	Purchased from Guru less 5%	5,000
Jan 21	Claimed allowance from Guru for shortage	500
Jan 24	Bought from Hari	14,000
Jan 25	Sold to Indra	16,000
Jan 27	Returned to Hari	1,000
Jan 29	Sent credit note to Indra	3,000
Jan 30	Sold to Jayaraj	20,000
Jan 31	Purchased from Kanaka	30,000

Solution

SUBSIDARY BOOKS

Purchases Book

Date	Particulars	Inward Invoice No.	LF	Details	Amount
2010					Rs.
Jan 1	Babitha				25,000
Jan 8	Eswar				16,000
Jan 18	Guru 5000-250				14,750
Jan 24	Hari				14,000
Jan 31	Kanaka				30,000
		Total			99,750

Sales Book

Date	Particulars	Outward Invoice No.	LF	Details	Amount
2010					Rs.
Jan 3	Chandan				20,000
Jan 5	David				13,000
Jan 10	Farooq 15,000-750				14,250
Jan 25	Indra				16,000
Jan 30	Jayaraj				20,000
	Total				83,250

Purchase Returns Book

Date	Particulars	Debit Note No.	LF	Details	Amount
2010					Rs.
Jan 12	Eswar				1,000
Jan 21	Guru				500
Jan 27	Hari				1,000
	Total				2,500

Sales Returns Book

Date	Particulars	Credit Note No.	LF	Details	Amount
2010					Rs.
Jan 6	Chandan				2,000
Jan 9	David				500
Jan 15	Farooq				2,000
Jan 29	Indra				3,000
	Total				7,500

Ledger Book

Purchases Account

Dr. Cr.

Date	Particulars	LF	Amount	Date	Particulars	LF	Amount
			Rs.				Rs.
2010 Jan.31	To Sundries A/c		99750				

Babitha's Account

Dr. Cr.

Date	Particulars	LF	Amount	Date	Particulars	LF	Amount
			Rs.	2010			Rs.
				Jan.1	By Purchases A/c		25,000

Eswar's Account

Dr. Cr.

Date	Particulars	LF	Amount	Date	Particulars	LF	Amount
2010			Rs.	2010			Rs.
Jan.12	To Purchases Returns		1000	Jan.8	By Purchases A/c		16,000

Guru's Account

Dr. Cr.

Date	Particulars	LF	Amount	Date	Particulars	LF	Amount
2010			Rs.	2010			Rs.
Jan.21	To Purchases Returns		500	Jan.18	By Purchases A/c		15,000

Hari's Account

Dr. Cr.

Date	Particulars	LF	Amount	Date	Particulars	LF	Amount
			Rs.	2010			Rs.
				Jan.24	By Purchases A/c		14,000

Kanaka's Account

Dr. Cr.

Date	Particulars	LF	Amount	Date	Particulars	LF	Amount
			Rs.	2010			Rs.
				Jan.31	By Purchases A/c		30,000

Dr. **Sales Account** Cr.

Date	Particulars	LF	Amount	Date	Particulars	LF	Amount
			Rs.	2010 Jan.31	By Sundries A/c		Rs. 83,250

Dr. **Chandan's Account** Cr.

Date	Particulars	LF	Amount	Date	Particulars	LF	Amount
2010 Jan.3	To Sales A/c		Rs. 20,000				Rs.

Dr. **David's Account** Cr.

Date	Particulars	LF	Amount	Date	Particulars	LF	Amount
2010 Jan.5	To Sales A/c		Rs. 13000	2010 Jan.9	By Sales Returns A/c		Rs. 500

Dr. **Farooq's Account** Cr.

Date	Particulars	LF	Amount	Date	Particulars	LF	Amount
2010 Jan.10	To Sales A/c		Rs. 14250	2010 Jan.15	By Sales Returns A/c		Rs. 2000

Dr. **Indra's Account** Cr.

Date	Particulars	LF	Amount	Date	Particulars	LF	Amount
2010 Jan.25	To Sales A/c		Rs. 16000	2010 Jan.22	By Sales Returns A/c		Rs. 3000

Dr. **Jayaraj's Account** Cr.

Date	Particulars	LF	Amount	Date	Particulars	LF	Amount
2010 Jan.30	To Sales A/c		Rs. 20000				Rs.

Dr. **Purchases Returns Account** Cr.

Date	Particulars	LF	Amount	Date	Particulars	LF	Amount
			Rs.	2010			Rs.
				Jan.30	By Sundries A/c		2,500

Dr. **Sales Returns Account** Cr.

Date	Particulars	LF	Amount	Date	Particulars	LF	Amount
2010			Rs.				Rs.
Jan.30	To Sundries A/c		7,500				

Illustration 2

Enter the following transactions in proper subsidiary books of Mr. Ajay, and post them into the ledger accounts.

2010

March 1 Bought from Bhavani Traders on account

10 bags of rice at Rs. 500 per bag

5 bags of wheat at Rs. 800 per bag

March 5 Bought from Shankar Traders on account

6 bags of greengram at Rs. 800 per bag

10 bags of Jower at Rs. 1000 per bag

March 15 Sales to Swamy Traders on account

3 bags of rice at Rs. 700 per bag

2 bags of green gram at Rs. 900 per bag

March 20 Sales to Vasu Traders on account

1 bag of green gram at Rs. 100 per bag

2 bags of rice at Rs. 600 per bag

March 22 Returned to Shankar Traders

1 bag of greengram

2 bags of Jower

March 24 Sold to Mr. Kothari

2 bags of Jower at Rs. 1,500 per bag

March 25 Cash sale of 1 bag of Jower at Rs. 1,200 per bag

March 26 Withdraw one bag of greengram for personal use Rs. 850

March 29 Kothari returned one bag of Jower

Solutions

SUBSIDIARY BOOKS

Purchases Book

Date	Particulars	Inward Invoice No	LF	Details	Amount
2010					Rs.
March 1	**Bhavani Traders**				
	10 bags of rice at Rs. 500 per bag			5000	
	5 bags of wheat at Rs. 800 per bag			4000	
					9000
March 5	**Shankar Traders**				
	8 bags of green gram at Rs. 800 per bag			6400	
	10 bags of Jower at Rs. 1000 per bag			10000	
					16400
					25,400

Sales Book

Date	Particulars	Outward Invoice No.	LF	Details	Amount
2010					Rs.
March 15	**Swamy Traders**				
	3 bags of rice at Rs. 700 per bag			2,100	
	2 bags of green gram at Rs. 900 per bag			1800	
					3900
March 20	**Vasu Traders**				
	1 bag of green gram at Rs. 1000 per bag			1000	
	2 bags of rice at Rs. 600 per bag			1200	
					2200
March 24	**Kothari**				
	2 bags of Jower at Rs. 1500 per bag				3000
	Total				**9,100**

Purchases Returns Book

Date	Particulars	Debit Note No.	LF	Details	Amount
2010					Rs.
March 22	**Shankar Traders**				
	1 bag of green gram Rs. 800 per bag			800	
	2 bag of Jower at Rs. 1000 per bag			2000	
					2800
	Total				**2800**

Sales Returns Book

Date	Particulars	Credit Note No.	LF	Details	Amount
2010					Rs.
March 29	**Kothari**				
	1 bag of Jower at Rs. 1500 per bag				1500
	Total				**1500**

Ledger Book

Purchases Account

Dr. Cr.

Date	Particulars	LF	Amount	Date	Particulars	LF	Amount
			Rs.				Rs.
2010 Mar.31	To Sundries A/c		25400				

Sales Account

Dr. Cr.

Date	Particulars	LF	Amount	Date	Particulars	LF	Amount
			Rs.				Rs.
				2010 Mar.31	By Sundries A/c		9100

Purchases Returns Account

Dr. Cr.

Date	Particulars	LF	Amount	Date	Particulars	LF	Amount
			Rs.				Rs.
				2010 Mar.31	By Sundries A/c		2800

Dr. **Sales Returns Account**

Date	Particulars	LF	Amount	Date	Particulars	LF	Amount
			Rs.				Rs.
2010							
Mar.31	To Sundries A/c		1500				

Dr. **Bhavani Traders Account** Cr.

Date	Particulars	LF	Amount	Date	Particulars	LF	Amount
			Rs.				Rs.
				2010			
				Mar.1	By Purchases A/c		9000

Dr. **Shankar Traders Account** Cr.

Date	Particulars	LF	Amount	Date	Particulars	LF	Amount
			Rs.				Rs.
2010				2010			
Mar.22	To Purchases Returns A/c		2800	Mar.5	By Purchases A/c		16400

Dr. **Swamy Traders Account** Cr.

Date	Particulars	LF	Amount	Date	Particulars	LF	Amount
			Rs.				Rs.
2010							
Mar.15	To Sales A/c		3900				

Dr. **Vasu Traders Account** Cr.

Date	Particulars	LF	Amount	Date	Particulars	LF	Amount
			Rs.				Rs.
2010							
Mar.20	To Sales A/c		2200				

Dr. **Kothari's Account** Cr.

Date	Particulars	LF	Amount	Date	Particulars	LF	Amount
			Rs.				Rs.
2010				2010			
Mar.24	To Sales A/c		3000	Mar.29	By Sales Returns A/c		1500

7.7 LET US SUM UP

Subsidiary books plays an important role in the field of accounting. All the business transactions are first recorded in a number of books as and when they take place. The books in which business transactions are recorded are called subsidiary books. From these subsidiary books transactions are posted to the appropriate books in the books of final entry called 'Ledger'.

7.8 KEY WORDS

Bills Payable Account : The Bills payable Account is credited with the monthly total of bills payable book.

Bills Receivable Account : The Bills Receivable Account should be debited with the monthly total of bills receivable book.

Sales Invoice : Whenever goods are sold by a trader on credit he will rise a statement giving the particulars of the quantity, quality, price of the goods sold.

7.9 TERMINAL QUESTIONS

1. Name the various subsidiary books.
2. State the purposes of each subsidiary book.
3. State the features of subsidiary books.
4. What is debit note? Why is it used?
5. Give the specimen of credit note.
6. Give the specimen of each subsidiary book.
7. Distinguish between debit note and credit note.
8. What are the transactions usually recorded in the journal proper?

9. Enter the following transactions in their proper subsidiary books and post them into Ledger accounts.

2009		Rs.
jan. 1	Purchased goods from Mr. A	1000
Jan. 3	Sold goods to Mr. X	2000
Jan 10	Purchased good from Mr. B	6000
Jan. 15	Returned goods to Mr. A	200
Jan 20	Mr. X returned goods	500
Jan. 22	Purchased goods from Mr. C	10000
Jan. 23	Sold goods to Mr. Y	5000
Jan 25	Bought goods from Mr. D	1600
Jan 29	Returned goods to Mr. B	200
Jan 30	Bought goods from Mr. E	1000

10. Mr. X, a businessman, enters into the following transactions in the month of March, 2010. You are required to record them in the Subsidiary books and post them into Ledger.

2010		Rs.
March 2	Sold goods to 'Y' subject to a trade discount of 10%	13000
March 4	Received a debit note from Y in respect of an overcharge in the bill	500
March 6	Y returned damaged goods	200
March 10	Sold goods to Mr. C	1000

7.10 REFERENCE

Accountancy - B.S. Raman

Accountancy - H.R. Appanniah, P.N. Reddy

Financial Accounting-I - B.S. Raman

Advanced Accountancy - Anil Kumar

UNIT - 8

TRIAL BALANCE

STRUCTURE:

8.0 OBJECTIVES

After going through this unit, you should be able to;

- Explain the Meaning and Definitions of Trial Balance
- Discuss the Features of Trial Balance
- Elucidate the Objectives of Trial Balance
- Bringout the Advantages of Trial Balance and Limitations
- Describe the Methods of preparing Trial Balance
- Draft the Format of Trial Balance
- Explain the Steps in the preparation of Trial Balance

8.1 INTRODUCTION

The main objective of accounting is to present the result (i.e. profit or loss) and the financial position of a business. This can be done by preparing the final accounts. The final accounts have to be prepared on the basis of the balances of various accounts in the ledger. Generally, the ledger accounts are spread over many pages of the ledger and it leads to inconvenient and consumes more time to prepare final accounts. To overcome this difficulty, a list of balances of various ledger accounts are drawn and a statement is prepared on the closing date of the financial year. This statement is known as **'Trial Balance'.** Trial balance presents the ledger balances of all accounts at one particular place and this facilitates easy understanding of the results and position of the business.

8.2 MEANING AND DEFINITIONS OF TRIAL BALANCE

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

In the words of J.R. Batliboi, "Trial balance is a schedule, prepared with the debit and credit balances of ledger accounts to test the arithmetical accuracy of the books."

According to Spicer and pegler, "A trial balance is a list of all the balances standing in the ledger accounts and cash book of a concern at any given date".

8.3 FEATURES OF TRIAL BALANCE

The important features of a trial balance are as follows :

1. A trial balance is a statement, and not an account.
2. It is prepared at the close of the accounting year before the preparation of the final accounts.
3. It is prepared on a separate sheet of paper i.e. not in any book of account.

4. It does not form part of any double entry system of accounting.
5. The preparation of a trial balance is not obligatory, but in practice, it is prepared before final accounts are prepared.
6. It is prepared with the balances of all the ledger accounts or with the totals and balances of all the ledger accounts.
7. It is helpful in checking the arithmetical accuracy of books of accounts.

8.4 OBJECTIVES OF TRIAL BALANCE

The main objectives of a trial balance are listed below :

1. To bring the balances of all the ledger accounts at one place, so that the balance of any particular account can be known without going through the ledger.
2. To check the arithmetical accuracy of the books of account.
3. To act as a means of discovering errors if any in the book-keeping work.
4. To help in the preparation of final accounts.
5. To help in the making of adjustments while preparing final accounts of the business.

8.5 ADVANTAGES AND LIMITATIONS OF TRIAL BALANCE

The important Advantages of a Trial Balance are listed below :

1. It facilitates easy and quick preparation of final accounts.
2. It ensures that final accounts are free from any errors or mistakes. Because errors are detected while preparing the trial balance.
3. The agreement of the trial balance is a prima facie evidence of the proper application of the principle of double-entry system.
4. The trial balance serve as a rough guide as to the state of affairs of the concern, because it gives the balances of all ledger accounts at one place in a consolidated form.
5. It facilitates the management to draw conclusions and decisions on comparing trial balances of previous years.

Limitations of Trial Balance

A trial balance suffers from the following limitations :

1. A trial balance can be prepared in such concerns where double entry system of accounting is practiced.
2. A tallied trial balance is not a conclusive proof of the accuracy of books of account. Because, certain errors remain even after trial balance tallies.

8.6 METHODS OF PREPARING TRIAL BALANCE

A Trial Balance can be prepared under two methods. They are :

1. Gross Total Method
2. Net Total Method

1. **Gross Total Method :** Under this method, the trial balance is prepared with the help of the debit and credit totals of all the accounts in the ledger. The debit totals of all the ledger accounts are entered in the debit column and the credit totals of all the ledger accounts are entered in the credit column of the trial balance. However, this method is an old and outdated one and is not followed frequently in practice.

2. **Net Total Method :** Under this method, the difference between two sides of an account is taken to the trial balance and not the totals of an account. In case, the debit side shows more than the credit side, the difference (i.e. excess debit) is taken to the debit column of a trial balance and vice-versa.

8.7 FORMAT OF A TRIAL BALANCE

The format of a trial balance is studied in two different forms. They are :

1. In the form of a Journal

Trial balance of .... As on ....

Sl. No.	Name of Accounts	LF	Debit	Credit
			Rs.	Rs.

2. In an Account form or 'T' form

Sl.No.	Name of Accounts	LF Rs.	Debit	Sl.No.	Name of Accounts	LF	Credit Rs.

8.8 STEPS (OR HINTS) IN THE PREPARATION OF A TRIAL BALANCE

At the time of preparing a trial balance from the balances of ledger accounts, the following points should noted :

1. The ledger accounts which show balances should appear in the trial balance. If a ledger account show a debit balance, the balance will appear in the debit column of a trial balance and vice-versa.
2. Total both the columns and observe whether they are equal.
3. If any difference is noticed, then once again verify the entries in the ledger accounts and check their totals.
4. Still if any difference is noticed, then the differences should be shown in a suspense account on the side which shows the balance. It must be noted that suspense account is only a temporary treatment until the error is detected.

8.9 SPECIMEN OF A TRIAL BALANCE

Trial Balance of .... as on ....

Sl. No.	Name of Accounts	LF	Debit	Credit
			Rs.	Rs.
1.	Capital A/c		-	xx
2.	Assets A/c		xx	
3.	Purchases A/c		xx	
4.	Sales A/c		–	xx
5.	Purchases Returnes A/c		-	xx
6.	Sales Returns A/c		xx	
7.	All Expenses A/c		xx	
8.	All Incomes A/c		–	xx
9.	All Liabilities A/c		–	xx
10.	Prepaid Expenses A/c		xx	
11.	Outstanding expenses A/c		–	xx
12.	Outstanding Incomes A/c		xx	
13.	Income received in advance A/c		–	xx
14.	Drawings A/c		xx	–
	Total		xxx	xxx

Note :

1. Closing Stock will not appear in the trial balance
2. Investment is an asset, it show debit balance
3. A bank balance may show either a debit or credit balance, The debit balance is treated as an asset and shows debit balance, while a credit balance (overdraft) is a liability.
4. Opening stock show a debit balance and is shown in the debit column.

Illustration 1

You are given Ledger balances extracted from the books of Sri Ganesh prepare a Trial Balance as on 31.12.2009

	Rs.		Rs.
Capital	74,000	Cash at Bank	7,300
Stock on 1.1.2009	8,500	Carriage	300
Furniture	2,600	Sales	22,500
Purchases	8,950	Buildings	12,000
Returns outwards	350	Returns inwards	1,900
Trade Expenses	1,000	Discount received	970
Salary	3,000	Office rent	2,270
Creditors	15,000	Motor Car	10,000
		Debtors	5,000
		Land	50,000

Solution :

Trial Balance of Sri Ganesh as on 31st December, 2009

Sl. No.	Particulars	LF	Debit	Credit
			Rs.	Rs.
1.	Capital		-	74,000
2.	Stock on 1.1.2009		8,500	-
3.	Furniture		2,600	-
4.	Purchases		8,950	-
5.	Returns Outwards		-	350
6.	Trade expenses		1,000	-
7.	Salary		3000	-
8.	Creditors		-	15,000
9.	Cash at Bank		7,300	-

10.	Carriage		300	-
11.	Sales		-	22,500
12.	Buildings		12,000	-
13.	Returns inwards		1,900	-
14.	Discount received		-	970
15.	Office rent		2,270	-
16.	Motor Car		10,000	-
17.	Debtors		5,000	-
18.	Land		50,000	-
	Total		**1,12,820**	**1,12,820**

Illustration 2

You are given an incorrect Trial Balance Re-write in its correct form :

Sl. No.	Particulars	L.F.	Debit Rs.	Credit Rs.
1.	Amount due to Vinay		11,400	-
2.	Due from Bhagawan		17,100	-
3.	office expenses		11,360	-
4.	Purchases		2,500	-
5.	Commission allowed		-	1,300
6.	Interest received		1,300	-
7.	Outstanding incomes		400	-
8.	Bad debts		-	11,200
9.	Sales		16,000	-
10.	Capital		-	47,000
11.	Buildings		-	26,000
12.	Furniture		10,000	-
13.	Bank overdraft		3,200	-
14.	Outstanding expenses		-	550
15.	Returns inward		200	-
16.	Reserve fund		-	5000
17.	Cash in hand		-	250
18.	Salary		4,140	-
	Total		**77,600**	**91,300**

Solution :

Trial Balance as on......

Sl. No.	Particulars	LF	Debit	Credit
			Rs.	Rs.
1.	Amount due to Vinay		-	11,400
2.	Due from Bhagawan		17,100	-
3.	Office expenses		11,360	-
4.	Purchases		2,500	-
5.	Commission allowed		1,300	-
6.	Interest received		-	1,300
7.	Outstanding incomes		400	-
8.	Bad debts		11,200	-
9.	Sales		-	16,000
10.	Capital		-	47,000
11.	Buildings		26,000	-
12.	Furniture		10,000	-
13.	Bank overdraft		-	3,200
14.	Outstanding expenses		-	550
15.	Returns inward		200	-
16.	Reserve fund		-	5000
17.	Cash in hand		250	-
18.	Salary		4,140	-
	Total		**84,450**	**84,450**

Illustration 3

Journalise the following transactions, post them to the ledger and balance the accounts. Also draft the trial balance as on 31st December 2009.

2009

Dec. 1 Raju started business with cash Rs. 35,000, Furniture Rs. 35,000, Buildings Rs. 1,00,000, Motor Car Rs. 50,000.

" 3 Sold goods to Babu Rs. 35,000

" 8 Bought goods from Chandu Rs. 60,000

" 15 Received from Babu in settlement of his account.

" 20 Returned goods chandu Rs. 5000

" 24 Paid Chandu on account Rs. 20,000

" 26 Bought goods from David for Cash Rs. 5,000

" 28 Sold goods for cash Rs. 60,000

" 30 Paid salaries Rs. 20,000, paid rent Rs. 15,000.

Solution :

Journal Entries in the books of Raju for the month of December, 2009

Date	Particulars		LF	Debit Rs.	Credit Rs.
2009					
Dec. 1	Cash A/c	Dr.		35,000	
	Furniture A/c	Dr.		35,000	
	Buildings A/c	Dr.		1,00,000	
	Motor Car A/c	Dr.		50,000	
	To Capital A/c				2,20,000
	(Being commenced business)				
Dec. 3	Babu's A/c	Dr.		35,000	
	To Sales				35,000
	(Being credit sales)				
Dec. 8	Purchases A/c	Dr.		60,000	
	To Chandu's A/c				60,000
	(Being credit purchases)				
Dec. 15	Cash A/c	Dr.		35,000	
	To Babu's A/c				35,000
	(Being cash received in full settlement of his account)				
Dec. 20	Chandu's A/c	Dr		5,000	
	To Purchases Returns A/c				5,000
	(Being returns outward)				

Dec. 24	Chandu's A/c	Dr.		20,000	
	To Cash A/c				20,000
	(Being paid in part settlement)				
Dec. 26	Purchases A/c	Dr.		5,000	
	To Cash A/c				5,000
	(Being Cash Purchases)				
Dec. 28	Cash A/c	Dr.		60,000	
	To Sales A/c				60,000
	(Being cash sales)				
Dec. 30	Salaries A/c	Dr.		20,000	
	Rent A/c	Dr.		15,000	
	To Cash A/c				35,000
	(Being salaries and rent paid)				
				4,75,000	**4,75,000**

Ledger of Ramu

Cash A/c

Dr. Cr.

Date	Particulars	LF	Amount Rs.	Date	Particulars	LF	Credit Rs.
2009				2009			
Dec.1	To Capital A/c		35,000	Dec. 24	By Chandu's A/c		20,000
Dec.15	To Babu's A/c		35,000	Dec.26	By Purchases A/c		5000
Dec.28	To Sales A/c		60,000	Dec.30	By Salaries A/c		20000
				Dec.30	By Rent A/c		15000
					By Balance C/d		70,000
			1,30,000				130000
Jan.1	To Balance B/d		70,000				

Furniture A/c

Dr. Cr.

Date	Particulars	LF	Amount Rs.	Date	Particulars	LF	Credit Rs.
2009				2009			
Dec.1	To Capital a/c		35,000	Dec. 31	By Balance c/d		35,000
			35,000				35,000
Jan.1	To Balance b/d		35,000				

Buildings A/c

Dr. Cr.

Date	Particulars	LF	Amount Rs.	Date	Particulars	LF	Credit Rs.
2009				2009			
Dec.1	To Capital a/c		1,00,000	Dec. 31	By Balance c/d		1,00,000
			1,00,000				1,00,000
Jan.1	To Balance b/d		1,00,000				

Motor car A/c

Dr. Cr.

Date	Particulars	LF	Amount Rs.	Date	Particulars	LF	Credit Rs.
2009				2009			
Dec.1	To Capital a/c		50,000	Dec. 31	By Balance c/d		50,000
			50,000				50,000
Jan.1	To Balance b/d		50,000				

Capital A/c

Dr. Cr.

Date	Particulars	LF	Amount Rs.	Date	Particulars	LF	Credit Rs.
2009				2009			
Dec.31	To Balance b/d		2,20,000	Dec. 1	By Cash a/c		35,000
				Dec. 1	By Furniture a/c		35,000
				Dec. 1	By Buildings a/c		1,00,000
				Dec. 1	By Motor Car a/c		50,000
			2,20,000				2,20000
				Jan.1	By Balance b/d		2,20000

Babu's A/c

Dr. Cr.

Date	Particulars	LF	Amount Rs.	Date	Particulars	LF	Credit Rs.
2009				2009			
Dec.3	To Sales a/c		35,000	Dec. 15	By Cash a/c		35,000
			35,000				35,000

Sales A/c

Dr. Cr.

Date	Particulars	LF	Amount Rs.	Date	Particulars	LF	Credit Rs.
2009				2009			
Dec.31	To Balance c/d		95,000	Dec. 3	By Babu's a/c		35,000
				Dec. 28	By Cash a/c		60,000
			95,000				95,000
				Jan.1	By Balance b/d		95,000

Purchases A/c

Dr. Cr.

Date	Particulars	LF	Amount Rs.	Date	Particulars	LF	Credit Rs.
2009				2009			
Dec.8	To Chandru's a/c		60,000	Dec. 31	By Balance c/d		65,000
Dec.28	To Cash a/c		5,000				
			65,000				65,000
Jan.1	To Balance b/d		65,000				

Chandru's A/c

Dr. Cr.

Date	Particulars	LF	Amount Rs.	Date	Particulars	LF	Credit Rs.
2009				2009			
Dec.20	To Chandru's a/c		5,000	Dec. 31	By Purchases a/c		60,000
Dec.24	To Cash a/c		20,000				
Dec.31	To Balannce c/d		35,000				
			60,000				60,000
				Jan.1	By Balance b/d		35,000

Purchases Returns A/c

Dr. Cr.

Date	Particulars	LF	Amount Rs.	Date	Particulars	LF	Credit Rs.
2009				2009			
Dec.31	To Balance c/d		5,000	Dec. 20	By Chandu's a/c		5,000
			5,000				5,000
				Jan.1	By Balance b/d		5,000

Salaries A/c

Dr. Cr.

Date	Particulars	LF	Amount Rs.	Date	Particulars	LF	Credit Rs.
2009				2009			
Dec.30	To Cash a/c		20,000	Dec. 31	By Balance c/d		20,000
			20,000				20,000
Jan.1	To Balance b/d		20,000				

Salaries A/c

Dr. Cr.

Date	Particulars	LF	Amount Rs.	Date	Particulars	LF	Credit Rs.
2009				2009			
Dec.30	To Cash a/c		15,000	Dec. 31	By Balance c/d		15,000
			15,000				15,000
Jan.1	To Balance b/d		15,000				

Trial Balance as on 31st March 2009

Sl.No.	Particulars		LF	Debit Rs.	Credit Rs.
2009					
1.	Cash A/c			70,000	-
2.	Furniture A/c			35,000	-
3.	Buildings A/c			1,00,000	-
4.	Motor Car A/c			50,000	-
5.	Capital A/c			-	2,20,000
6.	Sales A/c			-	95,000

7.	Purchases A/c		65,000	-
8.	Chandu's A/c		-	35,000
9.	Purchases Returns A/c		-	5,000
10.	Salaries A/c		20,000	-
11.	Rent A/c		15,000	-
		Total	355000	355000

8.10 LET US SUM UP

Trial Balance presents the ledger balances of all accounts at one particular place and this facilitates easy understanding of the results and position of the business. A trial balance is a list of debit and credit balances of all the ledger accounts prepared on any particular date to verify whenever the entries in the books of account are arithmetically correct.

8.11 KEY WORDS

Gross Total Method : Under this method, the trial balance is prepared with the help of the debit and credit totals of all the accounts in the ledger.

Net Total Method : Under this method, the difference between two sides of an account is taken to the trial balance and not the totals of an account.

8.12 TERMINAL QUESTIONS

1. What is a Trial Balance?
2. Why Trial Balance is prepared?
3. How is a Trial Balance prepared?
4. State the different methods of preparing a Trial Balance.

5. Prepare a Trial Balance from the following particulars:

	Rs.
Amount due to Murari	1,000
Furnitures	11,000
Sales	20,000
Returns outwards	1,000
Purchases	25,000
Office Expenses	2,000
Capital	16,000
Overdraft	1,500
Due from Javare Gowda	2,000
Rent Paid	5,000
Outstanding expenses	500
Commission received	6,000
Wages	1,000

8.13 REFERENCE

Accountancy - B.S. Raman

Accountancy - H.R. Appanniah, P.N. Reddy

Financial Accounting-I - B.S. Raman

Advanced Accountancy - Anil Kumar

Karnataka StateOpen University
Mukthagangothri, Mysuru - 570 006

I B.Com
Course - III
FINANCIAL ACCOUNTING-1

Department of Studies in Commerce

BLOCK 3

PREPARATION OF FINAL ACCOUNTS AND RECTIFICATION OF ERRORS

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BLOCK-3

BLOCK INTRODUCTION

This block states the importance of final accounts where a business concerns wants to know its financial status and financial position at the end of the accounting period and it emphasizes to verify books of accounts to ensure that there are no errors in preparing the final accounts.

This Block consists of four units:

Unit-9 : Deals with the preparation of manufacturing and trading account.

Unit-10: Explains the process of preparation of profit and loss account.

Unit-11: Gives an account of preparation of balance sheet.

Unit-12 : Speaks about identifying and rectification of errors.

UNIT-9

PREPARATION OF MANUFACTURING AND TRADING ACCOUNTS

Structure:

9.0 OBJECTIVES

After studying this unit, you should be able to :

- Give the meaning of manufacturing and trading concerns.
- Explain the process of preparing the manufacturing accounts.
- Discuss the process of preparing the manufacturing and trading account and
- Describe the process of preparing the trading account.

9.1 INTRODUCTION

The business concern which undertakes both the activities of manufacturing and trading prepares manufacturing as well as trading accounts. Manufacturing accounts reveals the cost of goods manufactured and trading account reveals the line of business whether it is profitable or not.

9.2 MEANING OF MANUFACTURING AND TRADING CONCERN

In order to find out the cost of manufacture and the profit or loss, the business concerns are classified as (A) Manufacturing and trading and (B) Trading concerns.

Manufacturing concern prepares both manufacturing and trading accounts. But trading concerns prepare only trading account prior to preparing profit and loss a/c and balance sheet.

9.3 MANUFACTURING ACCOUNT

The manufacturing account is prepared to as certain the cost of goods manufactured or produced by a concern. It has to be prepared in the following manner.

Dr.		Manufacturing Account	Cr.
	Rs.		Rs.
To Raw Materials consumed:		By Closing work-in- progress	xxx
Opening stock of		By Sale of by- product	xxx
Raw Materials	xxx	By Cost of goods produced	
Add: Net purchases	xxx	During the year	
of Raw Materials		(i,e., the difference between	
		the two sides) transferred to	
Less: Closing stock of	xxx	the Trading Account	xxx
Raw Materials			
To Opening work-in- progress	xxx		
To Direct Expenses, such as	xxx		
Carriage, cartage, freight,	xxx		
import duty, clearing charges,			
dock dues, excise duty, octroi,			
wages, power and other			
manufacturing expenses			
	xxx		
Rs.	**xxx**	**Rs.**	**xxx**

Cost of raw materials consumed opening work in progress, and other direct expenses pertaining to manufacturing such as carriage, freight, Import duty etc., as shown in the above format are entered on the debit side of manufacturing account.

Closing work in progress, sale of by product, and sale of scrap are entered on the credit side of manufacturing account. The difference of credit side is noted as cost of goods produced during the year and transferred to debit side of trading account.

Illustration-1: From the following details, prepare manufacturing account for the year ending 31-03-2012.

Particulars	Rs.
Opening stock of raw materials	45,000
Opening stock of work-in-progress	25,000
Purchase of Raw materials	1,85,000
Rent (¾ factory)	48,000
Power and fuel	22,000
Electricity (60% Factory)	10,000
Depreciation on plant and machinery	35,000
Depreciation on Furniture (50% Factory)	18,000
Stationery (10% factory)	2,000
Direct wages	85,000
Carriage on purchase of Raw materials	3,500
Work's manager's Salary	72,000
General Expenses (40% Factory)	40,000
Office manager's salary	10,000
Insurance (80% Factory)	60,000
Closing stock of Raw materials	26,000
Closing stock of work-in-progress	12,000
Sale of scrap	14,700

Solution:

Manufacturing account

for the year ended 31st march, 2012

Particulars		Rs	Particulars	Rs
To Raw Materials consumed			By Sale of scrap	14,700
To Opening stock	45,000		By Closing work-in-progress	12,000
Add: Purchases	1,85,000		Cost of production transferred to trading account) (Balancing figure)	5,11,000
	2,30,000			
Less; Closing stock	26,000			
Opening work-in-progress		2,04,000		
Carriage on purchase of raw materials		25,000		
		3,500		
Rent (48,000 x $\frac{3}{4}$)		36,000		
Power and fuel		22,000		
Electricity (10,0,00 x $\frac{60}{100}$)		6,000		
Depreciation on plant and machinery		35,000		
Depreciation on furniture (15,000 x $\frac{60}{100}$)		9,000		
Stationery (2,000 x $\frac{10}{100}$)		200		
Direct wages		85,000		
Works manager's salary		72,000		
General expenses (40,000 x $\frac{40}{100}$)		16,000		
Insurance (60,000 x $\frac{40}{100}$)		24,000		
		5,37,700		**5,37,700**

Note:

Office manager's salary is not taken into account, as it is wholly concerned with office management.

Illustration:2

Arun is a manufacturer of medicines and from the following figures prepare Manufacturing account for the year ended 31st December 2011.

Stock at commencement	**Rs.**
Raw materials – chemicals	1235
Finished goods	2454
Working progress(cost)	311
Purchase of raw materials	5322
Purchase of finished goods for urgent order	2800
Carriage on purchase of finished goods	300
Manufacturing wages	6328
Factory rent	600
Gas and water factory	434
Freight and carriages and duty on raw materials	1225
Stock at the end:	
Raw materials	938
Finished goods	1947
Partly finished goods	2107

Solution:

Manufacturing and trading account for the year ending 31-12-2011

Particulars		Amount	Particulars	Amount
To Raw Materials Consumed:			By Closing work-in-progress	2107
Op. stock of raw materials	1235		By cost of production carried to trading account (Balancing figure)	12866
Add: purchase of R.M	5322			
	6557			
Less: Closing stock of R.M	938	5619		
To Opening work-in-progress		311		
To Freight and carriage on purchase of raw materials		456		
To Landing charges and duty		1225		
To manufacturing wages		6328		
To Factory rent		600		
To Gas and Water for Factory		434		
		14,973		**14,973**

Trading Account

Particulars	Amount	Particulars	Amount
To opening stock of Finished goods	2454	By Sales	26328
To cost of Production brought down from manufacturing A/C	12866	By closing stock of finished goods	1947
To purchase of finished goods (FG)	2800		
To carriage on purchase of FG	300		
To Gross profit c/d	9855		
	28,275		**28,275**

9.4 TRADING ACCOUNT:

This account is prepared to know the trading results or gross margin on trading of the business., i.e, how much gross profit the businesss has earned from buying and selling during a particular period. Trading account consists of two sides debit side and credit side. The debit side entries are net purchases and all direct expenses incurred on purchases and bringing the goods to shop or godown. The credit side entries are net sales and closing stocks. If the credit total exceeds the debit side, the difference is called gross profit and if the debit side total exceeds the credit side total the difference is called gross loss and same will be transferred to profit and loss account.

Net purchases= purchases-(returns + drawings)

Net sales=sales-returns

Cost of sales or cost of goods sold= opening stock + purchases + all direct expenses – clos stock.

Gross profit/loss=net sales-cost of sales.

Proforma of trading account is given below.

Trading A/c

	Particulars	Rs.	Particulars	Rs.
To	Opening Stock	-	By Sales	
"	Purchases	-	Less: Returns Inward	-
"	Less: Return outward	-	By Closing Stock	-
"	Wages	-	By Gross Loss c/d (Balancing figure)	-
"	Carriage	-		
"	Fuel	-		
"	Power	-		
"	Octroi	-		
"	Import Duty	-		
"	Clearing Charges	-		
"	Dock Charges	-		
"	Stores Consumed	-		
"	Royalty based on Production	-		
"	Manufacturing Exp	-		
"	Gross Profit c/d (Balancing figure)	-		
	Total	**XXX**	**Total**	**XXX**

Illustration - 3

Prepare a Trading Account of a trader for the year ending 31st March 2012, from the following da

Opening Stock	2,40,000
Cash Purchases	2,08,000
Credit Purchases	4,00,000
Purchases Returns	8,000
Cost of goods distributed as free sample	5,000
Goods withdrawn by the trader for personal use	2,000
Cash Sales	3,50,000
Credit Sales	6,00,000
Sales Returns	10,000
Direct Expenses incurred:	
Freight	12,000
Import Duty	8,000
Clearing Charges	12,000
Stock damaged by fire	13,000
The cost of closing stock was Rs. 1,20,000 but its market value was Rs.	1,50,000

Solution :

Trading Account
(for the year ended 31st March, 2012)

	Particulars	Rs.	Rs.	Particulars	Rs.	Rs.
To	Opening stock	2,40,000		By sale		
"	Purchases			Cash	3,50,000	
"	Cash	2,08,000		Credit	60,000	
					9,50,000	
"	Credit	4,00,000		Less : S/R	10,000	9,40,000
		6,08,000				
"	Less : P/R	8,000		By Loss by fire		13,000
"	(Purchase Returns)	6,00,000				
"	Less : Drawings	2,000		By Closing Stock		1,20,000
		5,98,000				
"	Less : Cost of free	5,000	5,93,000			
"	samples					
"	Carriage		12,000			
"	Import duty		8,000			
"	Clearing charges		12,000			
"	Gross Profit c/d		2,08,000			
			10,73,000			**10,73,000**

Closing stock is valued at Cost or Market Price, whichever is lower

9.5 LET US SUM UP

The manufacturing account facilitates the manufacturers to know the cost of manufacture and trading account is useful to understand the line of business whether it is in profitable line or not. Both manufacturing and trading accounts are highly useful in manifactural discussion either to combine the business in the same way of business or not.

9.6 KEY WORDS

Trading Account - It is prepared to know the trading results or gross margin on trading of business

Cost of Sales - Opening Stock + Purchases + all Direct Expenses - Closing Stock.

Gross Profit / Loss - Net Sales - Cost of Sales.

9.7 TERMINAL QUESTIONS

1. From the following details of Patel Enterprises, prepare Manufacturing Account:

Particulars	Rs.
Opening stock:	
Raw materials	80,000
Work-in-progress	70,000
Finished goods	85,000
Factory stores	10,000
Carriage inwards of raw materials	60,000
Carriage inwards of finished goods	21,000
Carriage outwards	8,000
Purchases:	
Raw materials	6,04,000
Finished goods	2,52,000
Factory stores	20,000
Purchase returns of raw materials	4,000
Wages	6,15,000
Rent and Rates:	
Factory	5,5000
Office	3,5000
Lighting:	
Factory	7,500
Office	4,000
Insurance:	
Factory	9,000
Office	4,500
Repairs to machinery	17,000
Closing stock:	
Raw materials	57,000
Work-in-progress	66,000
Finished goods	87,000
Factory stores	6,000
Depreciation on Machinery	60,000

9.8 REFERENCE

Accountancy	- B.S. Raman
Accountancy	- H.R. Appanniah, P.N. Reddy
Financial Accounting-I	- B.S. Raman
Advanced Accountancy	- Anil Kumar

UNIT-10

PROFIT AND LOSS ACCOUNT

Structure:

10.0. OBJECTIVE

After studying this unit you should be able to :

* Discuss the process of preparing the profit and loss account.
* Explain the treatment of items given in the debit side as well as credit side of trial balance.
* Elucidate the treatment of items given in the adjustments and
* Ascertaining the Net profit/ Net Loss.

10.1. INTRODUCTION

After preparing the manufacturing and trading accounts, the next step is to prepare profit and loss account. Every business concern is intending to know whether the concern is running its business under profit or loss. For this purpose accounting is the only means to achieve its objective. The profit and loss account is prepared with an objective of finding out the profit or loss and to know the financial position of the business at the end of the financial year.

10.2. MEANING OF PROFIT AND LOSS ACCOUNT

The profit and loss account is an account which shows the net profit and loss of a business for a particular trading period. The net profit or net loss the profit earned or loss suffered after charging all business expenses including depreciation and provisions. It is the final profit or loss of a business.

The profit and loss account is prepared as shown in the following format.

10.3 FORMAT OF PROFIT AND LOSS ACCOUNT

A FORMAT OF PROFIT AND LOSS ACCOUNT

Profit and Loss a/c for the year ending............

Dr. **Cr.**

Particulars	Amount	Particulars	Amount
	Rs.		Rs.
To Trading a/c (Gross loss transferred from Trading a/c	xxxx	By Trading a/c (Gross profit transferred from Trading a/c)	xxxx
Administrative Expenses		By Rent received	xxxx
To Rent, Rates, Insurance and Taxes	xxxx	By Discount earned	xxxx
To Salaries	xxxx	By Commission received	xxxx
To Printing and Stationery	xxxx	By Income on investments	xxxx
To Office heating and lighting	xxxx	By Interest on drawings	xxxx
To Telephone	xxxx	By Bad debts recovered	xxxx
To Postage and courier		By Provision for bad debts (old)	xxxx
To Bank charges		By Discount on creditors	
To Legal expenses	xxxx	To Net Loss (Transferred to Capital a/c)	xxxx
Selling and Distribution Expenses			
To Traveling Expenses	xxxx		
To Advertising and Sales promotion	xxxx		
To Commission	xxxx		
To Freight/ Carriage outwards	xxxx		
To Bad debts	xxxx		
To Provision for bad debts	xxxx		
To Discount on debtors	xxxx		
To Discount allowed	xxxx		
Asset related Expenses			
To Depreciation	xxxx		
To Repairs and maintenance	xxxx		
To Insurance	xxxx		
Financial Expenses			
To Interest on Capital	xxxx		
To Interest on loan	xxxx		
To Net Profit (Transferred to Capital A/c)	xxxx		
	xxxx		**xxxx**

10.4. EXPLANATION TO THE FORMAT OF PROFIT AND LOSS ACCOUNT

For the purpose of preparing the profit and loss account, all the indirect revenue expenses and losses which are entered on the debit side of trial balance say administrative expenses, selling and distribution expenses, asset related expenses and finance expenses are transferred to debit side of profit and loss account. Likewise other incomes or indirect revenues of credit side of trial balance are also transferred to credit side of profit and loss account. While doing so the adjustments such as out standing expenses, prepaid expenses, bad debts, depreciation and income received in advance etc., are to be added or deducted from the concerned accounts. The balancing figure of profit and loss account, is transferred to capital account.

In the form of an equation, the net profit or loss can be stated as below.

Net profit/ Net loss = Gross Profit/ loss + other indirect revenues or incomes- (Administrative Expenses + Selling and distribution expenses + asset related expenses + financial expenses).

Important Points in Profit and Loss Account:

Other Incomes: Other incomes refer to incomes other than sales income such as interest earned, rent received, commission earned, discount allowed by suppliers, income on investments, etc.

Administrative Expenses: Expenses incurred in administering the business such as rent, printing and stationery, telephone bill, electricity bill, salaries of administrative staff, staff welfare expenses, insurance, etc.

Selling and distribution expenses: Expenses incurred on advertising, other sales promotion activities, travelling expenses. Salaries and commission of the sales team, transportation outwards, bad debts, discount's allowed to customers, debt collection costs, etc.

Asset related Expenses: This group of expenses consists of depreciation expenses, maintenance of assets, insurance premium paid for the assets, etc.

Financial Expenses: These are the expenses related to the financing of the business requirements, such as interest on capital, interest on loan, interest on bank over draft, etc.

10.5. EXAMPLES OF PROFIT AND LOSS ACCOUNT

While preparing the final accounts, it is the usual practice to prepare both trading and profit and loss account together as ' Trading and profit and loss account' However, The trading and profit and loss account is divided in to two sections or parts viz., the trading account in the first section and the profit and loss account in the second section.

Illustration -1: From the following balances extracted at the close of the year ended 31st March, 2010, prepare Profit and Loss Account of M/s Ashok and Son as at that date:

Particulars	Rs.	Particulars	Rs.
Gross Profit	1,01,000	Discount (Dr.)	500
Carriage Outward	2,500	Apprentice Premium (Cr.)	1,500
Salaries	5,500	Printing & Stationery	250
Rent	4,100	Rates & Taxes	350
Fire Insurance Premium	900	Travelling Expenses	200
Bad Debts	2,100	Sundry Trade Expenses	300
Income Tax Paid	3,500	Rent received on sub-letting	1,000
Life Insurance Premium	3,000		

SOLUTION

PROFIT & LOSS ACCOUNT OF M/S ASHOK & SON

for the year ended 31st March, 2010

Particulars	Rs	Particulars	Rs.
To Carriage Outward	.	By Gross Profit b/d	.
To Salaries	2,500	By Apprentice Premium	1,01,000
To Rent	5,500	By Rent received on Sub-letting	1,500
To Fire Insurance Premium	4,100		1,000
To Bad Debts	900		
To Discount	2,100		
To Printing & Stationery	500		
To Rates & Taxes	250		
To Travelling Expenses	350		
To Sundry Trade Expenses	200		
To Net Profit transferred to Capital	300		
A/c	86,800		
	1,03,000		**1,03,000**

Note: Income tax and life insurance premium being personal expenses of the proprietor have been debited to profit and loss account. These are to be taken as drawings and deducted from Capital Account.

Illustration-2: From the following particulars, prepare a Trading and Profit and Loss Account of the year ended 31st December. 2010:

Particulars	**Rs**
Opening Stock	.
Purchases (cash)	5,000
Credit purchases	10,000
Purchases returns	20,000
Sales (cash)	2,000
Sales (credit)	30,000
Returns from customers	40,000
Sales tax	1,000
Depreciation on furniture	4,000
Salaries	100
Rent and rates	10,000
Insurance	5,000
Trade expenses	3,800
Interest on investment	700
Advertisement ,	500
Maintenance expenses	1,000
Commission (Dr.)	2,000
Interest on bank balance	1,000
Discount received	50
Wages	20
Lighting	10,000
Closing stock	1,000
	8,000

Solution:

Trading and profit and Loss Account for the year ended 31st December, 2010

Dr. **Cr.**

Particulars	Rs	Particulars	Rs
To Opening Stock	.	By sales: Rs	.
To Purchases Rs	5,000	Cash 30,000	
Cash 10,000		Credit 40,000	
Credit 20,000		70,000	
30,000		Less: Returns from customers, i.e.,	
Less: Purchases		sales return 1,000	
Returns 2,000		69,000	
To Wages	28,000	Less: Sales Tax 4,000	
To Profit and Loss Account	10,000	By Closing stock	65,000
(Gross profit transferred to			8,000
profit and loss account)			
	30,000		
To Salaries	**73,000**	By Trading Account	**73,000**
To Rent and rates		(Gross Profit transferred from	
(i.e., municipal tax)	10,000	trading account)	30,000
To Lighting	5,000	By Interest on investments	
To Insurance		By Interest on bank balance	
To Trade expenses	1,000	By discount Received	700
(i,e., general expenses)	3,800		50
To Maintenance expenses	500		200
To Depreciation on furniture			
To Advertisement	2,000		
To Commission (Dr)	100		
(i,e., commission paid)	1,000		
To Carriage on sales	1,000		
(i.e., Carriage outward)			
To Bad debts			
To Interest on capital	500		
To Capital Account	500		
(Net profit transferred to capital	500		
account)	5,050		
	30,950		**30,950**

10.6. LET US SUM UP

Profit and loss account is a means to find out the business result of the concern at the end of the accounting period. In the process of profit and loss account, all revenue expenses and losses are entered on the debit side of profit and loss account after making necessary adjustments. Likewise all revenue incomes and profits are entered on the credit side of profit and loss account balancing figure of debit side is known as net profit. In the same way if there is any balancing figure in the credit side it is nothing but net loss.

10.7. KEY WORDS

Administration	-	Management, Supervision
Distribution	-	Sharing, Allocation
Depreciation	-	Reduction, Decrease
Discount	-	Price Cut, Concession
Net profit	-	Income, Revenue

10.8 TERMINAL QUESTIONS

1. What is meant by Trading Account?
2. What is Profit and Loss Account?
3. Differentiate between Gross Profit and Net Profit?
4. What is Depreciation?
5. Give an Example of Profit and Loss Account Items.

10.9 REFERENCE

Accountancy	- B.S. Raman
Accountancy	- H.R. Appanniah, P.N. Reddy
Financial Accounting-I	- B.S. Raman
Advanced Accountancy	- Anil Kumar

UNIT-11

BALANCE SHEET

Structure:

11.0 Objectives.

11.1 Introduction.

11.2 Meaning of Balance Sheet.

11.3 Preparation of Balance Sheet.

11.4 Marshalling or Grouping of Assets and Liabilities.

11.5 Table showing treatment of certain Ledger Balances appearing in Trial Balance.

11.6 Table showing treatment of some Adjustment Items given in Trial Balance.

11.7 Treatment of Adjustment Items given in the problem.

11.8 Practical Problems

11.9 Let Us Sum Up

11.10 Key Words

11.11 Terminal Questions

11.12 Reference

11.0 OBJECTIVES

After studying this unit you should be able to:

- Explain the process of preparing the balance sheet and treatment of items of trial balance and adjustment.
- Discuss the process of finding the financial position as (what the business concern owns and what it owes) on a particular date, and Prepare the balance sheet.

11.1 INTRODUCTION

A balance sheet is a statement prepared with a view to measure the financial position of a business on a certain fixed date. The financial position of a concern is indicated by its assets on a given date and its liabilities on that date. Excess of assets over liabilities represent soundness of a company.

11.2 MEANING OF A BALANCE SHEET

A balance sheet is a sheet containing the balances of all real and personal accounts i.e, assets and liabilities of a business. In other words it is a statement or list of all assets and liabilities of a business concern as on a given date.

11.3. PREPARATION OF THE BALANCE SHEET

The balance sheet of a concern is divided into two sides, viz., the left hand side and the right hand side. The left hand side is called the liabilities side and the right hand side is called as the assets side. All the liabilities and capital of the proprietor has to be entered on the liabilities side, and all the assets have to be entered on the assets side. Of all the liabilities and the capital of the proprietor and all the assets are properly entered in their respective sides, the two sides of balance sheet must be tally or agree.

The assets and liabilities of a business are shown in the balance sheet in certain order or form. The arrangement of assets and liabilities in the balance sheet is the marshalling or grouping of assets and liabilities.

11.4 MARSHALLING OF ASSETS AND LIABILITIES

The arrangement of assets and liabilities are made by two methods :

I. In the order of liquidity.

II. In the order of permanence.

(I) In the Order of Liquidity : The assets are stated in the order in which they can be converted into cash i.e., in order of their reliability.

The specimen of a balance sheet in order of liquidity is given below :

Balance Sheet As On.

Liabilities	Amount	Assets	Amount
Bank Overdraft	Rs.		Rs.
B/P	xxx	Cash in Hand	xxx
Creditors	xxx	Cash at Bank	xxx
Loan Creditors	xxx	Money at call and Short notice	xxx
Outstanding Expenses	xxx	Investment (Short term)	xxx
Long Term Loans	xxx	Debtors	xxx
Advance Receipts of Income	xxx	B/R	xxx
Reserve	xxx	Stock	xxx
Capital:	xxx	Stores	xxx
Add: Net Profit	xxx	Furniture	xxx
Less: Drawings	xxx	Fixtures	xxx
		Fittings	
		Patterns	
		Patents	
		Copyrights	
		Trade Marks	
		Live Stocks	
		Leasehold Properties	
		Investment (Long terms)	
		Vehicles	
		Plant and Machinery	
		Land	
		Land and Building	
		Goodwill	
		Income Accrued	
		Income Outstanding	
		Unexpired Expenses	
Total Rs.	XXX	Total Rs.	XXX

(II) **In Order of Permanence:** This order is exactly reverse of liquidity order. For example, the least liquid assets is shown first (like goodwill) and the most liquid asset is shown last (like cash in hand). A general format of a Balance Sheet in the order of permanence is shown as under:

Balance Sheet As on ....

Liabilities		Amount	Assets	Amount
Capital:	xxx		**Fixed Assets :**	
Add : Net Profit	xxx		Good will	xxx
Less : Net Loss	xxx		Land and Building	xxx
Less : Drawings	xxx		Plant and machinery	xxx
Loan		xxx	Plant	xxx
Creditors		xxx	Furnitures and Fixtures	xxx
Outstanding		xxx	Leasehold property	xxx
Expenses		xxx	Patents	xxx
B/P		xxx	Trademark	xxx
Bank Overdraft		xxx	Copyrights Designs Live Stock	xxx
			Motor Car	xxx
			Investment	xxx
			Current Assets :	
			Closing Stock	xxx
			Accrued Income	xxx
			Prepaid Expenses	xxx
			Debtors	xxx
			B/R	xxx
			Cash at Bank	xxx
			Cash in Hand	xxx
	Total	XXX	Total	XXX

Illustration: From the following particulars, prepare a balance sheet on 31st December 2011

	Rs
Capital	8,000
Long-term loan (Cr.)	2,000
Creditors	1,200
Bills Payable	500
Gash in hand	300
Plant and machinery	3,760
Sundry debtors	3,850
Drawings	1,000
Cash at Bank	1,000
Closing Stock	4,580
Net Profit	2,790

Solution:

Balance Sheet as on 31st December, 2011

Liabilities		Rs.	Assets	Rs.
1. Current Liabilities:			**1. Current Assets:**	
Bills payable		500	Cash in Hand	300
Creditors		1,200	Cash at Bank	1,000
2.Long-term Liabilities:			Sundry Debtors	3,850
Long-term loan		2,000	Closing Stock	4,580
3.Capital:	**Rs.**		**2. Long-term Investments**	**Nil**
Opening Capital	8,000		**3. Fixed Assets:**	
			Plant and Machinery	3,760
Add: Net profit of the year	2,790			
	10,790			
Less: Drawings	1,000	9,790		
Total		**13,490**	**Total**	**13,490**

Illustration 2: From the following particulars, prepare a Balance Sheet as on 31st December, 2010:

	Rs
Capital	50,000
Drawings	10,000
Land and Buildings	20,000
Machinery	18,000
Furniture	5,000
Motor Van	12,000
Cash in hand	2,000
Bank overdraft	4,000

Sundry Debtors	6,000
Bills Receivable	4,000
Bills Payable	5,000
Sundry Creditors	9,000
Loans (Cr.)	6,000
Investments	10,000
Net Profit	22,000
Closing Stock	12,000

Solution :

Balance sheet as on 31st December, 2010

Liabilities		Rs.	Assets	Rs
1. Capital			**1. Fixed Assets**	
Opening Capital	50,000		Land and Building	20,000
Add : Net profit of the year	22,000		Machinery	18,000
	72,000		Motor vans	12,000
Less Drawings	10,000	62,000	Furniture	5,000
2. Long-term liabilities :			**2. Long-term Investments :**	
Loan(Cr.) (i.e., loan borrowed) (Assumed to be long-term)		10,000	Investments (Assumed to be long-term investments)	10,000
3. Current liabilities :			**3. Current Assets :**	
Bank Overdraft		4,000	Closing Stock	12,000
Bills payable		5,000	Bills receivable	4,000
Sundry Creditors		8,000	Cash in hand	2,000
Total		**89,000**	**Total**	**89,000**

11.5 Table showing treatment of certain ledger balances appearing in trial balance

SL No.	Ledger account	When trial balance is given: Appearing on the debt side of a trial balance	When trial balance is given: Appearing on the credit side of a trial balance
1.	Returns	To be deducted from sales in the trading account	To be deducted from purchases in the trading account
2.	Carriage / freight	To be treated as carriage / freight on purchases (i.e. debited to trading account)	-
3.	Wages and Salaries	To be treated as wages and debited to Trading A/c	-
4.	Salaries and Wages	To be treated as salaries and debited to P&LA/c	-
5.	Discount	It is an expenditure (discount allowed) to be debited P&LA/c	It is an income (discount earned) to be credited to P&L A/c
6.	Commission	It is an expenditure (commission paid) to be debited to P & L A/c	It is an income (commission earned) to be credited to P&L A/c
7.	Interest / Rent	It is an expense for the business, to be debited to P & L A/c	It is an income for the business, to be debited to P & L A/c

11.6 Table showing treatment of some adjustment items given in Trial Balance.

Sl. No.	Adjustment	Accounting treatment
1.	Closing Stock	To be shown as current asset in the balance sheet.
2.	Outstanding Expenses	To be shown as current liability in the balance sheet.
3	Prepaid Expenses	To be shown as current asset in the balance sheet.
4.	Accrued Income	To be shown as current asset in the balance sheet.
5.	Income received in advance	To be shown as current liability in the balance sheet.
6.	Depreciation	To be shown on the debit side of the profit and loss Account.
7.	Bad debts and/or provision for bad debts	To be shown on the debit side of profit and loss Account
8.	Provision for discount on debtors	To be entered on the debits side of profit and loss Account
9.	Provision for discount on creditors	To be shown on the credit side of profit and loss Account
10.	Interest on capital	To be entered on the debit side of profit and loss a/c.
11.	Interest on drawings	To be shown on the credit side of the profit and loss a/c.

11.7 Treatment of adjustment items given in the problem.

SI. No.	Adjustment	Accounting treatment in the	
		Trading and/or Profit and Loss Account	Balance Sheet
1.	Closing Stock	Credited to the Trading account	To be shown as an asset in the balance sheet
2.	Outstanding Expenses	To be added to the concerned expense account on the debit side of the trading account or profit and loss account	To be shown as current liability in the balance sheet
3.	Prepaid Expenses	To be deducted from the concerned expense on the debit side of the trading or profit and loss account	To be shown as current asset in the balance sheet
4.	Outstanding income	To be added to the concerned income on the credit side of the profit and loss account	To be shown as current asset in the balance sheet
5.	Income received in advance	To be deducted from the concerned income on the credit side of the profit and loss account	To be shown as current liability in the balance sheet
6.	Bad debts, Provision for doubtful debts and discounts on creditors.	To be debited to P&L a/c.	To be deducted from sundry debtors on the assets side of the balance sheet.
7.	Provision for discount on creditors	To be credited to P&L a/c	To be deducted from sundry creditors on the liabilities side of the balance sheet
8.	Depreciation	To be debited to P&L a/c	To be deducted from the concerned fixed asset in the balance sheet
9.	Appreciation	To be credited to P&L a/c	To be added to the concerned fixed asset in the balance sheet
10.	Interest on capital	To be debited to P&L a/c	To be added to capital on the liabilities side of the balance sheet
11.	Interest on drawings	To be credited to P&L a/c	To be deducted from the capital on the liabilities side of the balance sheet

g) Points to be noted while preparing Final Accounts with Adjustments.

1. Trial balance items:

All items given in the trial balance should appear only once, i.e., either in the trading account or in the profit and loss account or in the balance sheet.

2. Adjustments:

All items given in adjustments should appear twice (i.e., first in the trading account or in the profit and loss account, and secondly, in the balance sheet) to complete the debit and credit aspects of the transactions given in adjustments.

3. Adjusted purchases:

Opening stock and closing stocks are not to be shown in trading a/c, only closing stock should be shown in B/s as asset.

4. Goods withdrawn by the proprietor for his personal use:

Goods withdrawn by the proprietor from his business for personal use are treated as drawings. Firstly, it should be deducted from purchases on the debit side of the trading account. Secondly, it should be deducted from the capital on the liabilities side of the balance sheet.

5. Goods distributed as free samples:

Goods distributed as free samples given in the adjustment should be deducted from purchases on the debit side of the trading account. Again, they should be entered on the debit side of the profit and loss account as advertisement.

6. Stock destroyed

Stock destroyed or damaged by fire, floods, etc., given in the adjustment should be treated in final accounts as follows:

Firstly, the value of stock destroyed should be entered on the credit side of the trading account as "By stock destroyed".

Secondly, if the value of stock destroyed is not covered by insurance, it should be treated as loss and entered on the debit side of the profit and loss account as "To loss on stock destroyed". On the other hand if the value of stock destroyed is fully covered by insurance, then, it should be entered on the asset side of the balance sheet as "Amount due from insurance company". If the value of the stock destroyed is partly covered by insurance, the portion of value of stock destroyed covered by insurance is entered on the assets side of the balance sheet and uncovered value of stock destroyed by insurance is treated as loss and entered on the debit side of the profit and loss account.

h) Calculations of Manager's Commission:

(1) If commission to factory manager is given at a certain percentage on gross profit, it will be calculated as under:

$$\frac{\text{Gross Profit x Percentage of Commission}}{100} = \text{Commission of Factory Manager}$$

(2) If percentage of commission of manager is given on net profit, it may be of following two types:

(a) Commission to manager at a percentage of net profit which is found out before charging such commission.

$$\frac{\text{Net Profit x Percentage of commission of manager}}{100} = \text{Commission of Manager}$$

This commission is written in the debit side of Profit and Loss Account and then real profit is found out.

(b) Commission to manager at a percentage of net profit which is found out after charging such commission.

$$\frac{\text{(Net Profit before (charging commission) x Percentage of commission of manager}}{100 + \text{Percentage of commission}} = \text{Commission of Manager}$$

This commission is deducted from above profit and then real profit is found out. If commission to manager is given in adjustments, then such commission is recorded on the debit side of profit and loss account and liability side of balance sheet.

11.8 PRACTICAL PROBLEMS

1. From the following trial balance and other information relating to the business of Sree Anagha Stores. You are required to prepare Trading, Profit and Loss Account for the year ended 31st December 2009 and Balance Sheet as on that date :

Particulars	Dr. (Rs.)	Cr. (Rs.)
Capital	-	1,68,000
Purchases and Sales	4,00,000	7,00,000
Freight	20,000	-
Carriage	16,000	-
Sundry Expenses	2,000	-
Sundry debtors and creditors	2,40,000	2,54,000
Bad debts	4,400	-
Salaries	38,000	-
Discount	6,000	2,400
Rent	6,000	-
Reserve for doubtful debts	-	7,000
Postage and Stationery	5,600	-
Drawings	4,800	-
Wages	16,000	-
Returns	17,200	20,600
Bills payable	-	40,000
Outstanding rent	-	8,000
Cash at Bank	14,000	-
Interest accrued on Investment	6,000	-
Stock 1-1-2009	1,60,000	-
Land and Buildings	2,00,000	-
Investment	40,000	-
Furniture	4,000	-
	12,00,000	**12,00,000**

Adjustments :

a) Closing stock was valued at Rs. 2,40,000

b) Wages outstanding Rs. 4,000 and salaries pre-paid Rs. 10,000

c) Provide 5% Reserve for doubtful debts.

d) Write off 15% Depreciation on Buildings.

e) During the year goods worth Rs. 10,000 were used for the personal use of the owner for which no entry is made as yet.

f) During the year goods costing Rs. 6,000 were destroyed by fire and Rs. 4,000 only is admitted by the insurance company.

Trading and Profit & Loss Account of Anagha Stores

(for the year ending 31-12-2009)

Particulars	Amount	Amount	Particulars	Amount	Amount
To Opening Stock		1,60,000	By Sales	7,00,000	
To Purchase	4,00,000		Less : Returns	17,200	6,82,000
Less : Returns	20,600		By Stock destroyed by fire		6,000
Less : Drawings	10,000		By closing Stock		2,40,000
		3,69,400			
To Freight		20,000			
To Carriage		16,000			
To Wages	16,000				
Add : O/S wages	4,000	20,000			
To Gross Profit transferred to Profit and Loss A/c		3,43,400			
		9,28,800			**9,28,800**
To Salaries	38,000		By Gross Profit b/d		3,43,400
Less : Prepaid	10,000	28,000	By Discount		2,400
To Sundry Expenses		2,000			
To Discounts		6,000			
To Rent		6,000			
To Postage & stationary		5,600			
To Bad debts	4,400				
Add : New RBD	12,000				
	16,400				
Less : Old RBD	7,000				
To Loss by fire		9,400			
To Depreciation on building @ 15%		2,000			
To Net Profit to capital A/c		30,000			
Total		**3,45,800**	**Total**		**3,45,800**

Balance Sheet of Sree Anagha Stores (As on 31-12-2009)

Liabilities			Amount	Assets		Amount
Capital		1,68,000		Land & Buildings	2,00,000	
Add Net Profit		2,56,800		Less :Depreciation@15%	30,000	1,70,000
		4,24,800		Furniture		4,000
Less Drawings	4,800			Investment		40,000
Less Goods drawn	10,000	14,800	4,10,000	Sundry Debtors	2,40,000	
Sundry Creditors			2,54,000	Less : RBD @5%	12,000	2,28,000
Bills Payable			40,000	Closing Stock		2,40,000
Out Standing Rent			8,000	Prepaid salary		10,000
Out Standing Wages			4,000	Out Standing Insurance Claim		4,000
				Interest accrued on investments		6,000
				Cash at Bank		14,000
		Total	**7,16,000**		**Total**	**7,16,000**

2. From the following Trial Balance of Nilgiri Stores, Mysore, prepare Trading and Profit and Loss account for the year ended 31st December 2009 and Balance Sheet as on that date.

	Dr. Rs.	Cr. Rs.
Purchases and Sales	4,10,000	6,58,000
Returns	5,000	10,000
Drawings and capital	15,000	30,000
Carriage on purchases	6,000	
Carriage on Sales	10,000	
Sundry Debtors and Creditors	1,19,000	1,00,000
14% Bank loan (1-1-2009)	50,000	
Investment and Interest on investment	1,50,000	7,500
Salaries and Salary outstanding	16,500	1,500

Continued in Next Page.....

Interest on Bank Loan	6,000	
Bills Receivable and Bills Payable	50,000	75,000
Bad debts and Reserve for doubtful debts	6,000	7,100
Discounts	4,000	3,000
Stock as on 1-1-2009	16,000	
Wages	7,000	
Insurance	6,000	
Computers	1,40,000	
Repairs	2,000	
Administration expenses	18,000	
Stationery purchased	5,000	
Cash in hand	1,600	
Land and Building	2,00,000	
Furniture and Fixtures	46,000	
Total:	**12,39,100**	**12,39,100**

Adjustment:

1. Closing stock was valued at Rs. 1,67,000
2. Write off further bad debts Rs.5,200 and maintain new reserve for bad debts at Rs.18,100.
3. Write off depreciation 20% on computers and 15%on furniture's.
4. Stock of stationary on 31st December 2009 was Rs.800.
5. During the year goods costing Rs.28,000 was destroyed by fire, but insurance company accepted the claim only for Rs.20,000.

Trading and Profit & Loss Account (for the year ended 31-12-2009)

Particulars		Amount	Particulars		Amount
To Opening Stock		16,000	By Sales	6,85,000	
To Purchases	4,10,000		Less : Returns	5,000	6,80,000
Less : Returns	10,000	4,00,000	By Closing stock		1,67,000
To Carriage on purchases		6,000	By Goods destroyed by fire		28,000
To Wages		7,000			
To Gross Profit C/d		4,46,000			
		8,75,000			8,75,000
To Salaries		16,500	By Gross Profit b/d		4,46,000
To Administration Expenses		18,000	By Interest on investment		7,500
To Insurance		6,000	By Discount		3,000
To Discount		4,000			
To Carriage on sales		10,000			
To Interest on Bank Loan	6,000				
Add : 0/s	1,000	7,000			
To Bad Debts	6,000				
Add : Further Baddebts	5,200				
Add: New RBD	8,100				
	19,300				
Less: Old RBD	7,100	12,200			
To Repairs		2,000			
To Stationery		4,000			
To Depreciation					
On Computers	28,000				
On Furniture	6,900	34,900			

To Loss by fire	8,000		
To Net profit	3,33,700		
Total	**4,56,500**	Total	**4,56,500**

Balance Sheet of Nilgiri Store, Mysore (As on 31-12-2009)

Liabilities		Amount.	Assets		Amount
Sundry Creditors		1,00,000	Cash in hand		1,600
Bills payable		75,000	Investment		1,50,000
14 % Bank loan	50,000		B/R		50,000
Add : Int. Out Standing	1,000	51,000			
Salary Out Standing		1,500	Sundry debtors	1,19,000	
Capital	3,00,000		Less : Bad debts	5,200	
Add : Net Profit	3,33,700			1,13,800	
	6,33,700		Less : New RBD	8,100	1,05,700
Less : Drawings	15,000	6,18,700	Closing Stock		1,67,000
			Amount due from Insurence Co.		20,000
			Stock of Stationery		800
			Computer	1,40,000	
			Less : Depreciation	28,000	1,12,000
			Furniture	46,000	
			Less : Depreciation	6,900	39,100
			Land & Buildings		2,00,000
Total		**8,46,200**	**Total**		**8,46,200**

3. The following is the Trial Balance of Sri Prakash as on 31st March 2010. You are required to prepare Trading and Profit and Loss Account for the year ended 31st March 2010 and Balance Sheet as on that date after making necessary adjustments.

The following adjustments are to be made:

1. Stock on 31st March 2010 was valued at Rs. 7, 25,000
2. A provision for Doubtful Debts is to be 5% on Sundry Debtors.
3. Depreciate Furniture and Fittings by 10% p.a., Motor car 20% p.a.
4. Sri Prakash had withdrawn goods worth Rs. 25,000 during the year for personal use.
5. Sales include goods worth Rs. 75,000 sent out to Shanti and Company on sale or return basis. No. intimation was received till 31st March 2010. The cost of the goods was Rs. 50,000.
6. Included amongst Debtors Rs. 4,000 due from Mr. Suresh and Included amongst Creditors Rs. 10,000 due to Mr. Suresh.

Particulars	Debit	Credit
	Rs.	Rs.
Debtors and Creditors	5,00,000	2,00,000
Machineries	55,000	
Wages	1,00,000	
Carriage outwards	1,10,000	
Carriage inwards	50,000	
General Expenses	70,000	
Discount	20,000	
Bad debts	10,000	
Motor car	2,40,000	
Printing arid Stationery	15,000	
Furniture and Fittings	1,10,000	
Advertisement	85,000	

Insurance (paid up to the year ended on 30-06-2010)	45,000	
Sales commission	87,500	
Postage and Telephone	57,500	
Salaries	1,60,000	
Rates and Taxes	25,000	
Drawings	20,000	
Capital account		14,43,000
Purchases and Sales	15,50,000	19,87,500
Stock on 1-4-2009	2,50,000	
Cash in hand and at bank	70,500	
	36,30,500	**36,30,500**

Solution :

Trading and Profit and Loss Account for the year ending 31-3-2010

Particulars	Rs.	Rs.	Particulars	Rs.	Rs.
To Opening Stock		2,50,000	By Sales	19,87,500	
To Purchases	15,50,000		Less : Goods on		
Less : Drawings by goods	25,000	15,25,000	sales returns	75,000	19,12,500
To Wages		1,00,000	By Stock with customers		50,000
To Carriage inward		50,000	By Closing Stock		7,25,000
To Gross Profit					
(Balancing fiture)		7,62,500			
		26,87,500			**26,87,500**
To Salaries		1,60,000			
To Rent		25,000	By Gross Profit		7,62,500
To General Expenses		70,000			
To Printing and Stationary		15,000			
To Postage		57,500			
To Insurance	45,000				
Less: Unexpired	11,250	33,750			
To Advertisement		85,000			
To Discount		20,000			
To Carriage Outwards		1,10,000			
To Bad debts	10,000				
Add : New Reserve	21,050	31,050			
To Sales Commission		87,500			
To Depreciation					
On furniture 10%		11,000			
On Motorcar 20%		48,000			
To Net Profit		8,700			
(Balancing figure)					
		7,62,500			**7,62,500**

Mrs. Praksh's Balance sheet as on 31-03-2010

Liabilities		Amount	Assets		Amount
Creditors	2,00,000		Cash in hand and at bank		70,500
Less : Due from 'Suresh'	4,000	1,96,000	Closing Stock		7,25,000
			Stock with Customers		50,000
Capital A/c Opening	14,43,000		Prepaid Insurance		11,250
Add : Net Profit	8,700		Debtors	5,00,000	
	14,51,700				
Less : Drawings (20,000 + 25,000)	45,000	14,06,700			
			Less : Goods on sales/ return	75,000	
				4,25,000	
			Less : Due from 'Suresh'	4,000	
				4,21,000	
			Less : RBD 5%	21,050	3,99,950
			Machinery		55,000
			Motor car	2,40,000	
			Less : Depreciation 20%	48,000	1,92,000
			Furniture	1,10,000	
			Less : Depreciation 10%	11,000	99,000
		16,02,700			**16,02,700**

4. From the following trial balance of Pramod as on 31-12-2009 prepare his Trading and profit and loss account for the year ending 31-12-2009 and the balance sheet as on that date.

Sl.No.	Particulars	Rs.	Rs.
1.	Pramod's Capital	-	50,000
2.	Pramod's Drawings	10,000	
3.	Opening stock	25,000	
4.	Bills receivable	5,000	-
5.	Sales	-	1,62,500
6.	Returns inwards	2,500	-
7.	Purchases	1,02,000	-
8.	Returns outwards	-	3,500
9.	Sundry debtors	16,000	-
10.	Sundry creditors	-	11,100
11.	Bills Payable	-	38,000
12.	Salaries	12,500	-
13.	Wages	9,000	-
14.	Machinery	30,000	-
15.	Furniture	4,000	-
16.	Rent and taxes	4,000	-
17.	Insurance	1,000	-
18.	Prinitng and stationery	1,500	-
19.	Cash in hand	500	-
20.	Cash at Bank	9,500	-
21.	Commission received	-	900
22.	Goods sent on consignment	1,500	-
23.	Advertisement	32,000	-
		2,66,000	**2,66,000**

Adjustments:

1. The closing stock was valued on 31-12-2009 at Rs. 18,000
2. A creditor has been paid directly by Pramod which has not been recorded in the books Rs.3,000
3. Wages include Rs. 1,200 for erection of new machinery purchased last year.
4. Furniture (book value on 1-1-2009 Rs. 400) was sold on 30-6-2009 for Rs. 450 and it was passed through sales book.
5. One third of the commission received is in respect of work to be done next year.
6. All the goods sent on consignment were sold for Rs. 2,000 subject to agent's commission at 5%.
7. Advertisement expenses is to be spread over for 4 years.

Dr. **Consignment Account** **Cr.**

Particulars	Rs.	Particulars	Rs.
To Goods sent on consignment A/c	1,500	By Consignee's A/c (Gross only)	2,000
To Consignee's A/c (2,000 x 5/100)	100		
To Profit (transferred to Profit and Loss A/c)	400		
	2,000		2,000

Dr. **Consignee Account** **Cr.**

Particulars	Rs.	Particulars	Rs.
To Consignee A/c	2,000	By Consignment A/c	100
		By Balance c/c	1,900
	2,000		2,000

Pramod's Trading and Profit and Loss Account for the year ending 31-12-2009

Particulars		Amount	Particulars		Amount
To Opening Stock		25,000	By Sales	1,62,500	
To Purchases	1,02,000		Less : Returns	2,500	
Less : Returns	3,500	98,500		1,60,000	
To Wages	9,000		Less: Sales of Furniture	450	1,59,550
Less : Errection of Machinery	1,200	7,800	By Closing Stock		18,000
To G. P.		46,250			
		1,77,550			**1,77,550**
To Salaries		12,500	By Gross Profit		46,250
To Rent and Taxes		4,000	By Profit on sale of furniture		50
To Insurance		1,000			
To Printing and Stationary		1,500	By Commission Received	900	
To Advertisement		8,000	Less : Received in Advance	300	600
To Net Profit (balancing figure)		20,300	By Profit on Consignment		400
		47,300			**47,300**

Pramod's Balance Sheet as on 31-12-2009

Liabilities		Amount	Assets		Amount
Capital	50,000		Machinery	30,000	
Less : Drawings	10,000		Add : Wages	1,200	31,200
	40,000		Furniture	4,000	
Add : Additional Capital	3,000		Less : Sold	400	3,600
	43,000		Closing Stock		18,000
Add : Net Profit	20,300	71,300	Bills Receivable		5,000
Commission			Amount due form Consignee		1,900
received in advance		300	Debtors		16,000
Bills Payable		38,000	Cash		500
Cundry Creditors	11,100		Cash at Bank		9,500
Less : Paid by owner	3,000	8,100	Advertisement (32,000-8000)		24,000
		1,09,700			**1,09,700**

5. Taking the following Adjustments into consideration and with the help of the undermentioned Trial Balance, prepare Manufacturing Account and Trading and Profit & Loss Account for the year ending 31st March, 2010 and Balance Sheet at that date :

Adjustments:

i. Depreciation : 10% on Plant and 5% on Furniture
ii. Outstanding expenses : Wages Rs. 600 and Salaries 250.
iii. Outstanding interest on loan Rs. 125
iv. Closing Stock Rs. 16,000
v. Make a reserve for bad and doubtful debts of Rs. 400. vi) Make a reserve of $2^1/2\%$ for discount on debtors.

Trial Balance
(as on 31st March 2010)

Particulars	Dr. Amount	Cr. Amount
Opening Stock	20,000	
Purchases	82,000	
Purchases Returns	-	2,000
Wages	10,000	
Coal	2,000	
Carriage inward	500	
Manufacturing Light	2,400	
Sales	-	1,18,000
Sales Returns	1,200	
Manufacturing Exp.	1,400	
Manufacturing Insurance Premium	700	
Repairs	1,000	
Carriage outward	900	
Office Rent	2,425	
Legal Charges	600	
Office Salary (Less : P.F. Contribution)	6,600	
Contribution in P.F. (Employer's share	800	
Interest	125	
Office Expenses	250	
Insurance Premium	600	
Capital	-	40,000
Cash in hand	1,500	
Cash with Bank	6,500	
Buildings	7,800	
Plant	1,500	
Furniture	1,500	
Tools	4,000	
Drawings		5,000
Bank Loan	16,000	9,000
Debtors & Creditors	1,500	
Income Tax		
	1,74,000	**1,74,000**

Solution :

Manufacturing Account, Trading & Profit and Loss Account
(for the year ended 31st march, 2010)

Particulars			Amount	Particulars		Amount
To Opening Stock		20,000		By Sales	1,18000	
Add: Purchases	82,000			Less Sales Return	1,200	1,16,800
+ Carriage inward	500					
	82,500					
-P/R	2,000	80,500				
		1,00,500				
Less : Closing Stock		16.000	84,500			
To Wages		10,000				
Add : Outstanding wages		600	10,600			
To Coal			2000			
To Manufacturing Light			2,400			
To Manufacturing Expenses			1,400			
To Manufacturing Insurance Premium			700			
To Cost of Production b/d			1,01600			
To Gross Profit c/d			15,200			
			1,16800			1,16800
To Repairs			1,000	By Gross profit b/d		15,200
To Carriage Outward			900	By Net Loss transferred		
To Office Rent			2,425	to Capital Account		120
To Office Salaries	6,600					
+ Employee's Contribution to P.F.	400					
+ Outstanding Salaries	250		7,250			
To Employer's Contribution to P.F.			400			
To Interest	125					
Add: Outstanding	125		250			
To Office Expenses			250			
To Insurance Premium			600			
To Depreciation on:						
Plant	780					
Furniture	75		855			
To Provision for D.D.			400			
To Provision for Discount on Debtors			390			
To Legal charges			600			
			15,320			15,320

Balance Sheet (as on 31st March 2010)

Liabilities		Amount	Assets		Amount
Creditors		9,000	Cash in hand		200
Outstanding Wages		600	Cash at Bank		1,500
Outstanding Salaries		250	Debtors	16,000	
Bank Loan	5,000		Less : Provision for D.D,	400	
Add -.Outstanding Interest	125	5,125		15,600	
			Less : Provision for Discount on Dbts.	390	15,210
Capital	40,000		Closing Stock		16,000
Less : Net Loss	120		Tools		1,500
	39,880		Furniture	1,500	
Less : Drawings	4,000		Less : Depreciation	75	1,425
	35,880		Plant	7,800	
Less : Income Tax	1,500	34,380	Less : Depreciation	780	7,020
			Buildings		6,500
Rs.		**49,355**	**Rs.**		**49,355**

6. From the following figures prepare Shri Desai Store's manufacturing Account, Trading and Profit & Loss Account for the year ending 31st March, 2010 and his Balance Sheet as on that date :

	Rs.		Rs.
Stock : Raw Materials (1-04-2009)	3,000	Discount allowed	1,000
Work-in-Progress (1-04-2009)	4,000	Discount received	2,000
Purchases of raw materials	35,000	Bad Debts	1,000
Factory Rent & Rates	2,000	Prov. for Doubtful Debts (1-04-	1,000
Wages	20,000	2009	35,000
Factory Manager's Salary	6,000	Capital	10,000
Carriage inward	2,000	Drawings	6,000
Factory Expenses	3,000	Loan (6%)	16,000
Finished Stock (1-04-2009)	10,000	Building	12,000
Sales less Sales Returns	1,00,000	Plant and Machinery	32,000
Advertisement	2,000	Debtors	36,000
Office Rent	4,000	Creditors	6,000
Office Salaries	6,000	Patent Rights	1,000
		Cash in hand	4,000
		Cash at Bank	

Following information is also given :

1. Closing Stock on 31-3-2010 : Raw materials Rs. 4,000, Work in- progress Rs. 5,000, Finished Goods Rs. 20,000.
2. Outstanding expenses on 31-03-2010, Wages Rs. 1,000, Salaries Rs. 11,000.
3. Bad Debts amounted to Rs. 1,000 and are to be written off. Make provision for doubtful debts at 5% on Debtors and for discounts at 2-1/2% on Debtors.
4. Depreciate Buildings at 2%, Plant & Machinery at 5% and Patent at 10%.
5. Allow 5% p.a. Interest on Capital.
6. No Interest is to be charged on drawings.
7. The General Manager has a right to receive commission at 10% which is to be calculated on net profits arrived at after charging such commission.

Trading Account for the year ended 31.03.2010

Particulars		Rs.	Particulars		Rs.
To Stock:			By Closing Stock:		
Raw materials	3,000		Raw Materials	4,000	
Work-in-progress	4,000	7,000	Work-in-progress	5,000	9,000
To Purchase of Raw materials		35,000	By Cost of Production c/d		67,000
To Wages	20,000				
Add: Outstanding	1,000	21,000			
To Carriage Inward		2,000			
To Factory Expenses		3,000			
To Salary of Factory Manager		6,000			
To Factory Rent & Rates		2,000			
To cost of Production b/d		**76,000**	By Sales		**76,000**
To Stock of finished products		67,000	By Closing Stock of		1,00,000
		10,000	finished product		20,000
To Gross Profit c/d					
		43,000			
To Office Salaries	6,000	**1,20,000**	By Gross Profit b/d		**1,20,000**
Add: Outstanding	11,000		By Discount Received		43,000
To Advertisement					2,000
To Office Rent		17,000			
To Discount Allowed		2,000			
To Bad debts1,000		4,000			
Add: Further Bad Debts	1,000	1,000			
	2,000				
Add: Provision for Doubtful Debts	1,550				
	3,550				
Less: Old provision For Doubtful Debts	1,000				
To Provision for Discount on Debtors		2,550			
To Depreciation on:		736			
Buildings	320				
Plant & Machinery	600				
Patent Rights	600				
To Interest on Capital					
To Interest on Loan		1,520			
To Manager's Commission		1,750			
To Net Profit transferred		360			
to Capital A/c		1,280			
		12,804			
		45,000			**45,000**

Balance Sheet (as on 31st March 2010)

Liabilities			Amount	Assets		Amount
Creditors			36,000	Cash in hand		1,000
Loans		6,000		Cash at Bank		4,000
Add : Interest		360	6,360	Debtors	32,000	
Outstanding Expenses :				Less : Bad Debts	1,000	
Wages		1,000		Less : Provision for	31,000	
Office Salaries		11,000	12,000	Doubtful Debts	1,550	
Outstanding Commission			1,280		29,450	
to Manager				Less:Provision for Discount	736	28,714
Capital		35,000		Closing Stock :		
Add : Interst on				Raw Materials	4,000	
capital	1,750			Work-in-Progress	5,000	
Profit	12,804	14,554		Finished Products	20,000	29,000
		49,554		Patent Right	6,000	
Less : Drawings		10,000	39,554	Less : Depreciation	600	5,400
				Plant & machinery	12,000	
				Less : Depreciation	600	11,400
				Buildings	16,000	
				Less : Depreciation	320	15,680
			95,194			**95,194**

Working Notes:

1. Debtors 32,000
   Less: Bad Debts 1,000
   Rs. 31,000

   $\frac{31,000 \times 5}{100} = \text{Rs.}1,550$

2. Debtors Less: Bad Debts 31,000
   Less: Provision for Doubtful Debts 1,550
   Rs. 29,450

3. $\frac{16000 \times 2}{100} = \text{Rs.}320$

4. $\frac{12,000 \times 5}{100} = \text{Rs.}600$

5. $\frac{6,000 \times 10}{100} = \text{Rs. } 600$

6. $\frac{35,000 \times 5}{100} = \text{Rs.}1,750$

7. $\frac{6,000 \times 10}{100} = \text{Rs.}600$

Note: Here interest on loan is implied adjustment, therefore interest on loan has been taken into consideration.

8. 45,000 - (17,000 + 2,000 + 4,000 + 1,000 + 2,550 + 736 + 1,520 + 1,750 + 360) = Rs. 14,084

14.084 x 10 = 1,280.36 or Rs. 1,280 Approx. 110

11.9 LET US SUM UP

A properly drawn up Balance Sheet gives information relating to (a) the nature and value of assets (b) the nature and extent of liabilities (c) whether the firm is solvent, (d) whether the firm is overtrading. If assets exceed the liabilities, the firm is solvent i.e., able to pay its debts in full. If the total of the debts due to creditors is greater than the liquid assets (i.e, cash, investments, bills etc) the position of the firm may be financially unsound. Where the debts are being incurred without sufficient means of paymnet, the firm is said to be over trading.

11.10 KEY WORDS

Trading Account - First Part of a Income Statement is Called Trading Account.

Gross Profit or Gross Loss - Difference Between the Cost of Goods and the Net Sale Proceeds.

Closing Stock - Goods or Finished Products that have remained unsold at the end of Year.

Octroi - Duty paid for goods purchased within the municipality limits.

11.11 TERMINAL QUESTIONS

The Trial Balance of a trader as on 31-12-2009 was as follows :

Trial Balance

Particulars	Dr.	Cr
	Rs.	**Rs.**
Capital		45,000
Stock 1-1-2009	27,000	
Cash in hand	1,200	
Balance with Bank	7,500	
Power and fuel	600	
Furniture	4,500	
Purchases	1,41,000	
Machinery	45,000	
Sales		2,52,450
Drawings	3,600	
Creditors		10,200
Reserve for bad and doubtful debts		120
Salaries (11 months)	9,900	
Wages	12,000	
Carriage inwards	1,500	
Carriage outwards	1,800	
Rent	2,700	
Printing and Stationary	1,680	
Miscellaneous expenses	360	
Advertisement	9,000	
Discount	210	
Insurance	420	
Debtors	37,800	
	3,07,770	**3,07,770**

Adjustments

a) Closing stock Rs. 23,000

b) Debtors include Rs. 800 bad debts and provision for bad and doubtful debts is to be maintained at 5%

c) A motor car purchased for Rs. 12,000 on 1-7-2009' has been included in purchases.

d) Provide depreciation on machinery at 10% p.a. on motor car at 20% p.a. and on furniture at 10% p.a.

e) Provide for accrued rent in respect of a portion of the office sublet at Rs. 100 per month for the last 6 months.

Prepare Final Accounts.

2. From the following Trial Balance of Mr. Satish and other information given, prepare Trading Account, profit and loss account and Balance Sheet as on 31-3-2010

Trial Balance

Particulars	**Dr.**	**Cr.**
Capital		
Drawings		2,40,000
Machinery	12,000	
Stock 1-4-2009	50,000	
Purchases	50,000	
Sales	1,84,000	
Returns		2,40,000
Discounts	4,000	2,000
Furniture	800	1,600
Freight _	30,000	
Carriage outwards	4,000	
Rent	4,000	
Printing and stationery	5,000	
General expenses	5,200	
Sundry creditors	800	
Debtors		40,000
Reserve for Bad debts	80,000	
One year rent received upto 30-6-2010		1,000
Insurance		2,400
Salaries	3,200	
Cash and Bank	42,600	
	51,400	
Total	**5,27,000**	**5,27,000**

Adjustments:

1) Closing stock Rs. 40,000.
2) A creditor has been directly paid by Satish which has not been recorded in the books Rs. 6,000.
3) Write off bad debts Rs. 2,000 and provide for bad debts at 5%.
4) A fire occured on 27-3-2010 and stock of the value of Rs. 4,000 was destroyed and Insurance Co. accepted the claim for Rs. 3,600 only.
5) Depreciate machinery by 5% p.a.

3. From the following Trial Balance and other Informations relating to the business of Sri Chandan, you are required o prepare Trading Account, Profit and Loss Account for the year ended 31st Dec. 2009 and a Balance Sheet as on that date.

Particulars	**Dr. Amount.**	**Cr. Amount**
Capital		84,000
Purchases	2,00,000	
Carriage Outwards		
Sales	8,000	3,50,000
Freight	10,000	
Salaries	19,000	
Discounts	3,000	
Rent	3,000	1,200
Sundry Expenses	1,000	
Sundry Debtors & Creditors	1,20,000	1,27,000
Bad dets	2,200	
R.B.D. (1-1-09)		3,500
Postage & Stationery	2,800	
Drawings	2,400	
Wages	8,000	
Returns	8,600	10,300
Bills Payable		20,000
Interest on Investment		4,000
Cash at Bank	7,000	
Cash in hand	3,000	
Stock on 1-1-2009	80,000	
Land and Building	1,00,000	
Investment	20,000	
Furniture	2,000	
	6,00,000	**6,00,000**

Adjustments :

1. During the year goods costing Rs. 3,000 were destroyed by fire, but insurance company admitted the claim for Rs. 2,000 only.
2. Closing Stock was valued at Rs. 1,20,000
3. Salary prepaid Rs. 5,000, Wages Outstanding Rs. 2,000.
4. Provide R.B.D. 5% on debtors.
5. Charge 10% depreciation on buildings,
6. Goods supplied by Mr. Pradeep worth Rs. 3,000 on 30 Dec. 2009 was not entered in the books.

4. From the following Trial Balance and Adjustments relating to Sri Ankanatha Stores , you are required to prepare Trading, Profit and Loss Account for the year ending 31-03-2010 and Balance Sheet as on that date :

a) Closing stock on 31-03-2010 Rs. 45,000
b) Stock destroyed by fire was Rs. 2,000 and the Insurance Company accepted the claim for Rs.1,500.
c) Goods supplied by Mr. Murthy worth Rs. 3,000 on 30-03-2010 was not entered in the books
d) Bills receivable Rs. 1,000 dishonoured, but no entries are made in the books of account.
e) Bad debts Rs. 500 and maintain bad debts reserve at 5% on debtors.

Trial Balance

Particulars	Amount	Particulars	Amount
	15,000	Sales	1,77,000
Stock in Trade on 1-4-2009	1,02,500	Returns outwards	2,500
Purchases	2,000	Discount	1,000
Return Inwards Wages	10,000	Reserve for Doubtful Debts	800
Carriage Inwards	2,500	Outstanding salaries	1,000
Stationery	1,000	Outstanding Rent	500
Discount	500	Creditors	25,000
General Expenses	7,500	Bills Payable	4,500
Salaries	5,000	Capital	1,00,000
Depreciation	7,500		
Rent	6,000		
Prepaied Insurance	500		
Insurance	1,000		
Income tax paid	1,500		
Land and Buildings	50,000		
Furniture	10,000		
Debtors	22,500		
Bills Receivable	5,000		
Drawings	3,000		
Cash in hand	1,300		
Cash at bank	18,000		
Plant and Machinery	40,000		
	3,12,300		**3,12,300**

5. From the following trial balance of Smt. Seetha, you are required to prepare trading Profit and Loss Account for the year endeded 31-03-2010 and a Balance Sheet as on that date:

Particulars	Dr. Rs.	Cr. Rs.
Stock in trade on 1-4-2009	25,000	
Purchases and Sales	2,10,000	3,54,000
Returns inwards and outwards	4,000	5,000
Wages	20,000	
Carriage on purchases	5,000	
Electricity charges	2,000	
Discounts	1,000	2,000
General Expenses	15,000	
Salaries	10,000	
Outstanding Salaries		3,000
Outstanding Rent		1,000
Depreciation	15,000	
Rent	12,000	
Prepaid insurance	1,000	
Insurance	3,000	
Land and Building	1,00,000	
Furniture	20,000	
Debtors and Creditors	45,000	50,000
Bills Receivable and Bills Payable	10,000	9,000
Drawings and Capital	6,000	2,00,000
Cash in hand	2,000	
Cash at Bank	38,000	
Plant and Machinery	80,000	
	6,24,000	**6,24,000**

Adjustments:

a) Closing stock on 31.03.2010 Rs. 42,500.

b) Stock destroyed by fire was Rs. 4,000 and the Insurance Company accepted the claim only for Rs. 3,000.

c) Purchase includes goods worth Rs. 1,000, purchased for private purpose.

d) Goods supplied by Mr. Murthy worth Rs. 3,000 on 30.03.2010 were not entered in the books.

11.12 REFERENCE

Accountancy - B.S. Raman

Accountancy - H.R. Appanniah, P.N. Reddy

Financial Accounting-I - B.S. Raman

Advanced Accountancy - Anil Kumar

UNIT-12

RECTIFICATION OF ERRORS

Structure:

12.0. Objectives

12.1. Introduction

12.2. Meaning and Types of Errors

12.3. Rectification of Errors

12.4. Examples of Rectification of Errors

12.5 Detection of Errors after Preparation of Final Accounts

12.6. Let Us Sum Up

12.7. Key words

12.8. Terminal Questions

12.9. Reference

12.0 OBJECTIVES

After studying this unit, you should be able to

- Discuss the concept of errors.
- Explain the various types of errors.
- Identify the procedure for locating errors.
- Rectify accounting errors by means of appropriate journal entries
- Give an account of the effects of different errors on computation.

12.1 INTRODUCTION

Every business concern intends to know its real picture of profit position as well as financial status for a certain period. Therefore it should take utmost care while preparing the books of accounts. Normally errors occur either due to negligence or lack of accounting knowledge of book keepers. But before preparing final accounts, errors must be rectified.

A trail balance, which is a statement of debit and credit balances extracted from the ledger, is prepared with an objective to test the arithmetical accuracy of the books. The agreement of a trail balance provides a very useful check upon the posting into the ledger. It is thus ascertained that both the aspects of each transaction that is debit and credit have been recorded and that the books are arithmetically accurate but it is not a conclusive proof. Thus arithmetically a trail balance may agree and yet there may be a number of errors in book-keeping. In any case, if the two sides of the trail balance does not tally. It is a definite proof of this fact that there are certain errors in the books of accounts. Thus, errors may be there in recording, classifying and summarizing the financial transaction whether the trail balance tallies or whether it does not tally.

12.2 MEANING OF ERRORS

Meaning of Errors : Errors are unintentional mistakes occurred while preparing the books of accounts. There is no intension of manipulation of accounts or misuse of funds. International mistakes are known as frauds.

Classification of Errors : Errors may be classified as below

A) Errors of Principle are those where transactions are not recorded as per the rules of debit and credit. Revenue expenditure recorded as capital expenditure ; expenses debited to personal accounts instead of expenses account are some of the examples of such errors.

B) Clerical Errors are those errors which are generally committed by the clerical staff while recording the transactions either in the books of prime entry or of final entry. Clerical staff either omits some transactions or commits the mistake while recording them. Therefore they are called

a) Errors of Omission and b) Errors of commission

a) Errors of omission : These are the errors where the transactions are either totally or partially omitted to be recorded in the books of accounts. Such errors are rectified either by passing fresh entries or making necessary adjustments.

b) Errors of commission : These are the errors committed while recording the transactions. Some of the examples of such errors are as follows.

1) Wrong posting i) to a wrong account ii) of wrong amount iii) to wrong side, and double posting

2) Wrong totaling : i) of subsidiary books ii) of accounts(undercasting or overcastting)

3) Wrong carry forward, 4) Wrong balancing 5) Wrong entry :

a) In original book and b) in subsidiary book

6) Wrong calculations and 7) Errors of duplication etc.

c) **Compensating Errors -** In this case, one or more errors compensate some other errors, and the error nullifies the effect of another error. That is why it is called as compensating errors. For example, a wrong debit of Rs. 50/- to discount account and excess credit of Rs, 50/- to a creditors account.

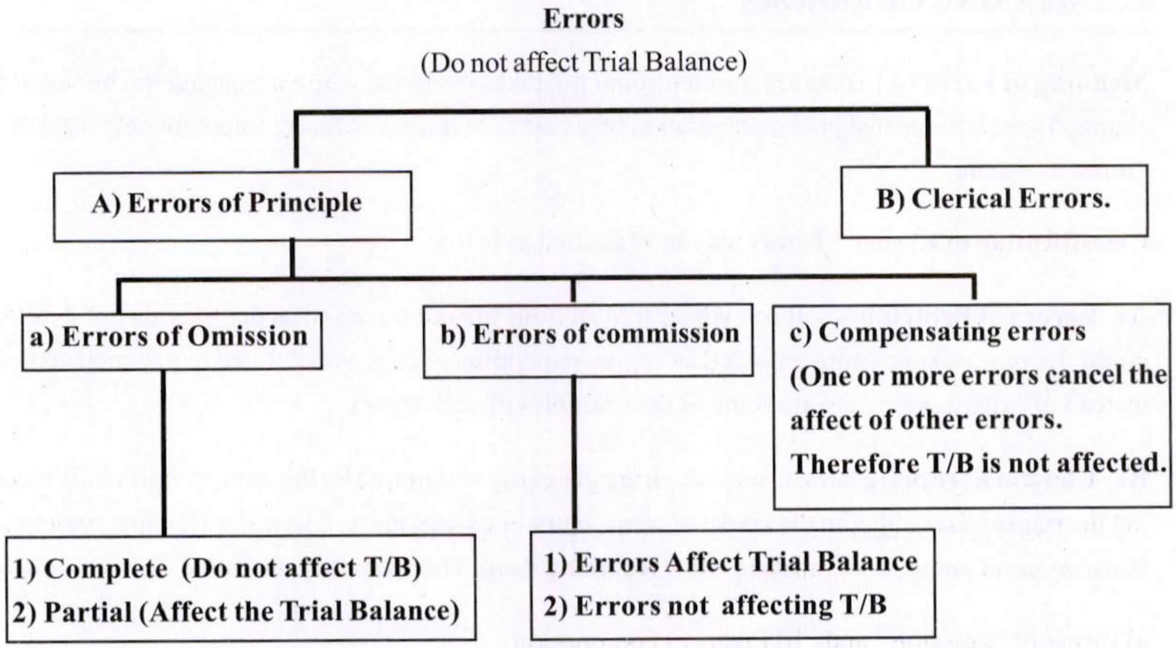
Classification of Errors on the basis of their effect on Agreement of Trial Balance :

These are classified into two categories as below :

A) Errors disclosed by the trial balance (one sided error)

B) Errors not disclosed by the Trial balance (two sided errors) Examples of such errors are as follows.

Classification of Errors
(Flow Chart)



A) Errors of Principle	B) Clerical Errors.
1) Omission of posting	1) Errors of principle
2) Omission of casting	2) Errors of complete omission
3) Omission of carry forward	3) Writing wrong amount in subsidiary book
4) Wrong posting	4) Posting an amount to the correct side but in wrong account
5) Wrong Totaling	5) Compensating errors
6) Wrong carry forward	6) Entering a transaction in two subsidiary books.
7) Wrong Balancing	
8) Omission of an amount from T/B	
9) Bringing the balance of an account to the wrong side of the T/B	
10) Double posting to one account.	

Suspense Account : The agreement of Trial Balance is a must for preparation of final accounts. If the trial balance disagrees and it is not possible to locate errors immediately, preparation of the final accounts cannot be postponed. Under such circumstances the difference in the T/B is transferred to an account called 'Suspense Account[1]. But latter on after location and rectification of such errors, this account will be closed automatically

Location of Errors :

When the trial balance disagrees it is necessary to find out immediately where the mistake lies. The following steps can be followed to locate the errors.

1) Check the debit & credit sides of T/B once again.
2) Check up whether the amount is written in the correct column.
3) See whether any ledger balance is left out of the T/B.
4) Check up the ledger balances in the accounts with the balances taken in the trial balance.

5) Watch carefully all carry forwards, check them with the help of previous balance sheet and other schedules.

Verify that subsidiary books are correctly totaled & posted.

12.3 RECTIFICATION OF ERRORS

After the error is located, the next step is to set right it. This process is known as rectification or correcting of error. Errors can be rectified in three ways :

1. By making direct entry for the transaction which is omitted from recording.
2. By erasing the wrong entry and writing the correct entry (Which is usually not in practice)
3. By passing rectifying entries
   a) For one sided error with the help of suspense account and
   b) For two sided error with a complete new journal entry.

Table showing Errors and their Rectification with examples

Error	**Rectification**
1. Error of Principle : (A) Purchase of Furniture from City Furniture Co., was entered through Purchases Book, Rs. 500. *[Furniture Account is not debited and Purchases Ale is wrongly debited]*	(A) Debit the Account that is not debited ; and Credit the Account that is wrongly debited. OR Do what is not done and Undo what is wrongly done. Now, Debit Furniture Account with Rs. 500, and Credit Purchases Account with Rs. 500. Because, Furniture Account was not debited earlier, and Purchases Account was wrongly debited.
(B) Sale of Machinery was passed through the Sales Book Rs. 1,000. *[Sales Account is wrongly credited instead of crediting Machinery Ale]*	B) Credit the Account that is not credited and Debit the Account that is wrongly credited. OR Do what is not done, and Undo what is wrongly done. Now, Debit Sales Account with Rs. 1,000; and Credit Machinery Account with Rs. 1,000.

2. Complete Omission : A credit purchase of Rs. 1,500 from M/s. Good Luck & Co. was omitted to be entered in the Day .Book. *[No entry has been passed at all]*	**Do what is not done :** As the entire transaction is not recorded, now it should be recorded by passing the following entry. Purchases Account Dr. 1,500 To Good Luck & Co. Account 1,500 (Omission of Purchases now recorded)
3. Wrong amount in **Subsidiary Book** (A) A credit sale to M/s. Fortune Writers of Rs. 2,575 was recorded as Rs. 5,725. *[Rs. 3150 (i.e.5725-2575) has been recorded in excess]*	(A) If the amount entered is more (in-excess) than required, a reverse entry should be passed for the excess amount recorded wrongly. Thus, the entry will be as under. Sales Account Dr. 3150 To Mis. Fortune Writers Account - 3,150 (Correction of excess amount entered in Sales Book)
(B) A credit purchase of stationery of Rs. 75 from M/s. Ram & Sons was recorded as Rs. 57. [Rs. 18 (i.e., Rs. 75-Rs. 57) has been recorded less]	(B) If the amount entered is less than re quired, similar entry should be passed for the difference. Thus, in this example, the entry will be as under : Stationery Account Dr. 18 To M/s. Ram & Sons Account - 18 (Correction of less amount entered)
4. Wrong Posting: (A) Posting correct amount on correct side but to wrong account: Goods returned by Watson Bros. Rs. 525, was Posted to Wetson Bros. A/c. *[Amount is correct but Wetson Bros. Ale is wrong. It should be Watson Bros. Ale]*	(A) (i) If the amount is posted to the debit side of the wrong Account in-stead of the correct A/c, then: Debit the correct Account and : Credit the wrong Account And (ii) If the amount is posted to the credit side of the wrong Account instead of the correct one I then : Debit the wrong A/c, and : Credit the correct A/c. Thus, in this case as Wetson Bros. Account is wrongly credited instead of Watson Bros. A/c, the entry is Wetson

(B) Posting of Wrong amount to the correct side of the correct account. Rent paid Rs. 520 was posted as Rs. 250. *[Only amount is wrong]*	(B) (i) If the amount posted is less, as in this case, post the difference to the correct side of the correct account. Thus, in this example, the difference of Rs. 270 (i.e., 520-250) should be written to the debit side of Rent A/c. (iii) If the amount posted is more than required, post the difference to the opposite side of the same account.
C) Posting of Wrong amount to correct side but of wrong account· Payment of Rent Rs. 350, for proprietors residence, was debited to Rent Account as Rs. 530. *[Amount posted is wrong > Account posted is wrong ,' but only side of the account is correct.]*	(C) (i) If wrong Account is debited (as in this case), it should be credited to remove, the mistake and the correct Account should be debited with the correct amount. Thus, here, Rent *Account should be credited with Rs. 530 and Drawings Account should be correctly debited with Rs. 350.*
(D) Posting correct amount to the wrong side of the correct account[1] An item of sale to Ramji, Rs. 350 was posted to the credit side of his account. *[Amount is correct! Account is correct; but only side is wrong]*	(D) As the amount is posted to the wrong side of the account, double the amount should be posted now to the correct side so as (i) to cancel the effect of wrong posting, and (ii) to have the correct posting itself. Therefore, in this example, Ramji Account should be debited with Rs. 700 to cancel the wrong credit of Rs. 350 plus to have the correct debit of Rs. 350.
(E) Posting wrong amount to the wrong side but of the correct account Commission received Rs. 89, was debited to that account as Rs. 98, *[Account is wrong, side of Account is wrong, but Account is correct]*	(E) Write on the opposite side of the same account, the wrong amount already posted, *(to nullify its effect)* Plus the correct amount (as required to be posted). Thus in this case, Rs. 187 (i.e., Rs. 98 + 89) should be written on the credit side (i.e. correct side) of the commission account.

(F) Posting wrong amount to the wrong side of the wrong account, Cash paid by X & Co. Rs. 30 was wrongly debited to XY & Co. Account as Rs. 300. [Everything is wrong]	(F) Undo what is wrongly done J and Do what is supposed to be done. *(i)As XY & Co. Account has been wrongly debited, now that account should be credited with the same amount to cancel the effect / and* *(ii)As X & C. Account is supposed to be credited with Rs. 30 /now it should be so credited with the correct amount* Thus, the correct posting would be as under ' Credit XY & Co. Account with Rs. 300 ; and also Credit X & Co. Account with Rs. 30.
(G) Posting of correct amount to the wrong side of wrong account. Rent paid to landlord, Mr. Shyamlal of Rs. 200 was credited to his personal accont. *[It should have been debited to Rent Account instead]*	(G) Undo what is wrongly done ; and Do what is not done. *Remove wrong credit from Mr. Shyamlal account,' and* *Give debit to Rent account.* Thus, to correct the above error ! Rent Account should be debited with Rs. 200 ; and Shyamlal Account also should be debited with the same amount.
5. Entries in Two Books : Cash purchases from D. Devdas Rs. 187 were recorded in Cash Book as well as in Purchases Book and posted from both.	Only the entery made in the wrong book. Should be reversed, As it is a cash transaction, it should not have been passed through the purchases book. As it is wrongly done, following entry should be passed in Journal Proper to reverse the effect. D. Devdas Account Dr. 187 — To Purchase Account — 187
6. Omission of Posting : Discount received from Hard Time and	Do what is not done Post the amount to the account

7. Omission of Casting : Returns Outward Book was left uncast, though posting to personal account was made, Rs. 421 *[Posting to Returns Outward Account is missing]*	(A) If the subsidiary book is not totaled it should be totaled now and the amount should be posted to the proper side of that account. Thus, here Rs. 421 should be posted to the credit side of Returns Outward account. (B) However, if the side of an Account is not totaled, it should be totaled now and the amount should be recorded to the proper side of the trial balance.
8. Omission of Carry Forward : A credit balance of Rs. 33 in P. Prasad Account was not brought forward this year.	Do What is not done : Enter the balance to the appropriate side (i.e., credit side) of P. Prasad account.
9. Wrong Totaling or Casting (A) Purchase Book was undercast by Rs. 1,000. (B) Purchases Book was overcast by Rs. 1.000. (C) Sundry Creditors Account shows a balance of Rs. 5,600. But while totaling the debit side, it was overcast by Rs. 100.	(A) If it is undercasting : the short amount should be recorded to the proper side of the concerned account. In this case, Rs. 1,000 should be posted to the *Debit side of Purchases Account* (B) If it is overcasting : the excess amount should be written to the opposite side of the concerned account. Thus, in this example ; Rs. 1,000 should be written to the credit side (opposite side) *of Purchases Account* (C) Rs. 100 is taken to be in excess on the debit side of the account. Hence it should now be written on the credit side i.e., opposite of sundry creditors account to cancel the wrong effect.

10. Double Posting : Salaries paid for the month of August, Rs. 1257, were posted twice to this account. 11. Wrong Carry Forward : (A)Debit side total of Discount column in the Cash Book, Rs. 752, was carried forward to next page as Rs.725. (B) Credit side total of commission received account Rs. 1520 was carried forward to next page as Rs. 2150. (C) Debit total of Commerce College Account Rs. 2,052, was carried forward to the next page on credit side as Rs. 2,502	If posted twice, the effect of extra posting should be removed by entering the excess posting on the opposite side of the concerned account. *Thus, Rs. 1257 should be written on the credit side of salaries Account* (A) If amount carried forward is less the short amount should be written to the same side of the account. Thus in this case, Rs. 27 (i.e., 752-725) should be written on the *debit side of Discount Allowed Account* . (B) If amount carried forward is more the excess amount should be written to the opposite side of the account. Thus Rs. 630 (i.e. 2150-1520) should be written on debit side (opposite side) of Commission Received Account (C) If the carry Forward is on wrong side; the enter amount (whether correct, less or more) should be entered on the opposite side (i.e., proper side) to nullify the effect of wrong carry forward and again, the correct amount should be written to the proper side of the account concerned, Thus, in this example, Rs. 4554 (i.e., Rs. 2052 as required + Rs. 2502 as to be cancelled) should be recorded on the debit side of Commerce College Account .
12. Omission from Trial Balance : Rent Account (Dr.) Rs. 800 was totally omitted to be recorded in Trial Balance.	The omission should be brought in the Trial Balance on its proper side. Thus Rent Account (Dr.) Balance

13. Entering the balance of an account on the opposite side of Trial Balance.	(i) Amount from the wrong side should be removed first; and (ii) It should be recorded on the proper side.

Rectification of One-Sided Errors :

Those errors which affect the agreement of the trial balance are called as one-sided errors. These errors generally occur due to under or over casting of subsidiary books, posting of wrong amount to concerned account, posing on wrong side of an account etc. If such errors are traced or located before the preparation of trial balance, then such errors are rectified by entering the correct amount in the affected account itself.

Illustration 1

The following errors were located before preparation of Trial Balance

1) Purchases book has been totaled Rs. 1,000 less.

2) Sales book has been totaled Rs. 2,000 more.

3) Cash received from Mr. A Rs. 2,500 has not been posted in his account.

4) Sales returns from Mr. B Rs. 700 has been recorded in B's Account as Rs. 70. Rectify the above errors.

Solution

As the errors have been located before the preparation of trial balance hence no journal entries are required to rectify the errors. Errors may be rectified as below :

1. In this case the purchases account has been debited less by Rs.1,000. To rectify the error purchases account will be debited by Rs. 1,000 as follow

Purchases Account.

Dr. Cr.

Date	Particulars	Amount	Date	Particulars	Amount
	To Undercasting of Purchase Book	Rs. 1,000			

2. Sales book has been overcasted by Rs. 2,000 more, that means it has been credited in excess by Rs. 2,000. To rectify the error, the sales account will now be rectified by debiting Rs. 2000 as follows :

Sales Account

Dr. Cr.

Date	Particulars	Amount	Date	Particulars	Amount
	To Overcasting of Sales Book	Rs. 2,000			

3. The amount received from Mr. A should have been credited in his account. Hence, to rectify the error A's account will be credited as follows.

A's Account

Dr. Cr.

Date	Particulars	Amount	Date	Particulars	Amount
				By Omission of Posting	Rs. 2,500

4. Here, Mr. B's account has been undercasted by Rs. 630 short. Hence, the error will be rectified as follow :

B's Account

Dr. Cr.

Date	Particulars	Amount	Date	Particulars	Amount
				By Error in Posting of Wrong Amount	630

Illustration- 2

Pass the rectifying entries for the following errors :

i) Goods of Rs. 300 were sold to Mahesh but its record was made in the Purchases Book. ii) Rs. 350 were received from Dinesh but this amount was credited in the account of Ramesh. (iii) Goods of Rs. 250 were returned by a customer, no record has been made for it, though these goods have been included in stock.

(iv) Goods of Rs. 324 were purchased from Mohan, but it was recorded in Sales Book, (v) Total of Sales Book was overcast by Rs. 170.' (vi) Total of Purchases Book was undercast by Rs. 230. (vii) Total of sales book was undercast by Rs. 10. (viii)Total of purchase book was overcast by Rs. 200,

Solution

Journal Entries

Date	Particulars		L.F.	Debit	Credit
(i)	Mahesh A/c	..Dr		600	
	To Sales A/c				300
	To Purchases A/c				300
	(Being wrong posting, now corrected)				
. (ii)	Ramesh A/c	...Dr.		350	
	To Dinesh A/c				350
	(Being wrong posting, now corrected)				
(iii)	Returns Inward A/c	.. Dr,		250	
	To Customer A/c				250
	(Being entry made for returns inward)				
(iv)	Purchases A/c	..Dr.		324	
	Sales A/c	...Dr.		324	
	To Mohan A/c				648
	(Being cancellation for sales entry and passing of purchase entry)				

(v) In the debit side of Sales Account following record will be made to Overcasting of Sales Book Rs. 170.

(vi) In the debit side of Purchases Account following record will be made to Undercasting of purchases Book Rs. 230.

(vii) In the credit side of sales account following record will be made by Undercasting of Sales Book Rs. 10.

(viii) In the credit side of purchases account following record will be made by Overcasting of Purchase Book Rs. 200.

Illustration -3

Following errors were in the books of a firm as on 31st March, 2010 : (i) Rs. 3,000 spent on extension of factory building were charged to Repairs Account (ii) Govind Ram's cheque of Rs. 250 was dishonoured, its amount was posted to Allowance Account, (iii) Goods of Rs. 200 were returned by Mahesh Chandra, these goods were included in stock but no record for it was made in the books of account,

(iv) Rs,560 were spent on the repair of a machine but this amount is posted in Machinery Account, (v) Rs, 450 spent in the extension of plant and machinery are posted to Wages Account (vi) A customer's cheque of Rs. 150 received through Sita Ram was credited to Sita Ram's account. (vii) An amount of Rs. 300 withdrawn .by the proprietor for his personal use, is posted to travelling expenses account.

Pass the rectifying journal entries in the books of the firm, for above errors and point out their effect on Gross Profit and Net Profit of the firm.

Solution	Journal Entries	*L.F.*	Amount	Amount
(i)	Factory Building A/c .. Dr. To Repairs A/c (Being wrong posting to Repairs Account, now rectified)		3,000	3,000
(ii)	Govind Ram ... Dr. To Allowance A/c (Being wrong posting of Allowance A/c now rectified)		250	250
(iii)	Returns Inward A/c Dr. To Mahesh Chandra (Being entry made for omission)		200	200

(iv)	Repairs A/c ... Dr. To Machinery A/c (Being wrong posting of machinery account, now rectified)		560	560
(v)	Plant and Machinery A/c ... Dr. To Wages A/c (Being wrong posting to wages account, now rectified)		450	450
(vi)	Sita Ram ... Dr. To Concerned Customer A/c (Being amount of Rs. 150 of a cheque received through Sita Ram wrongly credited to his account, now rectified)		150	150
(vii)	Drawings A/c ... Dr. To Travelling Expenses A/c (Being wrong posting to Travelling expenses Amount now rectifeid)		300	300

Illustration-4

The errors will effect profit only when nominal accounts which are recorded in profit & loss account or income statement are affected. The effect of above errors on profit will be as follows :

Effects on Gross Profit and Net Profit

Entries	Gross Profit	Net Profit
	Rs.	Rs.
(i)	X	+ 3,000
(ii)	X	+ 250
(iii)	- 200	- 200
(iv)	X	- 560
(v)	+ 450	+ 450
(vi)	X	X
(vii)	X	+ 300
	+ 250	**+ 3,240**

The effect of above rectifying entries is that gross profit will increase by Rs. 250 and net profit will increase by Rs. 3,240.

Rectification of one sided error after preparation of T/B:

In the process of rectification, the difference of T/B is temporarily transferred to suspense account in order to make the T/B agree so that the process of preparation of financial statement may not be delayed. If any error is traced out, then such errors are rectified by passing a journal entry in which the suspense account will be debited or credited as the case may be with the other account which has been effected due to the error.

Illustration-5

The difference of Trial Balance of a trader Rs. 459 has been transferred to Suspense Account. Later on following errors were discovered. Pass the necessary rectifying entries, open Suspense Account and show the effect of rectifying entries in profit or loss account : i) Total of Sales Returns Book was undercast by Rs. 50

ii) Instead of crediting Rs. 512 in Mohan's account, Rs. 215 were debied in his account. iii) A machinery of Rs. 2,000 was purchased, but was recorded in Purchases Book. iv) A sale of Rs. 172 was recorded in sales account as Rs. 217.

v) A discount of Rs. 41 was allowed to Ramesh ; but in his account only Rs. 14 were recorded, vi) Depreciation of Rs. 100 was charged on a machinery, but it was not recorded in depreciation account. vii) A credit sale of Rs. 50 has been credited to sales account and also to the sundry debtors account.

Solution: **Journal Entries**

Particulars		L.F.	Amount	Amount
Sales Returns A/c...	Dr.		727	
To Suspense A/c				727
(Being undercasting of sales returns, now rectified)				
Suspense A/c ...	Dr.		725	
To Mohan A/c				725
(Being rectifying entry made for wrong posting)				
Machinery A/c ...	Dr.		2,000	
To Purchases A/c				2,000
(Being wrong record of purchases, now corrected)				
Sales A/c ...	Dr.		45	
To Suspense A/c				45
(Being wrong posting to Sales Accent, now rectified)				
Suspense A/c ...	Dr.		27	
To Ramesh A/c				27
(Being wrong positng to Ramesh account, now corrected)				
Depreciation A/c ...	Dr.		100	
To Suspense Ac/				100
(Being omission of posting to depreciation account, now rectified)				
Sundry Debtors A/c ...	Dr.		100	
To Suspense A/c				100
(Being the sales wrongly credited to customer's account, now rectified)				

Rs. 512 + Rs. 215 = Rs. 727 ; Rs. 217 - 172 - Rs. 45; Rs. 41 - Rs. 14 = Rs. 27

Supplementary Trading and Profit & Loss Account

Particulars	Amount	Particulars	Amount
To Sales Returns A/c	50	By Purchases A/c	2,000
To Sales A/c	45		
To Depreciation A/c	100		
To Profit transferred to Capital A/c	1,805		
	2,000		**2,000**

Rectifying entries will increase the profit by Rs. 1,805.

Suspense Account

Particulars	Amount	Particulars	Amount
To Mohan	725	By Balance b/d	459
To Ramesh	27	By Sales Returns A/c	50
		By Sales A/c	45
		By Depreciation A/c	100
		By Sundry Debtor	100
	754		**754**

Illustration-6

There was a differences of Rs. 115 in the Trial Balance. It was transferred to the debit side of Suspense Account. Afterwards following errors were discovered. Rectify these errors and prepare Suspense Account -

(i) An amount of Rs. 275 was posted as Rs. 375 to the debit side of Commission Account.

(ii) Purchase from Mohan Lal on credit of Rs. 200 was posted to his account as Rs. 250.

(iii) Rs, 75 were paid for wages but no record was made for it.

(iv) An amount of Rs. 200 received from Dinesh was posted to the debit side of his account.

(v) A credit amount of Rs. 50 was debited to Personal Account (Drawing A/c) as Rs. 150.

(vi) Rs. 200 were entered as Rs. 20 only in Bills Receivable Book.

(vii) Rs. 75 paid for wages were posted twice to the Wages Account.

Ramesh's Account was credited with Rs. 840 two times instead of once.

Solution: **Journal Entries**

Sl.No.	Particulars	L.F	Amount	Amount
(i)	Suspense A/c… Dr. To Commission A/c (Being excess debit of Rs. 100 to commission account now corrected)		100	100
(ii)	Mohan Lal A/c … Dr. To Suspense A/c (Being excess credit of Rs. 50 in Mohan Lal's account now corrected)		50	50
(iii)	Wages A/c … Dr. To Cash A/c (Being record of omitted entry made)		75	75
(iv)	Suspense A/c ... Dr. To Dinesh (Being wrong posting in Dinesh's account, now corrected)		400	400
(v)	Suspense A/c ... Dr. To Drawings A/c (Being rectification of credit item of Rs. 50 debited to Drawings account as Rs. 150)		200	200
(vi)	Bills Receivable A/c… Dr. To Customer's A/c (Being under posting now rectified)		180	180
(vii)	Suspense A/c ... Dr. To Wages A/c (Being wrong posting to wages account, now corrected)		75	75
(viii)	Ramesh ... Dr. To Suspense A/c (Being wrong credit in Ramesh Account, now corrected)		840	840

Rs. 375 -275 = Rs. 100 ; Rs. 250-Rs. 200-Rs. 50; Rs. 200+Rs. 200=Rs. 400;

Rs. 50 + 150 - Rs. 200 ; Rs. 200-20 = Rs.180;

Suspense Account

Particulars	Amount	Particulars	Amount
To Balance B/d	115	By Mohan Lal	50
To Commission A/c	100	By Ramesh	840
To Dinesh	400		
To Personal A/c	200		
To Wages A/c	75		
	890		**890**

12.5 DETECTION OF ERRORS AFTER PREPARATION OF FINAL ACCOUNTS

Sometimes errors are detected after preparation of final accounts, in such a case rectification is made through Profit and Loss Adjustment Account.

When all the errors are rectified, then the balance of this new Profit and Loss Adjustment Account is transferred either to profit and Loss Account or to Capital Account.

Illustration-8

The difference in a Traial Balance which was transferred to profit and loss account and final accounts were prepared. Following errors were detected after preparation of final accounts.

(i) Goods of Rs. 9.90 were purchased but Rs. 99 were credited in the supplier's account,

(ii) A discount of Rs. 7.50 was allowed by a creditor which was recorded in the creditor's account but it was not posted in discount account,

(iii) A sale of furniture of Rs. 140 was recorded in the Sales Book.

(iv) An amount of Rs. 90 receivable from a debtor has been omitted from record in the debtor's list.

(v) A customer returned the goods of Rs. 300, it was included in stock, but no record for it was made in the books of account. (vi) An amount of Rs. 35.50 was recorded in the Sales Returns Book, but this amount was recorded in the debit side of that customer's account who returned these goods.

Pass necessary journal entries for the above errors and prepare Suspense Account.

Solution - ***Journal Entries***

Sl.No.	Particulars	L.F.	Amount	Amount
(i)	Supplier's A/c ...Dr.		89. 10	
	To Suspense A/c			89.10
	(Being excess posting of Rs. 89.10 to Supplier's A/c now corrected)			
(ii)	Suspense A/c ...Dr.		7.50	
	To Profit and Loss Adjustment A/c			7.50
	(Being omission of posting to Discount A/c, now corrected through P. & L. Adjustment A/c)			
(iii)	Profit and Loss Adjustment A/c ...Dr.		140.00	
	To Furniture A/c			140.00
	(Being wrong entry of sale of furniture in sales book, now corrected)			
(iv)	Debtors A/c ...Dr.		90.00	
	To Suspense A/c			90.00
	(Being an omission of Rs. 90 in Debtor's A/c, now corrected)			
(v)	Profit & Loss Adjustment A/c ...Dr.		300.00	
	To Customer's A/c			300.00
	(Being omission of entry for return of goods by a customer, now made)			
(vi)	Suspense A/c ...Dr.		71.00	
	To Customers A/c			71.00
	(Being wrong posting, now corrected)			
(vii)	Profit & Loss A/c or Capital A/c ...Dr.		432.50	
	To Profit & Loss Adjustment A/c			432.50
	(Being balance of P. & L. Adj. A/c transferred to P. & L. A/c or Capital A/c)			

Suspense Account

Particulars	Amount	Particulars		Amount
To P. & L. Adjustment A/c	7.50	By Supplier	's A/c	89.10
To Customer's A/c	71.00	By Debtor's	A/c	90.00
To Capital A/c (balance)	100.60			
	179.10			**179.10**

[1] Rs. 99 - Rs. 9.90 = Rs. 89.10 [2] Rs. 35.50 x 2 = Rs. 71

[3] (Rs. 140 + 300) - 7.50 = Rs. 432.50.

Illustration-9

The Trial Balance of ABC Ltd. as on Dec. 31, 2009 did not agree. The difference was put to a Suspense Account. During the next trading period, the following errors were discovered

i) The total of the Sales book of one page Rs. 6,531 was carried forward to the next page as Rs. 6,351.

ii) Goods returned by a customer for Rs. 1,200, but entered in Purchases Returns book,

iii) Personal Car Expenses amounting to Rs. 250 were debited to Trade Expenses.

iv) Sales Returns Book was undercast by Rs. 2,750

v) Rs. 50 discount allowed by a supplier, was wrongly posted to debit side of Discount Account.

vi) An item of purchase of Rs. 151 was entered in purchases book as Rs. 15 and posted to supplier's account as Rs. 51.

You are required to give Journal entries to rectify the errors through Profit & Loss Adjustment A/c in a way so as to show the Curent year's profit or loss correctly.

Solution-9 ***Journal Proper of ABC Ltd.***

Sl.No.	*Particulars*	*L.F.*	*Amount*	*Amount*
(i)	Suspense A/c ... Dr. To Profit & Loss Adjustment A/c (Correction of errors by which sales A/c was under credited last year was made)		180	180
(ii)	Profit and Loss Adjustment A/c ...Dr. To Customer's A/c (Goods returned by a customer, wrongly entered in P/R book last year, now the error rectified)		2,400	2,400
(iii)	Drawings A/c ... Dr. To Profit & Loss Adjustment A/c (Personal car expenses debited to trade expenses last year, now corrected)		250	250
(iv)	Profit and Loss Adjustment A/c ...Dr. To Suspense A/c (Sales returns a/c was under debited last year, now the error corrected)		2,750	2,750
(v)	Suspense A/c .... Dr. To Profit & Loss Adjustment A/c (Discount received for Rs. 50 but discount was debited wrongly, now the error rectified)		100	100
(vi)	Profit & Loss Adjustment A/c ... Dr. To Supplier's A/c To Suspense A/c (Correction of error by which purchases a/c was debited in short by Rs. 136 and supplier was credited in short by Rs. 100)		136	100 36

12.6 LET US SUM UP

Every business wants to know the real picture of profit or loss position as well as financial status for a certain period. Normally the errors occur either due to negligence or lack of accounting knowledge of book keepers, but before preparing final accounts errors must be rectified.

12.7 KEY WORDS

Compensating Errors : One or more errors compensating some other errors.

Errors of Commission : Intentionally committed the errors for taking benefits.

Errors of Omission : Omission either totally or partially.

Errors of Principle : when transaction is recorded in the books without following our general accounting principles.

Suspense account : Difference in the trail balance replaced by a new account.

12.8 TERMINAL QUESTIONS

1. Rectify the following errors.

a) Purchase of office Furniture for Rs. 3000 has been debited to the purchase A/c

b) Rs. 2000 being wages paid for erection of new machinery has been debited to wages A/c.

c) An amount of Rs. 200 being the credit sale to Naidu, although correctly entered in the sales book has been posted to his A/c as 2000

d) Goods sold to Kumar Rs. 1 000 recorded in purchase book.

e) Return inwards book has been short cast by Rs. 60.

f) Rs. 2000 Cash paid to Chandan is debited to Nandan A/c

g) Rs. 200 received.from Gopal a customer credited to capital A/c

h) Purchase of goods for Rs. 500 on credit not recorded at all,

i) Goods returned to Datta Rs. 1 000 credited to sales A/c.

j) A sale of old machinery for Rs. 3000 credited to Sales A/c.

2. Pass Journal Entries to rectify the following errors.

a) Rs. 1 500 paid for purchase of Furniture debited to Purchase A/c.

b) A sale of Rs. 4000 to Sriram has been wrongly entered in the sales book as Rs. 400.

c) A purchase of goods for Rs. 600 from Santhosh has been wrongly passed through the Sales Book.

d) An amount of Rs. 900 withdrawn by the proprietor for his personal use has been debited to trade expenses A/c.

e) A Credit purchase of goods for Rs. 1000 from Ganesh has been wrongly entered in purchase Returns book.

f) A Bills Receivable of Rs. 700 received from Shankar has been wrongly passed through Bills payable book.

g) Rs. 650 paid to Mr. Rao, against our acceptance was debited to his personal A/c.

h) Carriage of Rs. 1000 paid on purchase of machinery was debited to carriage A/c.

i) Goods worth Rs. 500 taken by proprietor for his private use were entirely ommitted.

j) An amount of Rs. 250 spent on repairs to machinery has been wrongly debited to machinery A/c.

3. Pass rectifying Journal Entries.

1. Goods worth Rs. 3000 returned by Keshava were taken into stock but no entry was made for this.

2. A purchase of goods for Rs. 6,000 from Narayan was wrongly passed through the Sales Book.

3. A Sales returns from Madhava Rs. 280 was wrongly passed through the Sales Book an4 from there wrongly posted to the credit side of Madhavas A/c as Rs. 820.

4. A credit sale of Rs. 1000 to Govinda was wrongly passed through the purchase book.

5. A Bills Receivable received from Vishnu for Rs. 1,500 was sent to bank for collection. This was returned by the banker, as it was dishonoured. It was debited to Bill Receievable A/c.

6. Rs. 1700 paid to Lakshmi against our aceptance was by mistake debited to saraswathi's A/c.

7. Rs. 250 received from shiva as final diviends whose a/c has been written off as Bad-debts was credited to his a/c and included in creditors.

4. Pass rectifying entries and find out the effect on profit.

a) Rs. 3000 spent on expension of Factory Building were charged to Building Repairs A/c.

b) Govind's cheque for Rs. 250 was dishonoued which was debited to allowances A/c.

c) Goods worth Rs. 300 were returned by Mahesh and taken into stock but no entry was made for it.

d) Rs. 560 spent for repairs to machinery was debited machinery A/c.

e) Rs. 450 spent for installation of Machinery was debited to wages A/c.

f) An amount of Rs. 300 withdrawn by propritor for his personal use is debited to travelling expenses A/c.

g) An amount of Rs. 300 withdrawn by propritor for his personal use is debited to travelling expenses A/c. h) Rs. 500 paid to Vijayalakshmi was debited to Bhagyalakshmi's A/c.

h) Rs. 250 received from Srihari. Whose A/c had been written off as Bad debts was standing to the credit of his A/c and included in the list of sundry creditors.

5. Give Journal Entries to rectify the following errors.

a) An amount of Rs. 500 spent on repairs to machinery debited to machinery A/c.

b) Furniture purchased for Rs. 2000 debited to purchase A/c,

c) Goods purchased for Rs. 950 from Shivanna have entered in the purchase Book as Rs. 905.

d) A sum of Rs. 250 received from Rajan credited to Rajan A/c.

e) Goods worth Rs. 3000 purchased on credit from Gopal have been wrongly passed through the sales book.

f) A credit sale of Rs. 1800 to Somesh has been wrongly passed through the purchase book.

g) Rs. 4000 paid to Balaram against our acceptance were debited to his personal A/c.

h) Goods worth Rs. 500 were distributed as free samples no entry was made for this,

i) A bills Receivable received from Keshava was sent to bank for collection. This was dishonoured and debited to Bills Receivable A/c.

6. A Book -keeper prepared a trial balance on 31-12-2009. Which showed a difference Rs. 140 excess credit. The difference was placed to suspence A/c Subsequently, the following errors were found.

a) A sale of goods to Raju for Rs. 600 has been posted to the wrong side of his A/c.

b) A purchse of godos for Rs. 1640 from Umesh had been posted to his personal A/c as Rs. 640.

c) A credti sale of old Furniture for Rs. 150 had been passed through the sales book.,

d) The discount received account had been short cast by Rs. 60.

e) Payment of Rent Rs. 340 was debited to Land Lord's personal A/c. Pass rectifying entreies and prepare suspense A/c.

7. A book keeper finds that his trial balance was out by Rs. 88 excess credit which he placed to suspenses A/c. In the next year the following errors were discovered.

a) Goods bought from Govinda for Rs. 5 has been credited to his A/c as Rs. 55.

b) A discounted B/R of Rs. 200 was dishonoured. This was debited to B/R A/c.

c) An item of Rs. 10 entered in the Sales Return book has been posted to the debit side of that customer's A/c.

d) Sundry items of plant sold for Rs. 260 have been credited to sales A/c.

e) An amount of Rs. 58 owing by a customer had been omitted from the schedule of debtors. Draft Journal Entries and prepare suspense A/c.

8. The trial balance of Varadaraja Stores taken out as on 31-12-2009 was short on the debit side by Rs. 1870. Which was placed to Suspense A/c. Later the following mistakes were found.

a) A cash purchase of Rs. 210 not posted to purchase A/c.

b) A credit purchase of Rs. 600 from Vinay was posted to his a/c as Rs. 60.

c) A credit sale of Rs. 1000 to Bhat entered in the Sales Returns book.

d) Payment of Rs. 280 for Rent debited to Land Lord's Personal. A/c.

e) Payament of Rs. 2000 to Nagaraj posted to his credit as Rs. 200. Pass rectifying entries prepare suspense A/c.

9 The Trial balance prepared by Mohan showed a difference of Rs. 955 excess debit, which was placed to suspense A/c. In the next year the following errors were discovered.

1. The total of one page of the sales book was carried forward to the next page as Rs. 6785 instead of Rs. 6587.

2. The total of purchase book was added Rs. 1000 short.

3. A sale of Rs. 350 to Dutta was entered in the sales book as Rs. 530.

4. Cash Reeived Rs. 150 from Mr. Ramesh was credited to Rajesh A/c.

5. Rs. 580 spent on repairs to motor van is debited to motor Vehicles A/c.

6. The total of the discount column on the debit side of the cash book for Rs. 385 was carried forward to the next page as Rs. 538.

7. Goods returned by Mirza for Rs. 200 were not entered in the books at all.

8. Rs, 290 was paid to Mr. A and Rs. 920 to Mr. B. But Mr. A's A/c was debited with Rs. 920 and B's a/c with Rs. 290. Pass rectifying entries and prepare suspenses A/c.

12.9 REFERENCE

Accountancy - B.S. Raman

Accountancy - H.R. Appanniah, P.N. Reddy

Financial Accounting-I - B.S. Raman

Advanced Accountancy - Anil Kumar

NOTES

ಆದೇಶ ಸಂಖ್ಯೆ : ಕರಾಮುವಿ : ಅಸಾವಿ : 01–04 : 2021–22
ಒಳಪುಟ : 70 GSM ಮ್ಯಾಪ್ಲಿತೊ ಮತ್ತು ರಕ್ಷಾಪುಟ : 220 GSM 'ಆರ್ಟ್ ಕಾರ್ಡ್'
ಮುದ್ರಕರು : ಪೂರ್ಣಿಮ ಪ್ರಿಂಟರ್ಸ್, ಬೆಂಗಳೂರು – 560 040, ಪ್ರತಿಗಳು : 3000

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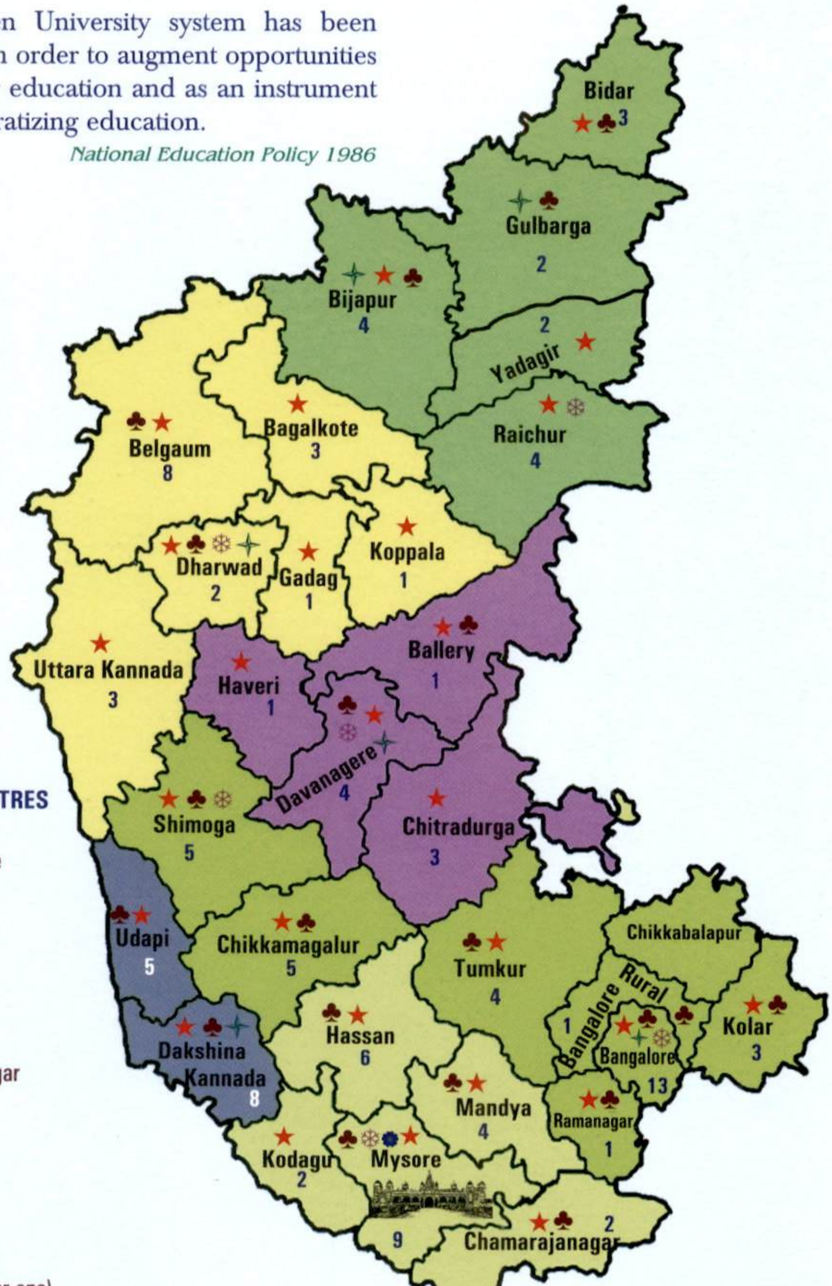

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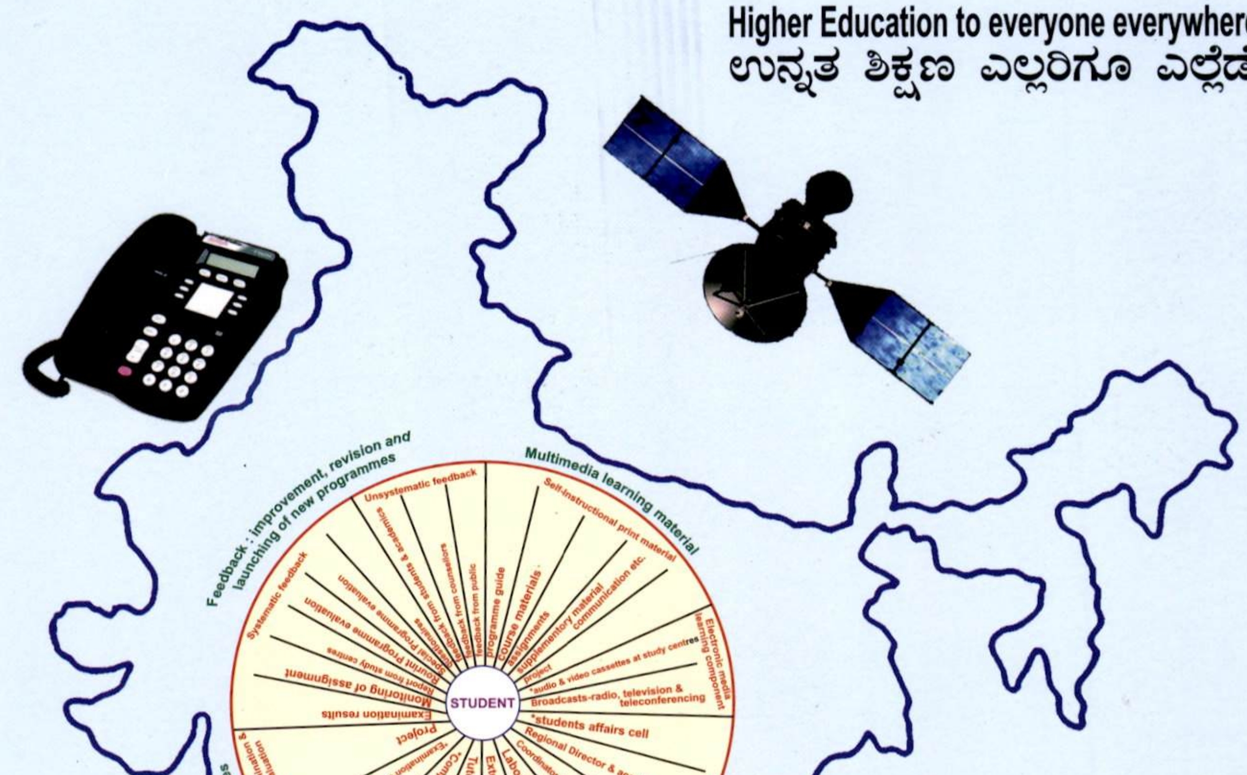

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